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2019 ANNUAL MEETING & EXHIBIT

October 27-30
Toronto, Canada

Session 105: Updates on Proposed Changes and (Current) Financial Status of Social Security

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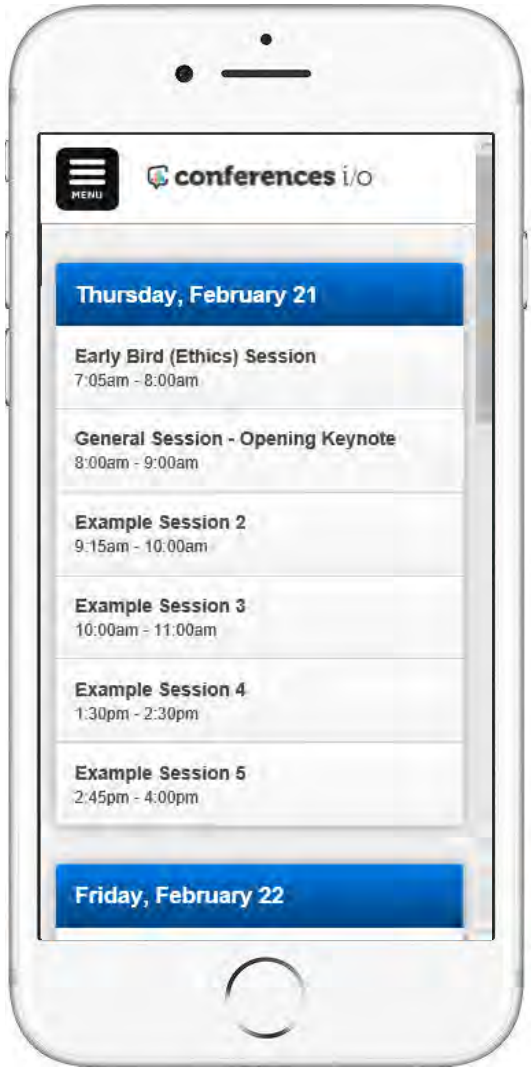

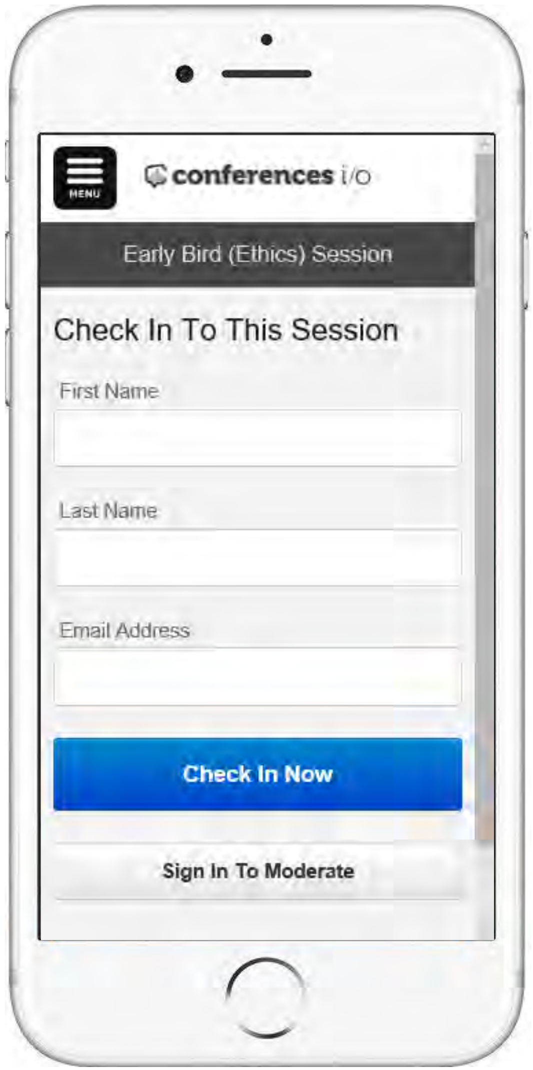

2019 ANNUAL MEETING & EXHIBIT

Heading Toward Social Security Reform

Bruce D. Schobel, FSA

October 29, 2019

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Social Security's Financial Status

- For more than 30 years now, Social Security's annual Trustees Reports have shown a very similar financial picture for the program.
- The 2019 Trustees Report, issued on April 22, contains no surprises:
  - The Social Security trust fund assets are near their peak of $3 trillion.
  - Starting in 2020, trust fund assets will decline, as outgo exceeds income.
  - The trust funds will be exhausted in 2035.
  - After that, income will be sufficient to cover just 80 percent of outgo.
  - That percentage will decline gradually over time.
  - The government will be unable to pay full benefits on time.
- Something needs to be done before 2035.
- The sooner, the better.

Historical reform efforts

- The last *major* legislation affecting Social Security was the Social Security Amendments of 1983 (Public Law 98-21), signed by President Reagan on April 20 of that year.
- That legislation produced the financial buildup and drawdown that we have witnessed for 36 years now and that will play out between now and 2035, absent corrective legislation.
- In 2005, President George W. Bush made Social Security reform his highest domestic priority, with a proposal based on establishing supplemental individual accounts invested in private-sector equities.
- That proposal went nowhere, and individual-account plans lost all momentum with the Great Recession of 2007-09.

Recent reform efforts

- Over the years, many members of Congress have proposed ways to solve Social Security's problems, but these proposals have lacked broad support and gone nowhere.
- In 2019, that changed, with Democrats retaking control of the House of Representatives.
- On January 30, Rep. John Larson (D-CT), the new chair of the Ways and Means Committee's Social Security Subcommittee, introduced his Social Security 2100 bill, designated H.R. 860.
- This bill may actually go somewhere, with 211 cosponsors at last count (and 218 votes assures passage in the House).

Social Security 2100 bill

- Rep. Larson's bill is designed to carry the program through to the year 2100, without any reductions in current or future benefits.
- SSA's actuaries project that the legislation, if enacted into law, would succeed in that goal.
- The bill has seven substantive provisions that we'll explore one-by-one.

1. Across-the-board benefit increase

- The news media have described this as a 2-percent benefit increase for average beneficiaries, but that's not very precise.
- The bill would raise the first percentage in Social Security's weighted benefit formula from 90 percent to 93 percent.
- Today, in calculating the primary insurance amount – PIA, the basic building block of all Social Security benefits and the amount paid to retired workers who first claim benefits at their full retirement age – the first $926 (for workers born in 1957) of average indexed monthly earnings is multiplied by 0.90. Because the vast majority of retired workers have average lifetime earnings exceeding $926/month (or a corresponding smaller amount for those born before 1957), that first band of the benefit formula contributes $833.40 to the PIA for most people.
- The Social Security 2100 bill would change 0.90 to 0.93, raising the contribution of the first band of the PIA formula by $27.78, to $861.18 (before rounding, which occurs later in the benefit-computation process). That roughly $28/month increase is about 2 percent of the average $1400/month Social Security benefit, but the actual percentage is larger for low-income beneficiaries and smaller for high-income ones.

2. Revised COLA calculation

- Social Security's cost-of-living adjustments are based on the consumer price index for urban wage earners and clerical workers, or CPI-W.
- The Social Security 2100 bill would substitute the CPI-E for elderly consumers, in calculating Social Security's COLAs.
- The CPI-E is supposed to better reflect the costs that elderly consumers actually bear.
- This provision has no connection to recent efforts (included in at least one of President Obama's budget proposals) to substitute a so-called chain-weighted CPI, which considers substitution effects, such as consumers buying more chicken when beef gets expensive, and vice versa.
- That proposal would have had the effect of reducing COLAs; substituting the CPI-E is expected to increase them slightly.

3. Special-minimum benefit increase

- Social Security once had a minimum benefit for everyone, but it was repealed in 1981
- Social Security law still includes a "special" minimum benefit for low-earning, long-service workers, designed to produce a larger benefit than the regular formula but no longer has much effect at all. The special-minimum benefit exceeds the regular benefit today for only about 50,000 of Social Security's 62 million beneficiaries, and new eligibilities became mathematically impossible starting in 2018.
- The Social Security 2100 bill would breathe new life into the special-minimum benefit by linking it to 125 percent of the Federal poverty level for single individuals. Retired workers with 30 years of coverage, based on having earned four coverage credits per year, would receive that amount. The amount for newly eligible beneficiaries would be wage-indexed, rather than price-indexed, so that it does not erode over time.

