

# SAVINGS POLICY BRIEFING BOOK



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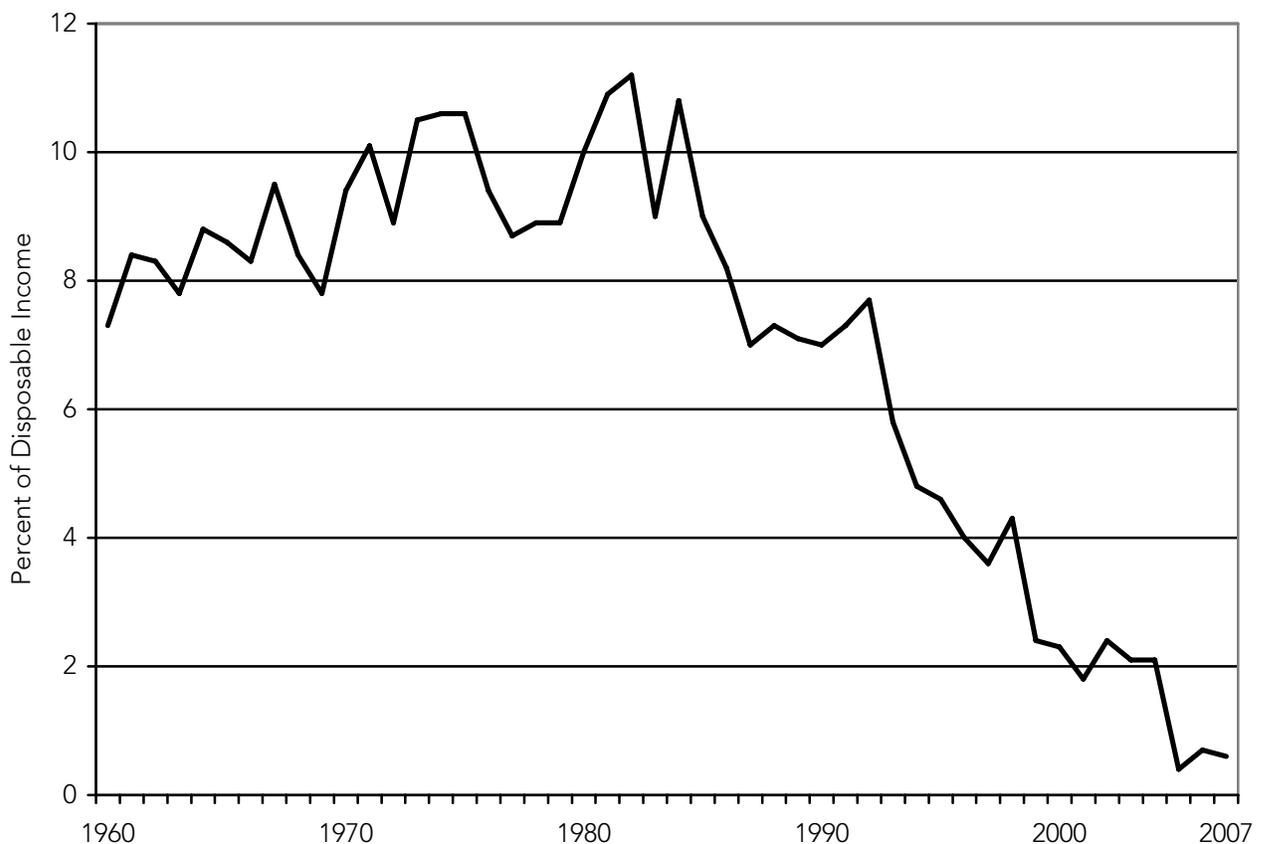
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# U.S. PERSONAL SAVINGS RATE 1960-2007

