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An Enhanced Social Security Annuity

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Social Security provides what most actuaries like to see in terms of how to address retirement, meaning individuals are best protected by annuitizing retirement. What is desired is a steady flow of income on which people can depend. That Social Security is a government program instead of a private insurer also means the benefit is from a trusted source. That gives an assurance it will be there when needed. It also helps that Social Security is structured as a benefit one cannot outlive. Imagine you had bought a private annuity guaranteed to a certain age, even 100. For many, that source of funds would dry up.

Having said that Social Security is wonderful—and not even getting into how it also is wonderful because it tends to aid poorer individuals more than the rich—it is not enough for many. My proposal does not address how to help the lowest income individuals. It would, however, help those who do not have enough quarters of work to qualify for Social Security.

Right now, tens of millions of people put money aside to protect themselves in retirement. In many cases, they tap it before they wish. In other cases, they could have saved/invested but did not. My proposal pushes—nudges—individuals in the direction they should be going, namely putting more money away in a vehicle that best maximizes their savings dollars.

As we know from Nobel laureate Richard Thaler, people do not act completely rationally. As reported in the *New York Times* when he won the Nobel Prize in Economics, Thaler "did not simply argue that humans are irrational, which has always been obvious but is not particularly helpful. Rather, he showed that people depart from rationality in consistent ways, so their behavior can still be anticipated and modeled."[1]

Why This and Not Something Else?

What is envisioned here is the creation of a right to buy additional annuity protection through the Social Security system, in essence to leverage the idea that Thaler had to nudge people toward better decision-making.[2]

Now someone will point out that people can already buy annuities. My reply is they can but they don't. Part of this is likely due to companies and brokers that sell annuities not making a compelling case. Another part is the funding requirement. Most annuities are paid (bought) in a lump sum. But that is not the only way to do it. All an annuity really amounts to is money at the front end (either a lump sum or a monthly flow) that triggers a promise to pay a lump sum or flow of money in the future. The Appendix demonstrates what it might cost to create such protection through the private market rather than Social Security.

To achieve more widespread adoption of annuities, the government could wage an educational campaign. Or employers could provide annuities instead of life insurance. None of the various ideas will likely alter the fact that private sector annuities are, in my opinion, simply not constructed or delivered well to expand coverage for the great mass of the public.

An analogy would be how extensive term life insurance is versus whole or universal life. If the annuity industry could have created a term life equivalent, they would have done so and sales would presumably have been as robust as term life, at least if employer interest had been as great as with term life.

Established Models

This brings up the question as to what might be the best method for delivering such a product. The model

1 Roger Lowenstein, "Exuberance is Rational," New York Times Magazine, Feb. 11, 2001, *http://www.nytimes.com/library/magazine/home/20010211mag-econ.html.*

2 From Lowenstein: "Along with Shlomo Benartzi, a collaborator at UCLA, Thaler cooked up a plan called Save More Tomorrow. The idea is to persuade employees to commit a big share of future salary increases to their retirement accounts. People find it less painful to make future concessions because pain deferred is, to an extent, pain denied. Therein lies the logic for New Year's resolutions. Save More Tomorrow was tried with a Chicago company, and workers tripled their savings within a year and a half—an astounding result." Ibid.

I would propose is the Federal Employees' Group Life Insurance (FEGLI) Program, established in 1954. It is the largest group life insurance program in the world, covering more than 4 million federal employees and retirees, as well as many of their family members.

FEGLI provides group term life insurance. A private entity—the Office of Federal Employees' Group Life Insurance—was created to pay claims under FEGLI. Well over 100 life insurance companies participate in the program. They originally split the risk but since there is essentially no longer any risk with a program this large, there is no longer an insurance charge. MetLife receives a management fee to run the program.

Another model is the federal retiree program known as the Thrift Savings Program (TSP). TSP is a defined contribution retirement savings and investment plan for federal employees and members of the uniformed services. It was established in 1986 and offers the same types of savings and tax benefits many private corporations offer under 401(k) plans. What is interesting about this model is that the federal government is the administrator. No brokerage firm is hired to run the program.

How It Would Work

There is no reason FEGLI (or TSP) administrators could not be brought into the picture for identifying annuity companies that would offer their products to Social Security beneficiaries. These insurance products would not be identified by carrier. More important, the rules for how the carriers price and reserve for the annuities would all be the same. There are certainly reasons why competition is good. But for this kind of product approach, it is better we treat it as a commodity product and reduce competition and differentiation to make it accessible and more desirable to Social Security beneficiaries.

If we go back to earlier in this essay, you'll recall that an annuity can be a flow of money at the front end. For this proposal to work, we have to envision a system where people move small bits of change forward over time. A 20-year-old can easily divert $5 to 10 or so a month into a retirement account . . . or a Social Security annuity.