4. Increased thresholds for benefit taxation

- About 40 percent of Social Security beneficiaries today pay some Federal income tax on their benefits.
- Taxation begins for single filers with total income of $25,000 annually, and for married couples filing jointly with total income of $32,000. These thresholds are frozen in the law; they have never changed since they were enacted in 1983. Thus, more and more beneficiaries pay some tax on their benefits each year.
- The revenue from taxation of benefits is transferred by the Treasury to the Social Security and Medicare trust funds.
- The Social Security 2100 bill would raise the taxation thresholds to $50,000 for single filers and $100,000 for married couples filing jointly, also frozen. This provision would reduce both the number of beneficiaries subject to benefit taxation and the amount of income-tax revenue transferred to the Social Security trust fund.

5. Impose payroll tax on high earnings

- Earnings above $132,900 in 2019 are not subject to Social Security taxation, although they are subject to the Medicare tax, which has no maximum.
- The Social Security 2100 bill would introduce a so-called “donut hole”: Social Security taxation would end at the current-law maximum but start again at $400,000 and continue forever.
- This would affect the top 0.4 percent of workers. Obviously, most workers would see no change at all in their Social Security taxes. However, the $400,000 amount would be frozen, so a larger percentage of workers would be affected each year as average earnings rise. This is the most financially significant provision of the entire bill.

6. Benefits on newly taxed earnings

- Social Security has always provided earnings-related benefits.
- Some proposals to tax additional earnings dropped that principle and would have simply taxed higher earnings without providing any benefit credit at all.
- The Social Security 2100 bill keeps the earnings-related principle intact – but just barely – by providing a small additional benefit based only on newly taxed earnings over $400,000.
- The average indexed earnings (calculated in the usual way) at that new, high level would be multiplied by 2 percent, and the result would be added to the PIA.
- Social Security's weighted benefit formula has three earnings bands today: the lowest band receives 90 percent credit toward the PIA, the second (and largest) band receives 32 percent, and the highest band under current law receives 15 percent. This new, super-high band would receive just 2 percent.

7. Higher payroll-tax rate

- The Social Security payroll-tax rate has been 6.20 percent on employees and employers, each, since 1990. The self-employed pay both halves of the tax, but they can deduct the "employer" half for Federal income-tax purposes, just as regular employers can.
- The Social Security 2100 bill would raise the payroll-tax rate by 0.05 percentage point per year, starting in 2020 and ending in 2043, when it would top out at 7.40 percent. This is the second-most financially significant provision of the bill, raising almost as much revenue as the increase in the maximum taxable amount, net of additional benefits.

Where is this bill going?

- Unlike prior proposals, the Social Security 2100 bill has a powerful subcommittee chair as sponsor and more than 200 cosponsors.
- It can certainly pass the House of Representatives whenever the leadership chooses to bring it to a vote.
- The bill has no Republican cosponsors at this time. Getting some Republicans on board would be a big advantage.
- The Republican-controlled Senate is unlikely to do anything with the bill. The 2020 election may change that situation.
- Nobody knows what President Trump would do with this legislation.

What amendments might we see?

- The 1983 law contained a nearly equal balance between tax increases and reductions in future benefits. (Hardly anyone wants to reduce benefits already being paid to beneficiaries.)
- The Social Security 2100 bill has no reductions in benefits at all; it's composed entirely of modest benefit increases and substantial tax increases.
- To garner Republican support, some reductions in future benefits will probably be added at some point in the legislative process.
- Those could include (1) COLA reductions along the lines of previous proposals and (2) further increases in the full retirement age, which is gradually increasing to age 67 for workers born in 1960 and later.

Conclusion

- We may be seeing the emerging outlines of future Social Security reform.
- Rep. Larson's bill won't sail through the legislative process without some changes, but a lot of it is likely to survive.
- The bill has lots of support and accomplishes the mission of restoring the Social Security program to close actuarial balance over the long range.
- Something has to happen between now and 2035.
- This bill is worth watching closely.

Key Takeaways

- Social Security is heading toward a financial crisis in about 15 years.
- Legislation is necessary to allow full benefits to be paid on time after 2035.
- We are watching a key piece of legislation moving through the House of Representatives this year.
- If enacted into law, it would actually raise benefits modestly and increase taxes on all workers, especially on the top 0.4 percent.
- People need to anticipate these possible changes and incorporate them into their personal financial planning.

QUESTIONS?