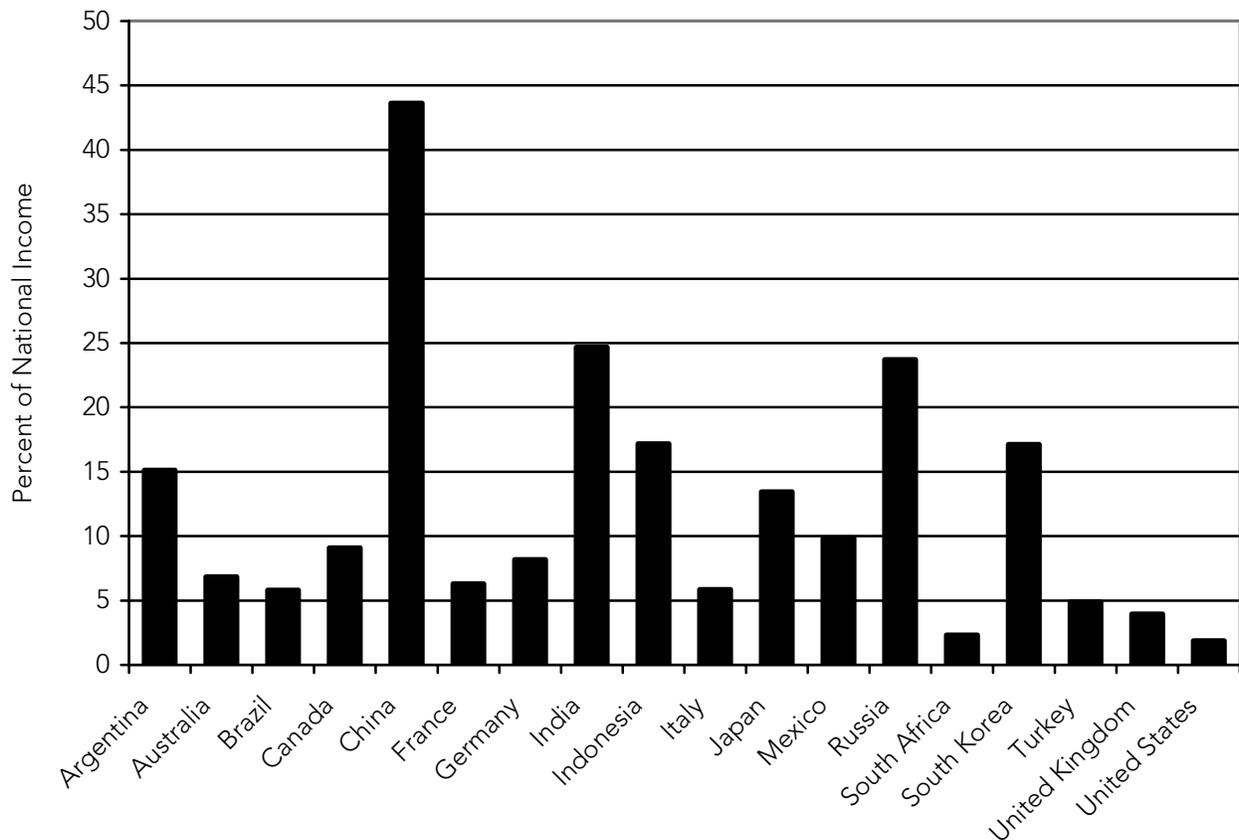
Personal savings is personal income minus consumption expenditures – the amount you earn minus the amount you spend. The personal savings rate (personal savings as a percentage of disposable income) was for the most part consistently above 8 percent in the years following World War II. In 1982, it reached 11.2 percent. Since then, however, there has been a long and steady erosion in personal savings. By 2005, the rate had fallen to 0.4 percent, and in 2007, it stood at 0.6 percent – an almost 95 percent decline in 25 years.

For three consecutive years – 2005 to 2007 – the personal savings rate has hovered just above zero. Even with the expected uptick in savings in 2008, the United States is experiencing a period of lower personal savings than at any time since the Great Depression.



# NET NATIONAL SAVINGS IN SELECTED COUNTRIES 2006

National savings is the sum of a nation's personal savings, savings by businesses, and savings by government (or negative savings in the case of a governmental budget deficit). On this front, the United States lags far behind most other countries of the world. In 2006, the U.S. national savings rate was 1.87 percent, compared to over 43 percent in China, 17.12 percent in South Korea, and over 9 percent in both Canada and Mexico.