Social Security actually uses percentages, not dollar figures: You pay 6.2% and the employer pays 6.2% (which is not the same as the Federal Insurance Contributions Act, or FICA, rate since that includes Medicare). That approach would probably be adopted to make it easier. In fact, here is where Thaler comes into play. If you had to grit your teeth and lock down some money you couldn't touch for 40 years, which is psychologically better, $10 or .3%? Some people will like the idea of a set amount of cash. Others would say setting aside, say, another .3% of income into Social Security makes it an "even" savings of 6.5% of salary. Either works and it is not the final amount that is important but the fact that people default to one or the other and put money away.

One departure from Social Security is that the person can turn the savings on or off but they cannot withdraw the funds prematurely. Whatever they do put into the system goes into a dedicated account they keep for life. They can add to it or not as time goes by. Individual retirement accounts and 401(k) plans can be accessed ahead of time, with a penalty. These could not be accessed early.

A parenthetical note here. If we were in a world where there was only the Social Security system, you might need to build in a way to access the money ahead of time. But with the ability to tap into these other retirement accounts in case of emergency, there is less need to go after the Social Security annuity. This also prevents what has happened politically to retirement accounts. The law now allows people to access their retirement accounts for education or to buy a first home. These are laudable provisions but if anyone thinks they were added because of the hue and cry of the public, they are missing how things work in Washington. These came from the industries that benefit from letting people tap their retirement accounts for those other, nonretirement uses.

Triggering Provisions

The system cannot be kept so pure that there is not an exit plan for some hardships, specifically, in the event of a permanent disability. In that case, it makes sense to allow a diversion of retirement savings.

In essence, there would be only two triggering events. One trigger allows access earlier for permanent disability. The main one is the date you set after retirement for when you want the money to flow. This probably should be no earlier than age 66, the current age for

Social Security distributions for those born before 1954. As is scheduled for Social Security itself, the distribution age could be moved to 67 for those born after 1960. As with longevity annuities, the idea is to protect people at older ages. What might be nice is not to require this be a permanent election when they start putting the money away. Frankly, the closer to retirement, the more likely the person would know their financial situation.

One matter open for discussion is whether to make this an auto-enrollment option. We know auto-enrollment works. I would suggest we do that here. But the amount we would want to tap becomes an issue. Too low and people sign on but it does not amount to that much when they retire. Too large and they reject the enrollment altogether. We could make it a sliding scale with larger salaries getting a larger percentage put aside.

But I tend to think we should start out simple—and relatively small—until we have more real-world experience.

While a lot of the organizational matters have been set out, there is still a lot missing. For instance, whether to introduce a difference in pricing between males and females, which exists in the private annuity market but not in Social Security. Other issues include indexing for inflation, survivor benefits and so forth.

Concluding Thoughts

Since this is a thought exercise and not in-depth research, the next step would seem to be to flesh this out more. One way to do this is built on work already done by the Social Security Administration, especially that of Dale Kintzel and his colleagues.[3] I'd also suggest that while much has been discussed about better structuring 401(k) plans now that we have moved from a defined benefit world to one of defined contributions, we are missing the larger picture: There are other tools we can employ to protect and help people secure their future retirement. A new Social Security annuity would help do so.

3 While it is slightly off-topic, the Social Security Administration has a very detailed analysis of what it would take to create Social Security-like benefits via private annuities. See Dale Kintzel, "Social Security Retirement Benefits and Private Annuities: A Comparative Analysis," Social Security Administration issue paper no. 2017-01 (May 2017), *https://www.ssa.gov/policy/docs/issuepapers/ip2017-01.html.*

Appendix

Table 1 illustrates a pretty devastating picture of what it would take to duplicate Social Security, as you can see from a 2015 Social Security Administration publication.[1] My proposal is not an attempt to displace Social Security but rather a way to augment it.

Table 1 Premiums for Annuities With Monthly Payments Equal to the Average Social Security Retirement Benefit, December 2014 (in Dollars)

		SPIA Premiums		100% JS Annuity Premiums	
Sex	Average Monthly Social Security Benefit at Age 65	For a Nominal Fixed Monthly Payment	With 3% Inflation Protection	For a Nominal Fixed Monthly Payment	With 3% Inflation Protection
Men	1,317	263,043	359,045	359,045	471,066
Women	1,033	229,262	321,954	321,594	367,338

Sources: Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin, 2015," SSA Publication No. 13-11700 (April 2016): Table 5.A1.1, *https://www.socialsecurity.gov/policy/docs/statcomps/supplement/2015/index.html*, "Get Your Best Annuity Quotes Instantly Online!" accessed 2016, *https://www.immediateannuities.com/*.

Notes: While Social Security benefits are gender neutral, annuity premiums and monthly payments are based on the differences in life expectancy between men and women. Equivalent annuity amounts were imputed from these data.

SPIA stands for single premium income annuity; JS stands for joint survivor.

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1 Dale Kintzel, "Social Security Retirement Benefits."