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October 29, 2019

Society of Actuaries Annual Meeting
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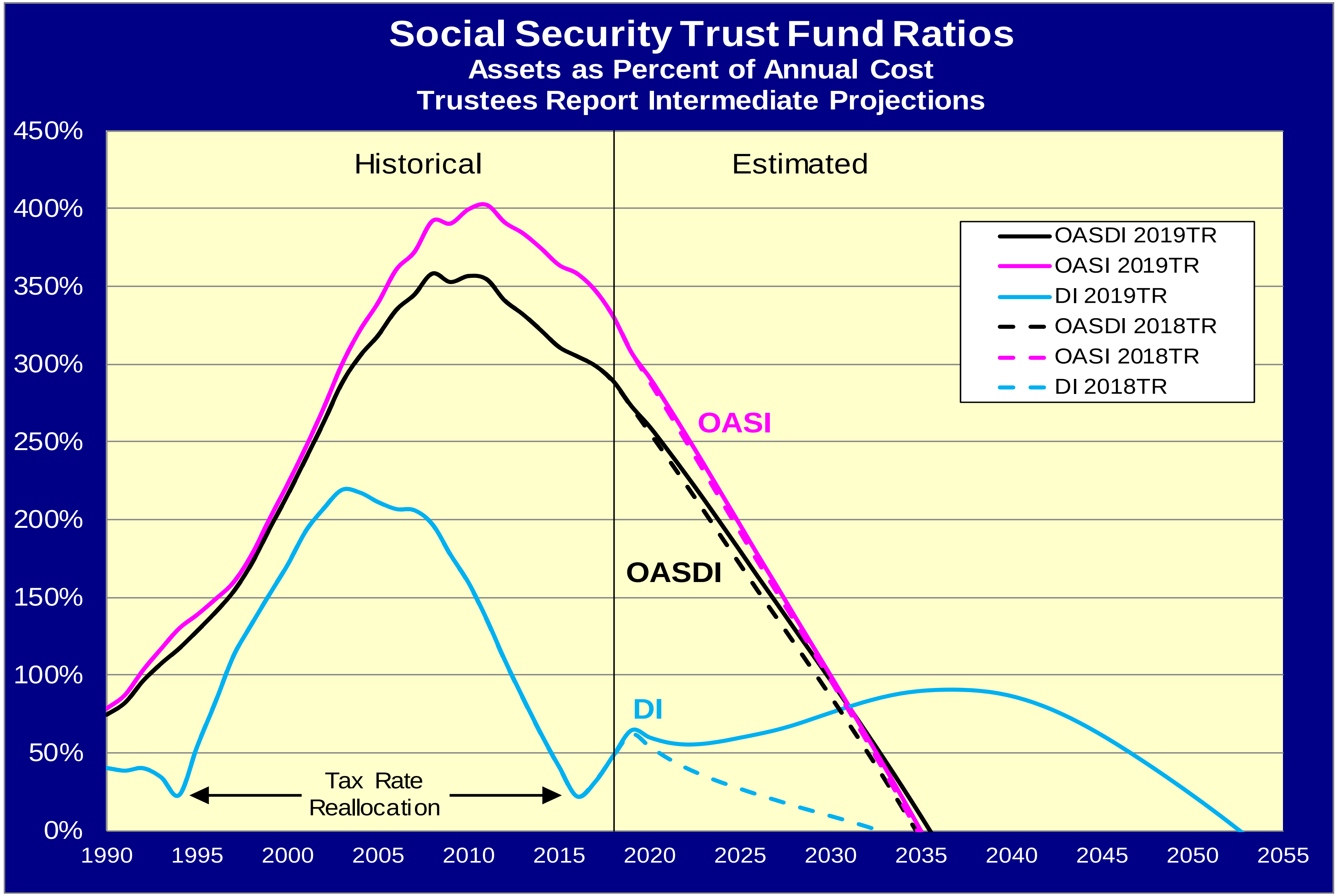
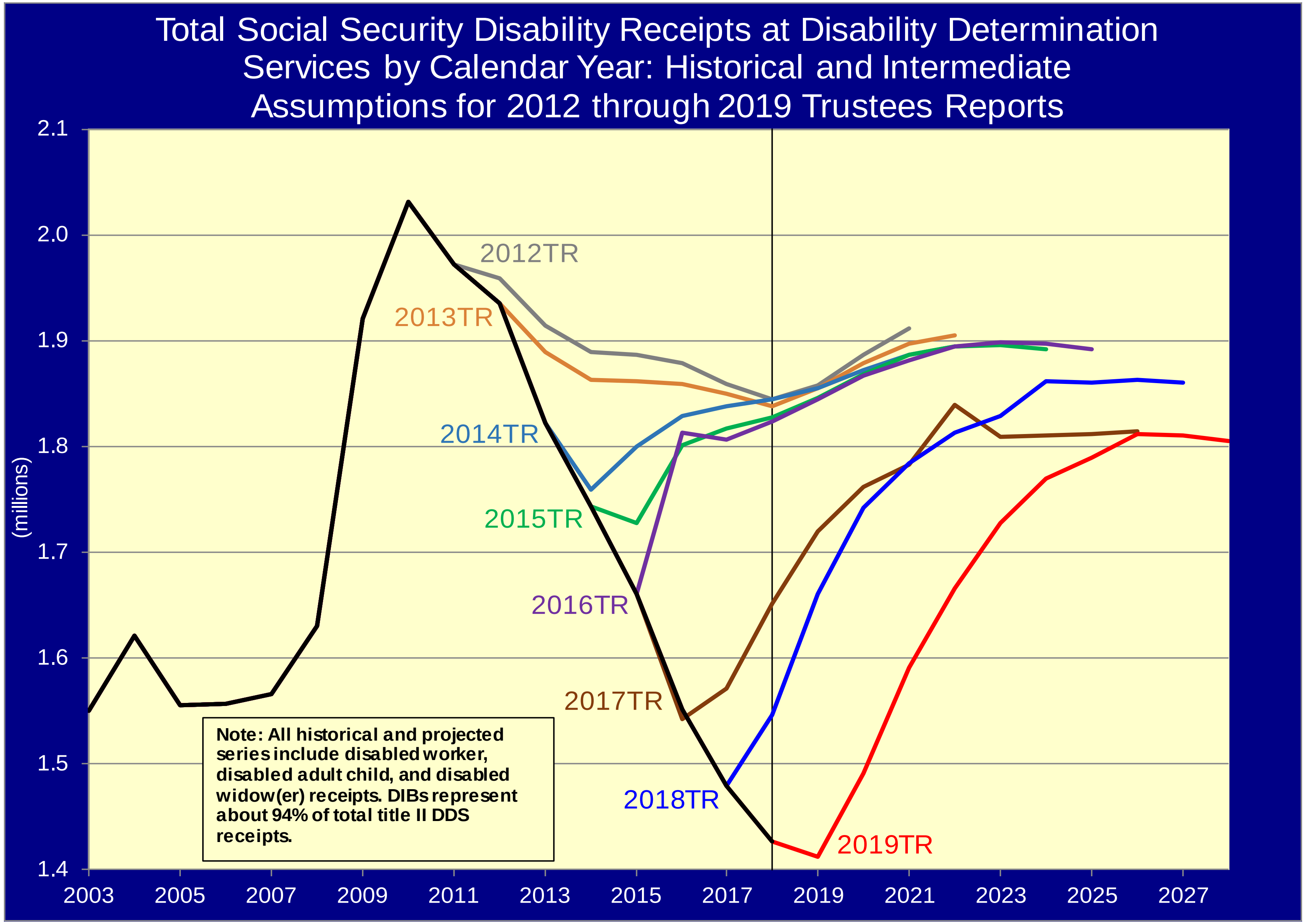
SOLVENCY: OASDI Trust Fund Reserve Depletion in 2035 (one year later than last year)



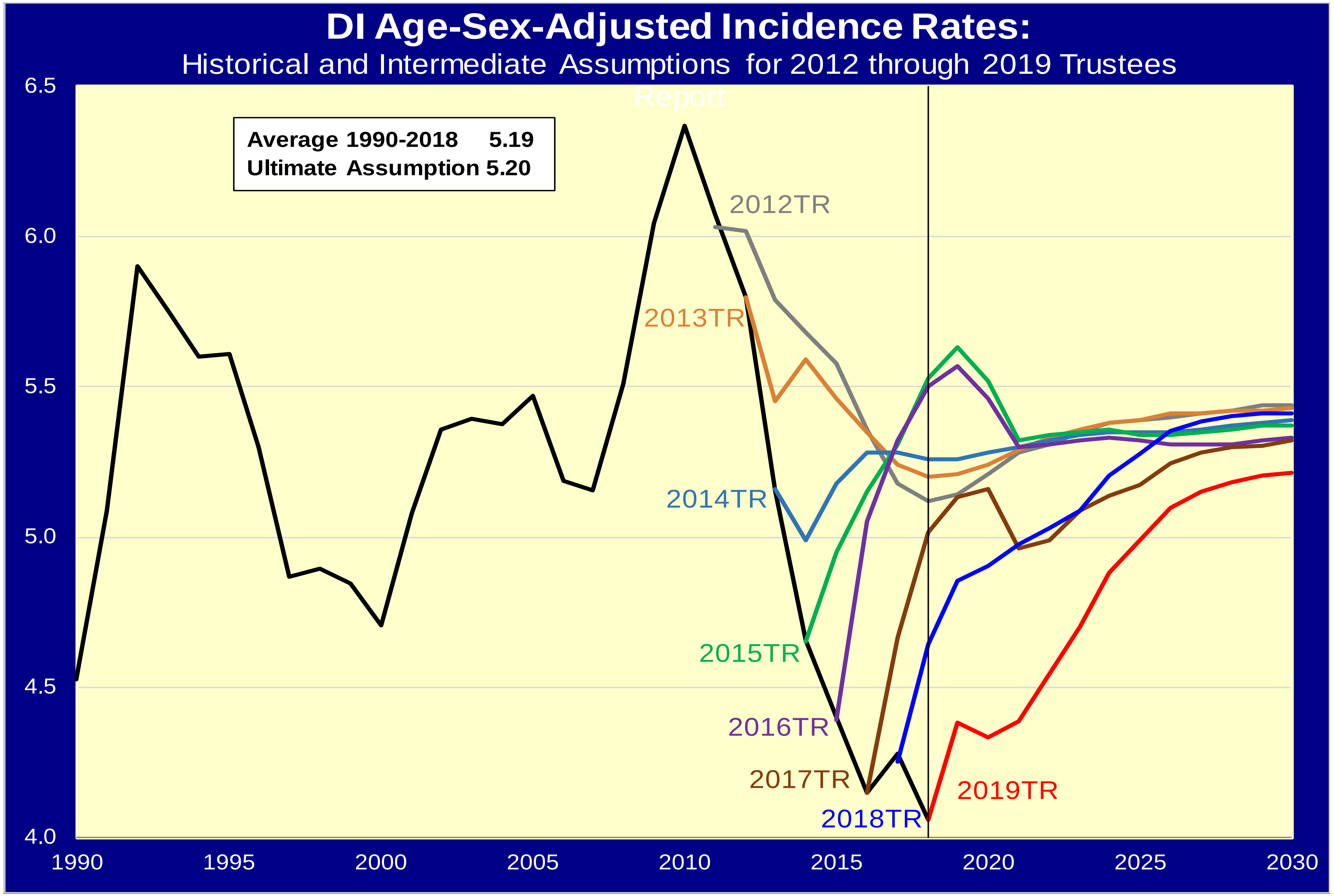
- OASDI reserve depletion date varied from 2029 to 2042 in reports over the past 29 years (1991-2019)
- DI Trust Fund: reserve depletion in 2052, twenty years later than last year
  - Due largely to lower recent and near-term disability applications and awards, plus lower ultimate incidence