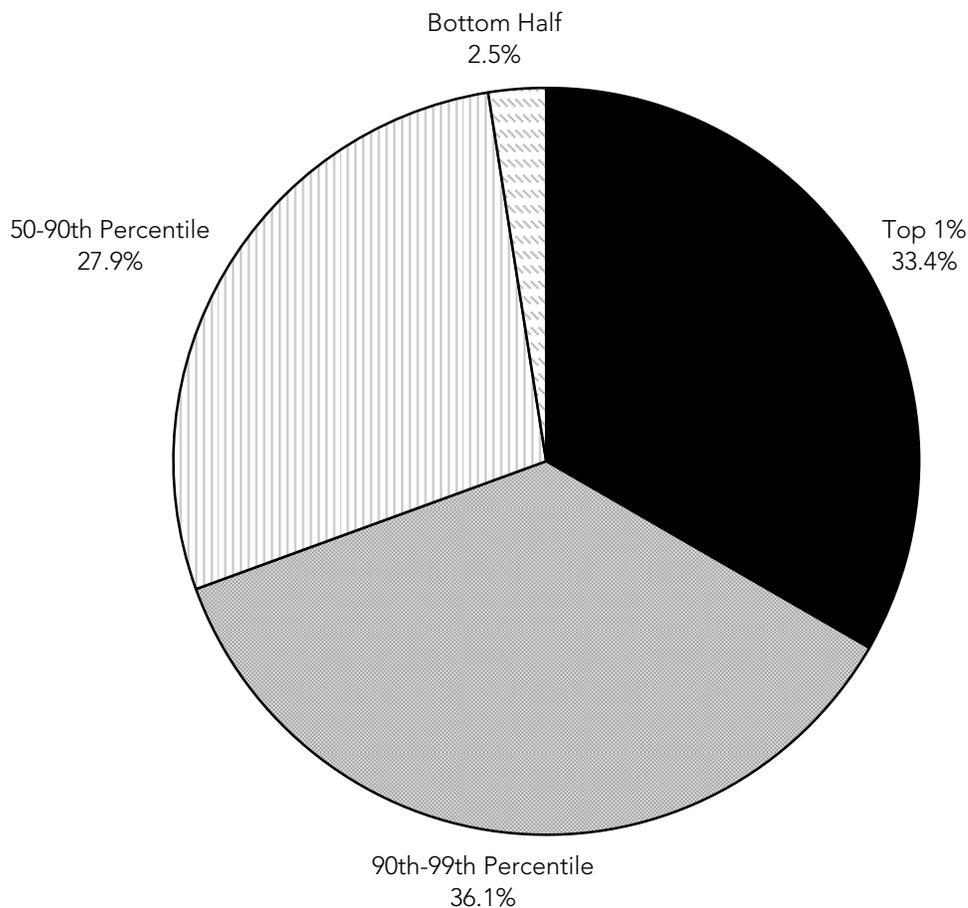
Source: World Bank

# DISTRIBUTION OF NET WORTH

## 2004

Net worth is a person's total assets minus his or her total liabilities (excluding consumer durables, such as televisions and furniture, as well as the future value of benefits from Social Security and private defined benefit pension plans). Aggregating the net worth of all the people in a country is a way to measure the wealth of that nation's people. However, looking at how net worth is distributed among a nation's population can also provide insights into how financially equal the nation is.

In 2004, Americans cumulatively had a total net worth of \$50.3 trillion. However, almost 70 percent of the net worth – 70 percent of America's wealth – is held by just 10 percent of the people. The top 1 percent of Americans hold a third of the net worth, while the bottom half of Americans held just 2.5 percent.

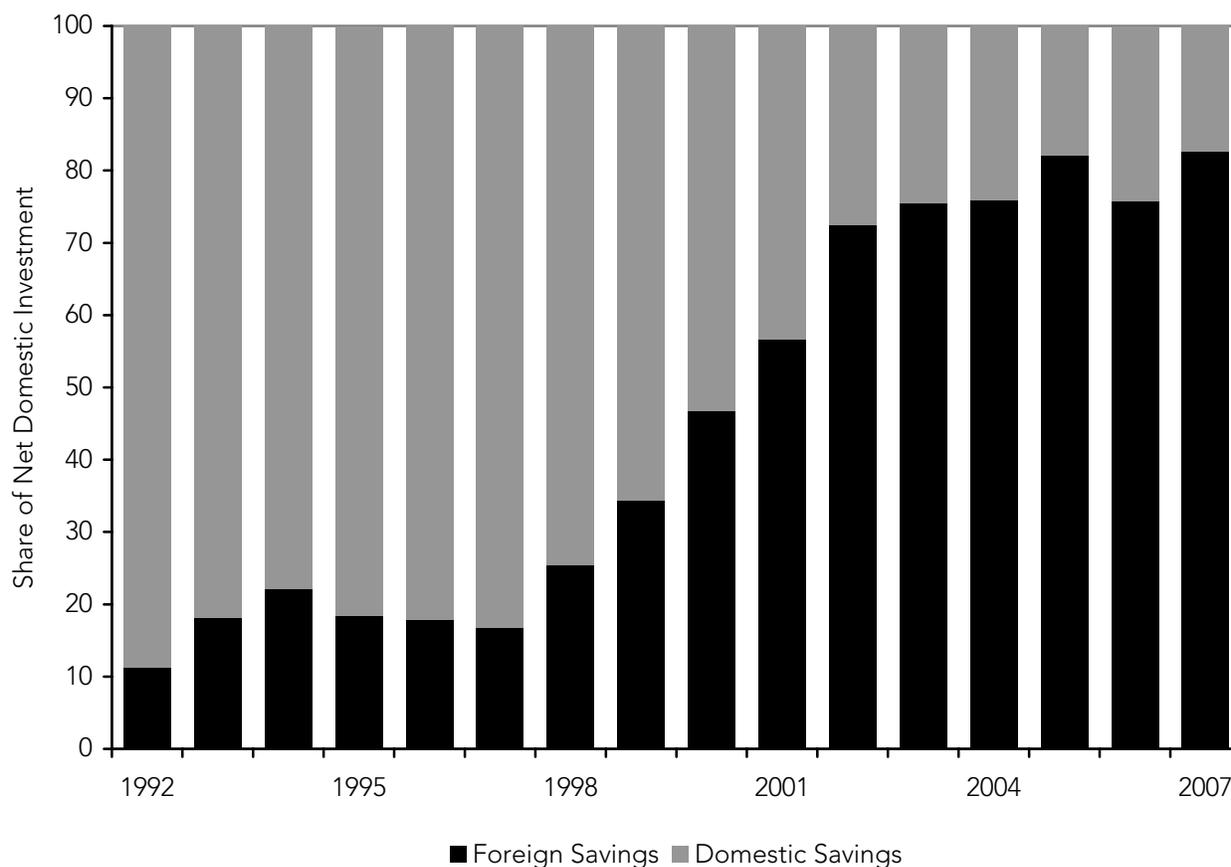


Source: 2004 Survey of Consumer Finances (Arthur B. Kennickell, *Currents and Undercurrents: Changes in the Distribution of Wealth, 1989-2004* (Washington, DC: Federal Reserve Board, January 30, 2006) 11.)

# DOMESTIC AND FOREIGN SAVINGS AS A SHARE OF INVESTMENT 1992-2007

Investment is key to a nation's long-term economic growth; investment is key to higher productivity. But a nation can invest only what it saves – unless it borrows another nation's savings. Because of a declining personal savings rate as well as a relatively low national savings rate, the United States has increasingly relied on savings from abroad to fuel investment here at home.

In 1992, over 88 percent of domestic investment in the United States was from domestic savings. But in the late 1990s and early 2000s, there was a sharp increase in reliance on foreign savings. In 2007, the domestic versus foreign share of investment had almost fully reversed itself from 1992: over 82 percent of domestic investment came from foreign savings.