Applications for Disability Benefits Continue to Fall



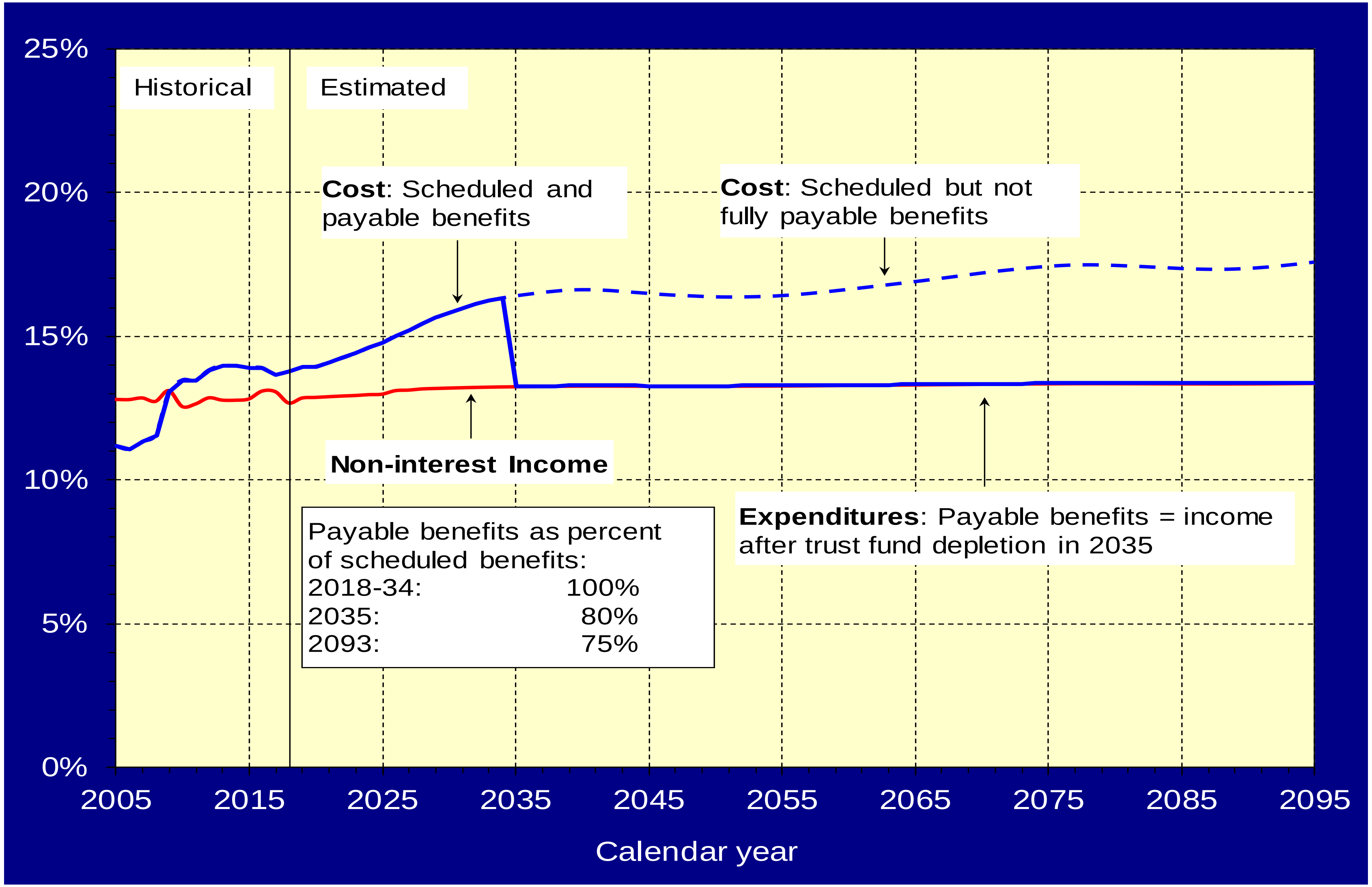
- At the peak of the last economic cycle in 2007, applications were low, but increased rapidly in the recession to over 2 million in 2010.
- In 2016, 2017, and 2018, with the economy still below the sustainable full-employment level, applications have dropped well below the 2007 level—and the decline continues in 2019

Disability Incidence Rate Falls to Historic Lows



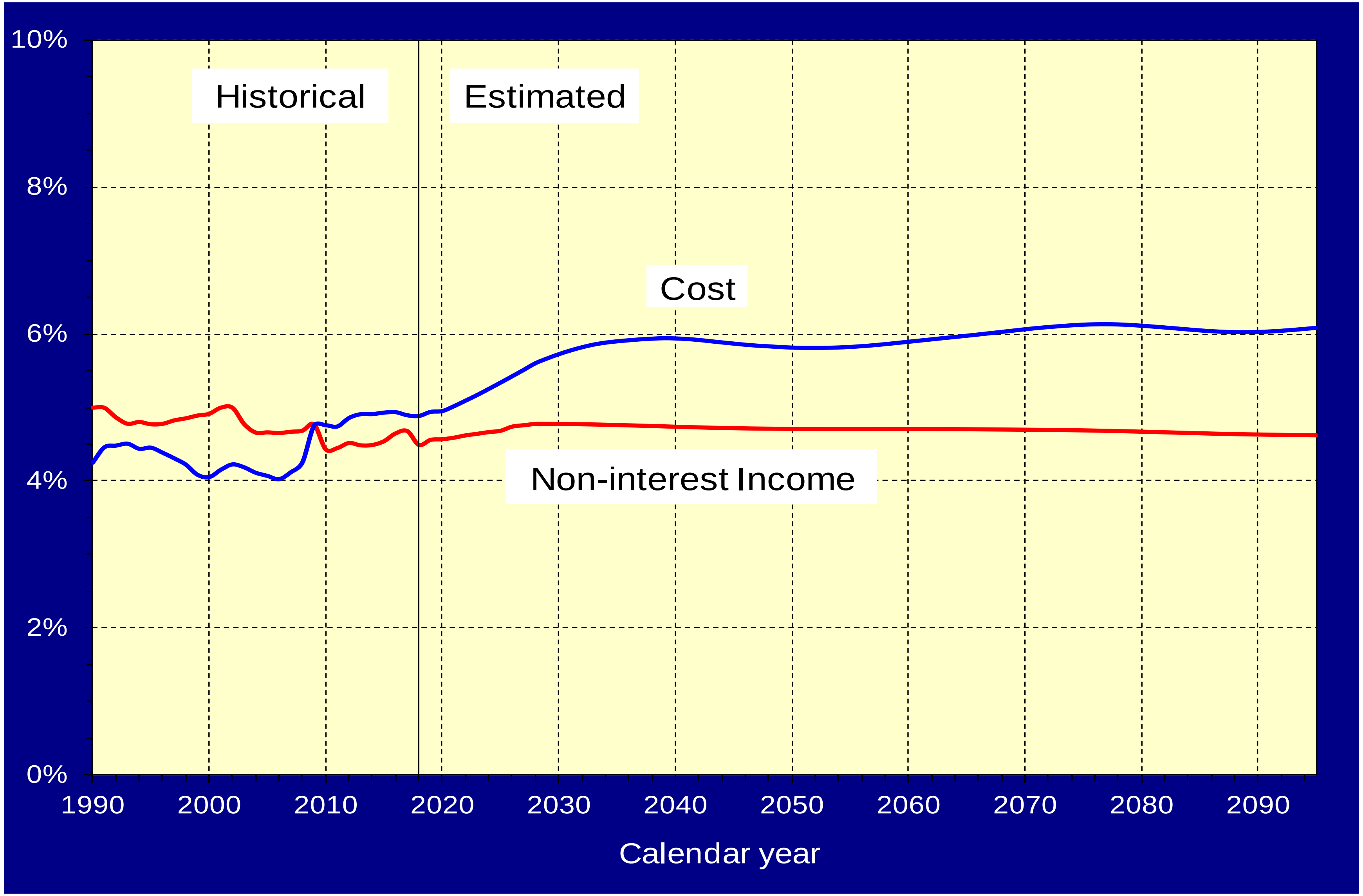
- DI disabled worker incidence rate rose sharply in the recession, and has declined since the peak in 2010 to extraordinarily low levels for 2016, 2017, and 2018
- The ultimate incidence rate was lowered to 5.2 for the 2019 report