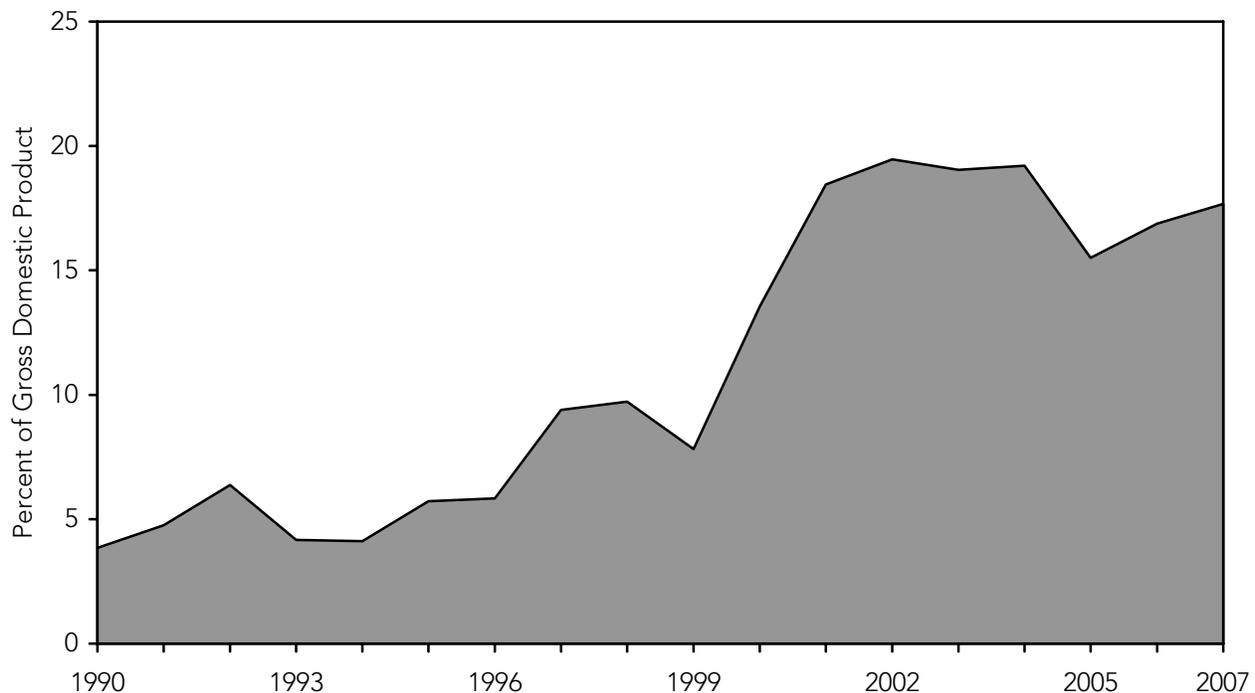
Source: IFS calculations based on data from Bureau of Economic Analysis

# NET FOREIGN INDEBTEDNESS

## 1990-2007

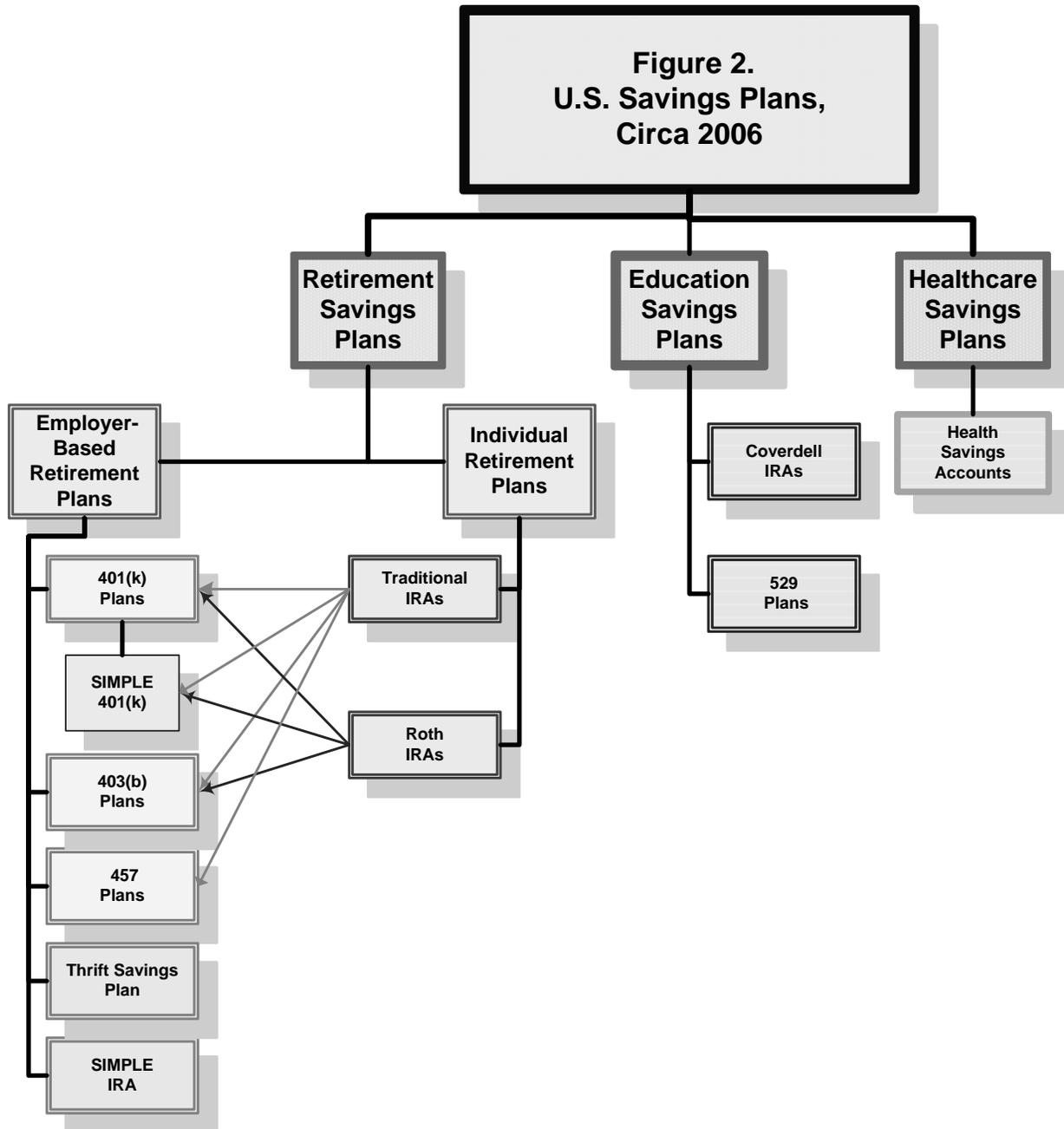
As the United States has increasingly relied each year on foreign savings to fund domestic investment, the I.O.U.s have been piling up. In 1990, net U.S. indebtedness to the rest of the world was just 3.85 percent of Gross Domestic Product (GDP). In 2007, however, net foreign indebtedness had climbed to nearly \$2.5 trillion. The United States now owes the equivalent of 17.68 percent of GDP to overseas lenders.

The implications are twofold. First, foreign investment must eventually be repaid. While that investment does allow for greater productivity growth than relying solely on domestic savings, the returns on the higher productivity are reduced because a portion of it – and an increasing portion at that – must be repaid overseas. Second, greater foreign investment means greater foreign control over the economic future of the United States. Should overseas investment appreciably decline – or dry up – it could cause a serious economic slowdown in the United States, or plunge the U.S. economy into a deeper recession.



Source: IFS Calculations based on data from Bureau of Economic Analysis.

# U.S. SAVINGS PLANS



# BASIC FEATURES OF TODAY'S SAVINGS PLANS

	Plan Eligibility	Plan Access	Saving Decisions	Savings Vesting	Investment Decisions	Investor Protection	Complex Rules
401(k)	Only workers; employer chooses; subject to discrimination rules	Only available through employers; employers not required to offer a plan	Must sign up; decide/change amount of contributions; payroll deductions	Worker savings fully-vested; over time vesting for employer	Employer chooses menu; employees choose account investments and allocations	Employers may be responsible for a poor investment menu	Most complex rules for both employers and employees
SIMPLE 401(k)	All workers			Fully-vested			
403(b)	Workers; service providers; employer chooses		Same as 401(k) but often must choose among employer-authorized providers	Same as 401(k)	Employers choose providers; employees choose among providers, investments and allocations	None	Much less than 401(k)
457(b)							
Thrift Savings Plan	All workers		Automatically in plan but must sign up to contribute, otherwise same as 401(k)	3 year vesting for 1% agency contributions; employee and matching fully-vested	Same as 401(k)	Only through federal oversight of investments	
SIMPLE IRA				Fully-vested	Same as 401(k)		
Traditional IRA	Anyone under age 70 ½, some income limits	Sold by financial service companies or available in an employer's plan	Must choose provider, decide if eligible to contribute, decide how much to contribute, contributions usually made annually		Account owners choose among provider options	None	
Roth IRA	Income limits						
529 Plans	Any child, some states limit contributions to residents	Sold by state-approved financial service companies		Fully-vested	States select investment providers; contributors or parents choose investments	Possibly through state oversight of investments	Rules far less complex than in any employer plan but tax rules are tricky
Coverdell IRA	Child under age 18, income limits on contributors	Sold by financial service companies			Contributors, parents choose investments		
HSA	Anyone with a high deductible health plan, not on Medicare or a dependent	Sold by financial service companies or available from an employer	Must find a high deductible health plan, decide when and how much to contribute		Same as IRA	None	