OASDI Annual Cost and Non-Interest Income as Percent of Taxable Payroll
Persistent Negative Annual Cash-Flow Balance Starting in 2010



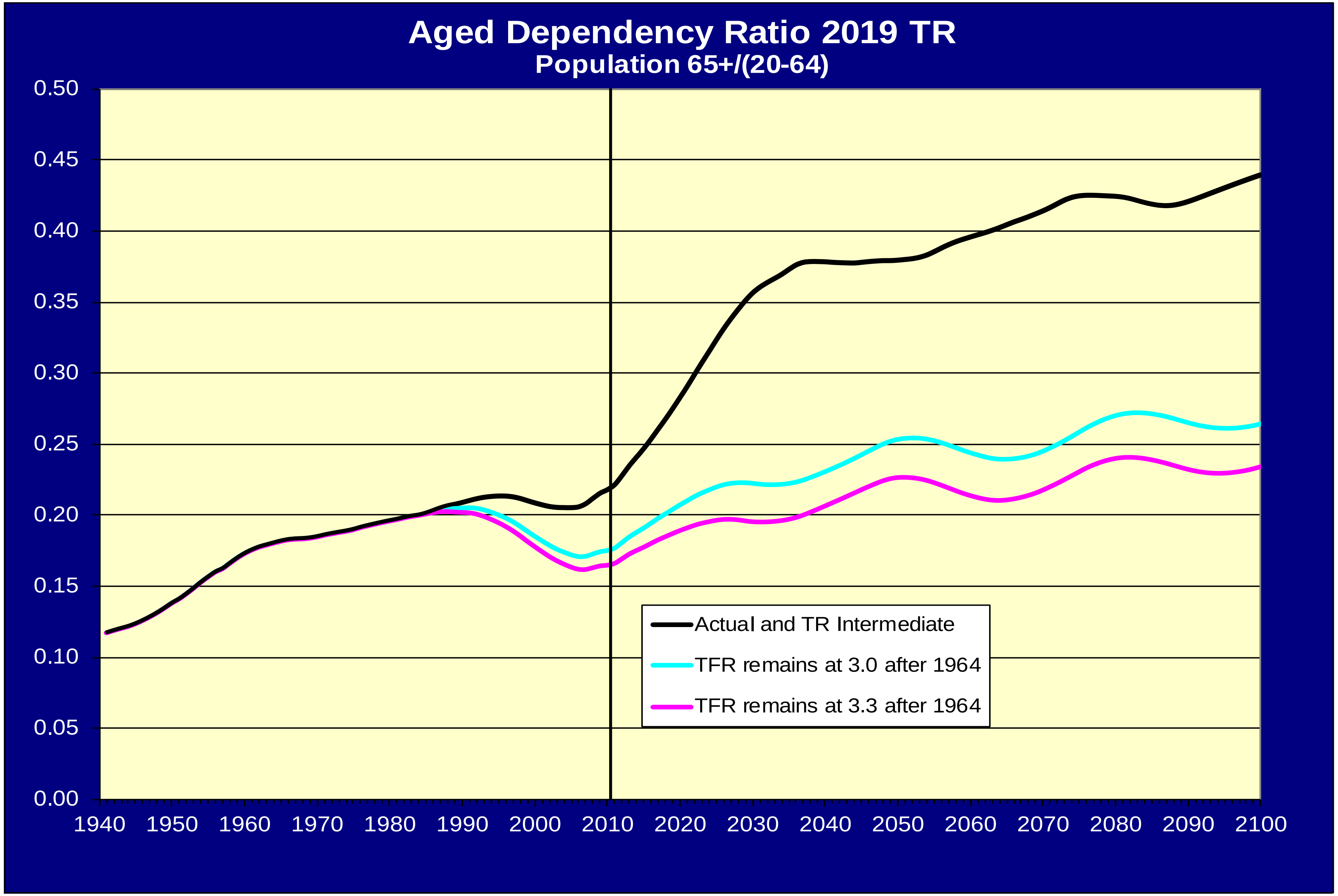
- 80% of scheduled benefits still payable at trust fund reserve depletion
- Annual deficit in 2093 is 4.11 percent of payroll — 0.25 percent smaller than last year

SUSTAINABILITY: Cost as Percent of GDP



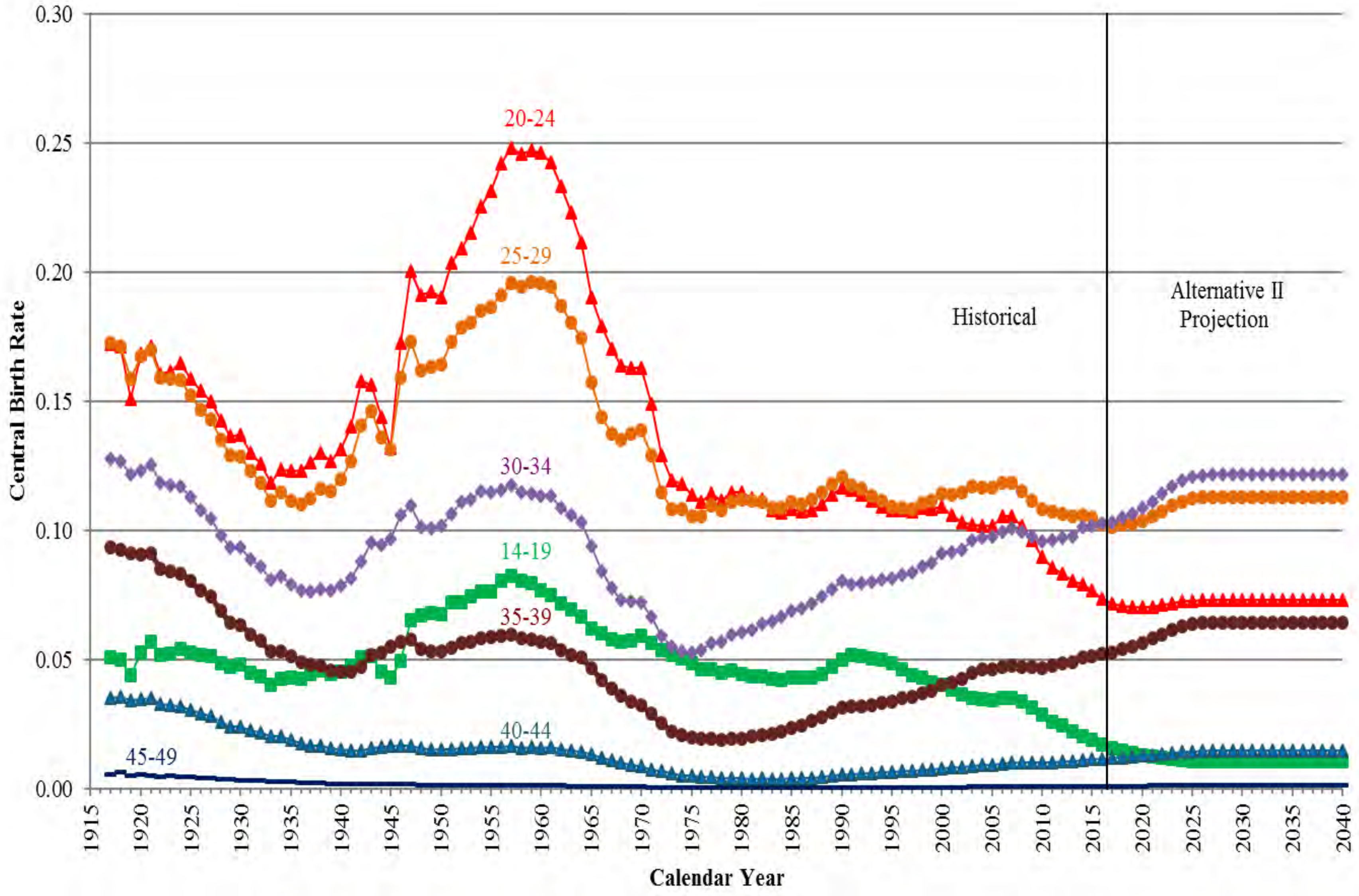
- Rises from a 4.2-percent average in 1990-2008 to about 5.9% by 2039
- Then declines to 5.8% by 2052, and generally increases to 6.0% by 2093
- Stable shortfall

Cost Increase Mainly Due to Aging (change in age distribution)



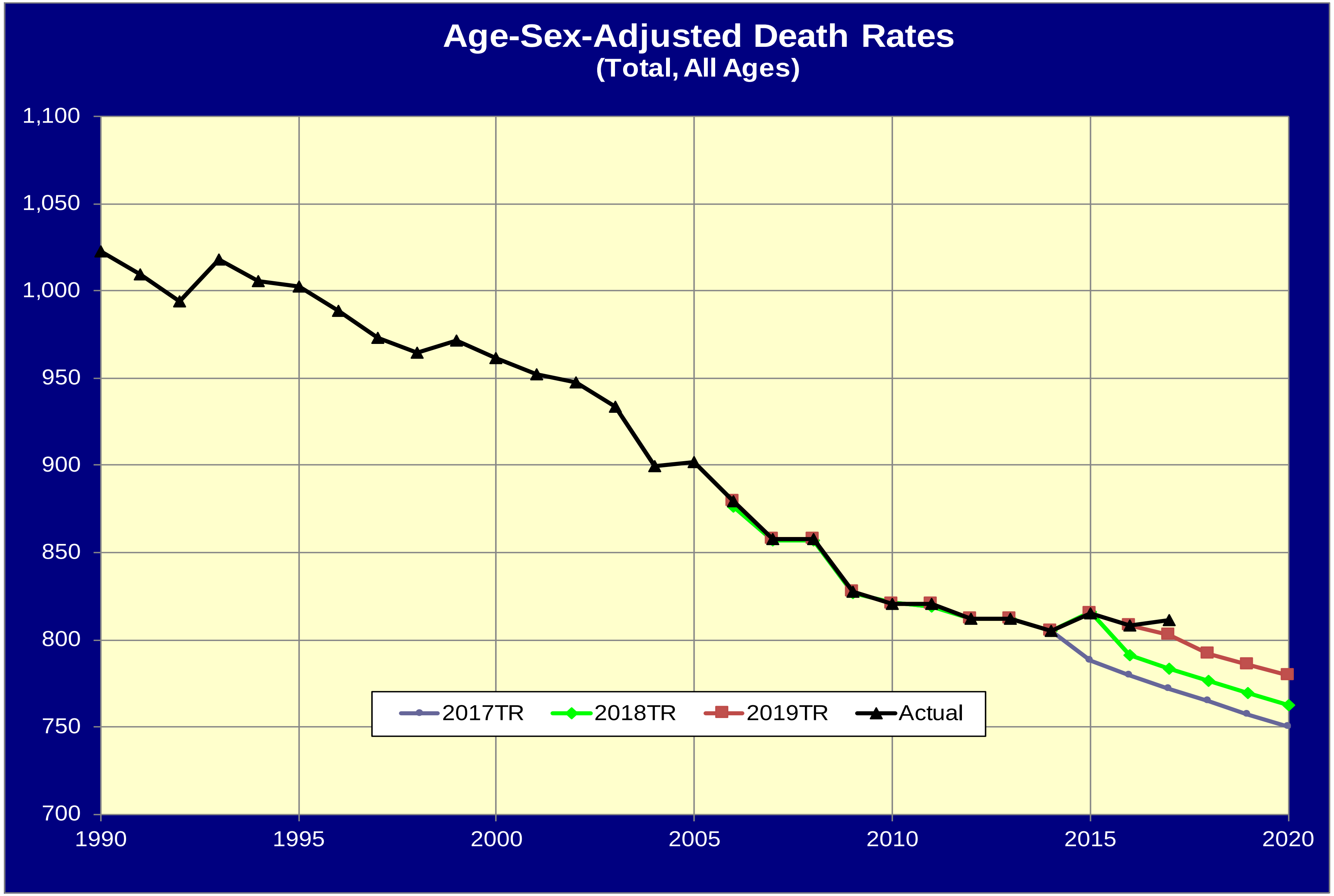
- Largely due to drop in birth rates
- If birth rates had stayed at boom levels, cost would have risen little relative to payroll and GDP
- But they haven't and could be lower in the future

Central Birth Rates for Five-Year Age Groups

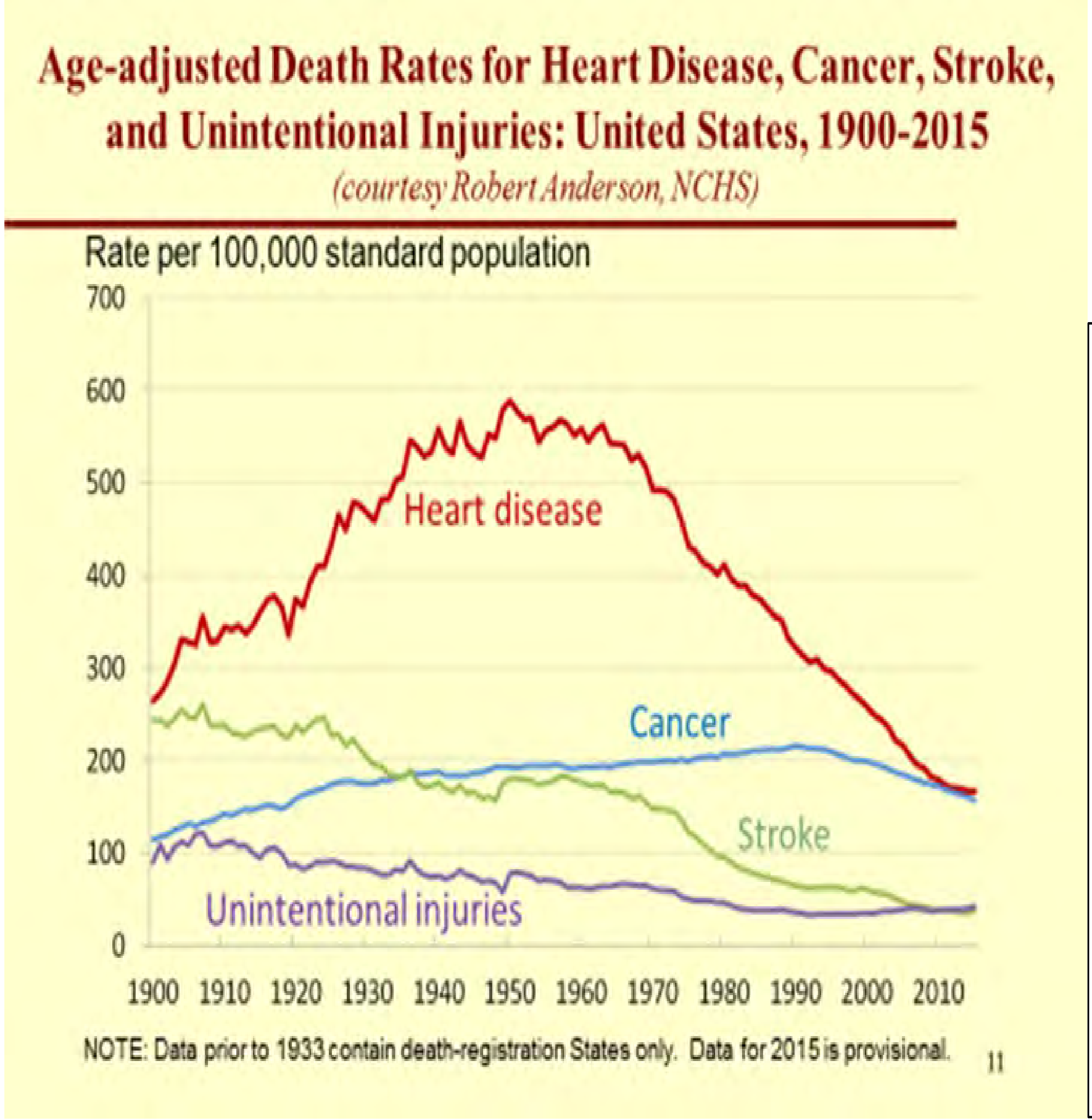


- How much of the decline since 2007 was recession versus more persistent effects?
- Will the tempo effects we have been assuming extend longer, as the recent Technical Panel suggested?

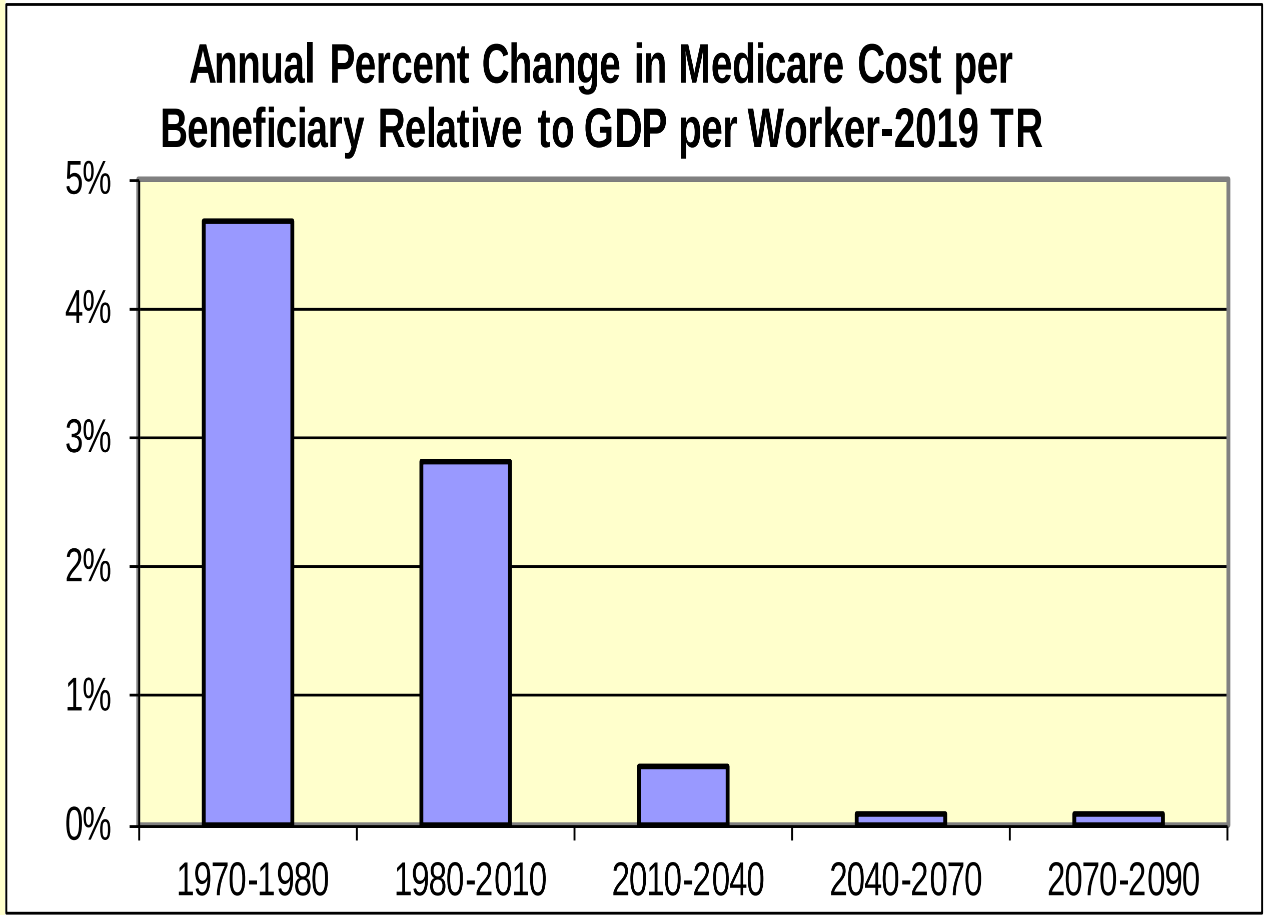
Mortality Experience: All Ages—Age-Sex Adjusted



- Reductions continue to fall short of expectations
- We need to accept that gains from reduction in heart disease and growth in medical spending are in the past



We cannot logically expect mortality declines to return to 20th century rates…

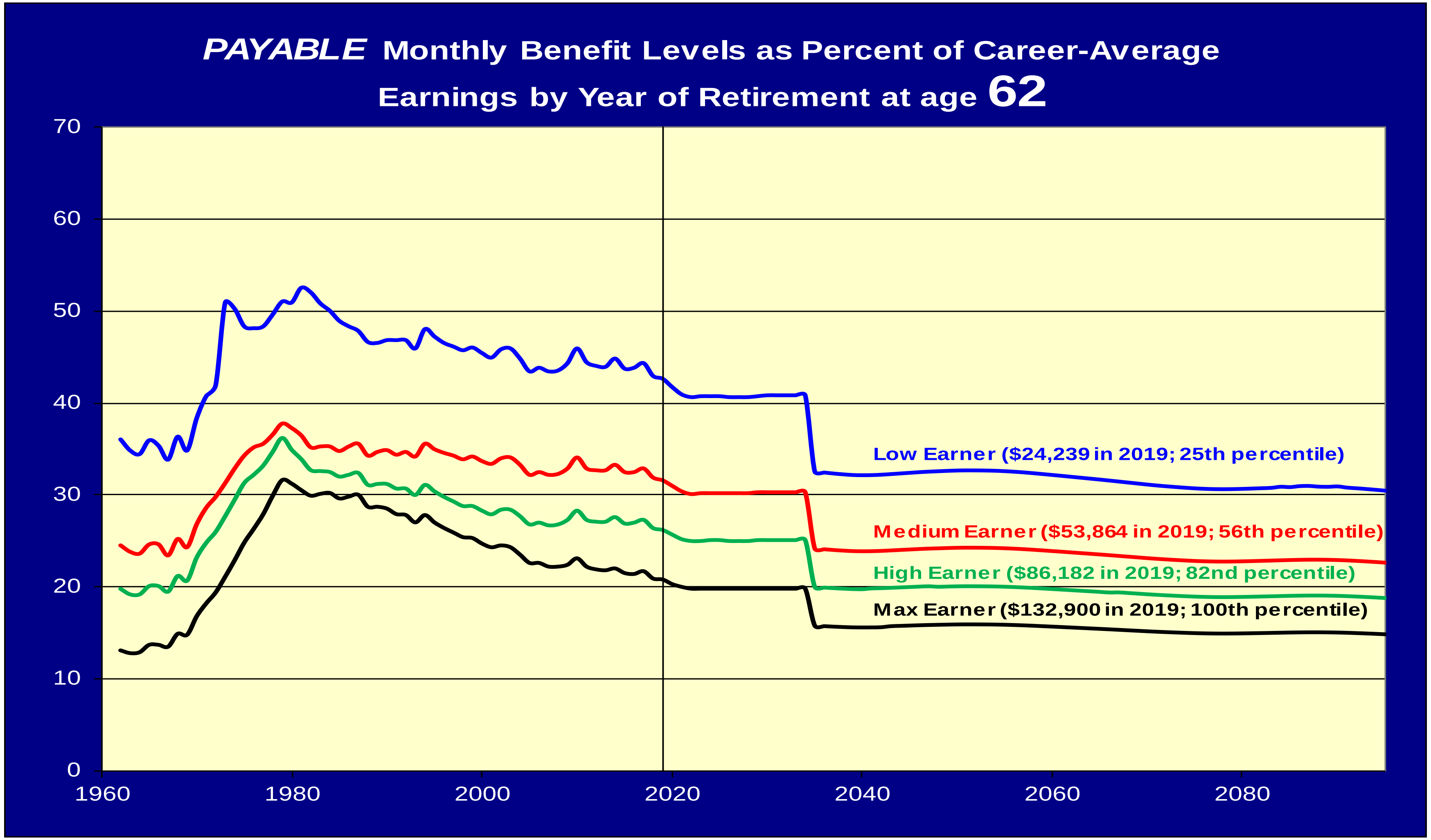


What Does Congress Need To Do To Eliminate Social Security's Long-Term Underfinancing?

By 2035 (preferably sooner), Congress will need to:

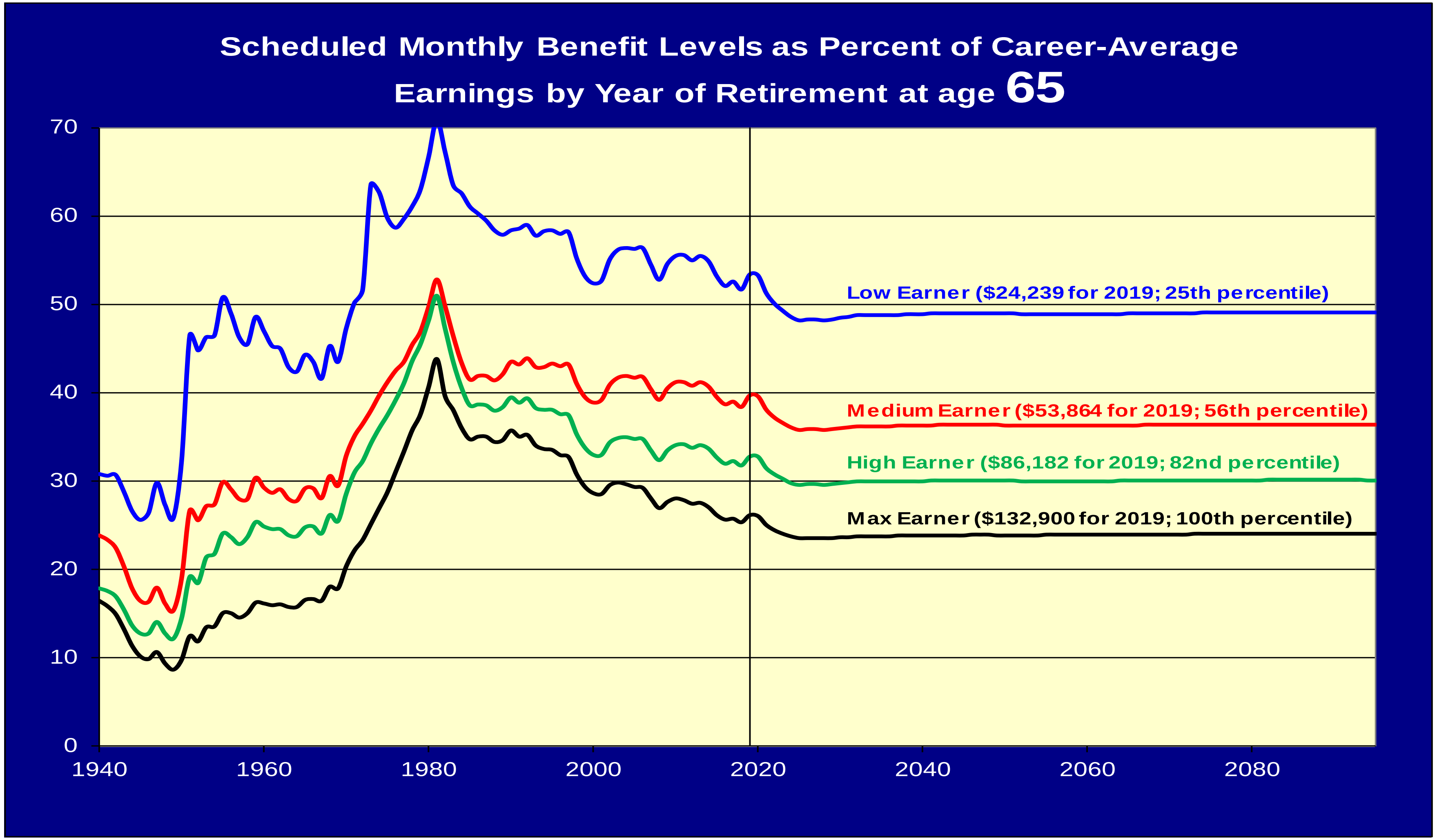
- Lower cost (reduce benefits) by about one-fourth
- Increase revenues by about one-third
- Or some combination of these approaches
- Also consider benefit adequacy?

If the Law is NOT Changed: Full Benefits Will Not Be Payable on a Timely Basis Starting in 2035



- Congress has never allowed a sudden drop like this to happen
- Highly doubtful it ever will

Even if Scheduled Benefits are Fully Financed, and Retirees Wait Until 65, Will Benefits be Adequate ?



- DC plans have all but replaced DB plans, transferring longevity risk to individuals
- Annuities have become rare

Ways to Lower Cost

- Lower benefits for retirees—not disabled
  - Increase normal retirement age (lowers OASDI cost, but increases DI cost)
  - Can increase gradually, maintaining balance between work and retirement years, which would reduce long-range shortfall by about 20 percent
  - Can exempt long-career low earners

- Lower benefits mainly for high earners
  - Reduce PIA above some level
  - Flatten the “benefit” level, making monthly benefits more progressive
    - Note higher earners live longer, but become disabled somewhat less frequently
  - Often combined with increasing PIA below some level, subject to work year requirements

Ways to Lower Cost (continued)

- Lower benefits mainly for the oldest old
  - Reduce the COLA by using a *chain-weighted* CPI (reduces shortfall by 20%)
    - ➢But lessens the ability of Social Security to offset declines in other income
  - Some say instead raise the COLA by using the CPI-E (based on purchases of consumers over age 62) (increases the long-range shortfall by 14%)

- Increase number of years used in benefit calculation (currently 35)
  - In conjunction with increasing NRA, assuming people work longer
  - But hurts those who have gaps in work, or who cannot work to older ages

Ways to Increase Revenue

- Raise tax rate on all earners
  - Increasing rate from current 12.4 percent to about 15.3 percent is projected to completely eliminate the long-range shortfall

- Raise tax on highest earners
  - Increase taxable maximum amount
  - 83% of earnings below the max now, was 90% back in 1982-3
  - Raising max to 90% again would eliminate over 1/4 of the long-range shortfall
  - Eliminating the max (as for HI) would eliminate over 2/3 of the shortfall
  - Some tax on all earnings above the maximum (even if not the full 12.4 percent)?
  - For each option, extra benefit credit? Or not?

Ways to Increase Revenue (continued)

- Tax employer-sponsored group health insurance premiums (eliminates 1/3 of shortfall)
  - The main form of employee compensation not now taxed
  - Affects only middle class if taxable maximum is not increased

- Maintain larger trust fund reserves, and invest for higher return
  - Could do this by investing some portion of reserves in equities
  - Added interest/yield can lower needed taxes

More Fundamental Changes

- “Privatize”: Partially or fully replace Social Security retirement benefits with personal accounts
- Means-test Social Security benefits
  - Reduce benefits based on assets and/or total income
- Tax additional forms of income
  - Investment income: like ACA approach
  - Inheritance tax
  - Value-added tax (VAT)
  - Wealth

Finally, Timing for Change

- Historically, Congress has waited until reserve depletion is imminent
- Given uncertainties, difficult to lower benefits or raise taxes until you must
- Enacting “sooner” allows more options, more gradual phase in, and more advance notice
  - Best example: 17-year delay in implementing NRA increase in 1983 amendments
- OASDI reserve depletion now projected for 2035
  - The date has varied between 2029 and 2042 over the past 29 years
  - So we may still have some time for study and careful consideration

For More Information Go To http://www.ssa.gov/oact/

There you will find:

- The 2019 and all prior OASDI Trustees Reports, back to 1941
- Detailed single-year tables for recent reports
- Our estimates for comprehensive proposals
- Our estimates for the individual provisions
- Actuarial notes; including replacement rates
- Actuarial studies
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