# FINANCIAL FEATURES OF SAVINGS PLANS IN 2006

	Tax Benefits	Annual Limits	Income Limits	Leveraged Contributions	Loans	Withdrawals	Hardship Categories			
401(k)	Pre-tax	\$15,000; Catch-ups	Can be, if low-paid workers save too little	Optional by employer; Saver's Credit	Lesser of \$50,000 or 50% of the account	At age 59 ½ or as a hardship; extra 10% tax before age 59 ½	Medical expenses, home purchase, prevent foreclosure, casualty loss, education			
SIMPLE 401(k)		\$10,000; Catch-ups	No	Required; Saver's Credit						
403(b)		\$15,000; Catch-ups		Optional but not common; Saver's Credit	Same as 401(k) but worker savings only					
457(b)				Required; Saver's Credit		After age 70 ½ or as a hardship				
Thrift Savings Plan				Required; Saver's Credit				Once after age 59 ½; hardship; extra 10% tax before 59 ½		
SIMPLE IRA	\$10,000; Catch-ups	Required; Saver's Credit		Same as 401(k)	Any time; extra 25% tax in 1st 2 years; extra 10% tax before 59 ½	Medical expenses, cash crunch, personal casualty loss, divorce				
Traditional IRA	Pre-tax or after-tax	\$4,000 Combined; Catch-ups	None except Saver's Credit				Any time; extra 10% tax before age 59 ½			
Roth IRA	Roth							If not the only plan, deduction limits begin at \$45,000/ \$75,000	Contribution limits begin at \$95,000/ \$150,000	
529 Plans	Roth	Varies by state	No				Minority of states have matches/other enhancements	No	After age 59 ½ and 5-year waiting period	Not relevant
Coverdell IRA	Roth	\$2,000 (until child is 18), per account/per contributor	Contribution limits begin at \$95,000/ \$190,000				No			
HSA	No-tax	\$2,700/ \$5,450; Catch-ups	No	Optional by employer; Saver's Credit	Anytime but tax + penalty before 65 and tax after 65 if not for qualified purposes					

# ASSETS HELD IN SAVINGS PLANS

Plans	Assets	Individuals (I) or Households (H) Holding Accounts	Account Size - Average (A) or Median (M)
401(k)/SIMPLE 401(k)	\$3 trillion	About 50 million (I)	\$121,202 (A) \$66,650 (M)
403(b)	\$743 billion	NA	NA
457(b)	\$176 billion	NA	\$29,900 (A)
Thrift Savings Plan	\$231.5 billion	3.8 million (I)	About \$61,000 (A)
SIMPLE IRA	\$4.7 trillion	9.2 million (H)	NA
Traditional IRA		37.7 million (H)	\$42,500 (M)
Roth IRA		17.3 million (H)	\$14,500 (M)
529 Plans	\$112.5 billion	8.3 million (I)	\$13,500 (A)
Coverdell IRA	\$6 billion (only mutual funds)	NA	NA
HSA	NA	6.1 million	\$1,380 (A)

Sources: Investment Company Institute; Thrift Savings Plan; Employee Benefit Research Institute; and AHIP Center for Policy and Research.

# SELECTED ASSET-RELATED TAX EXPENDITURES

Encouraging savings and asset building is not a new role for the federal government. Policies have long existed, for example, to encourage saving for retirement – primarily in pension plans – and to encourage homeownership. Most of these policies are done through the tax code. That is, rather than spending directly on, say, matching contributions or downpayment subsidies, the federal government subsidizes the activities by providing tax deductions, tax credits, and tax exclusions. These are known as “tax expenditures.”

Selected Asset-Related Tax Expenditures (in billions)		
	Current Year (FY 2009 Estimate)	Fiscal Year 2012 (Estimate)
Net Exclusion of Pension Contributions and Earnings	\$107.5	\$151.4
Individual Retirement Accounts	\$19.5	\$23.0
Mortgage Interest Deduction	\$80.1	\$107.3
First Time Home Buyers Credit	\$13.6	-\$1.7*

\*The Housing and Economic Recovery Act of 2008 created a \$7500 tax credit for first-time home buyers, but it requires those who take the credit to repay it over 15 years.

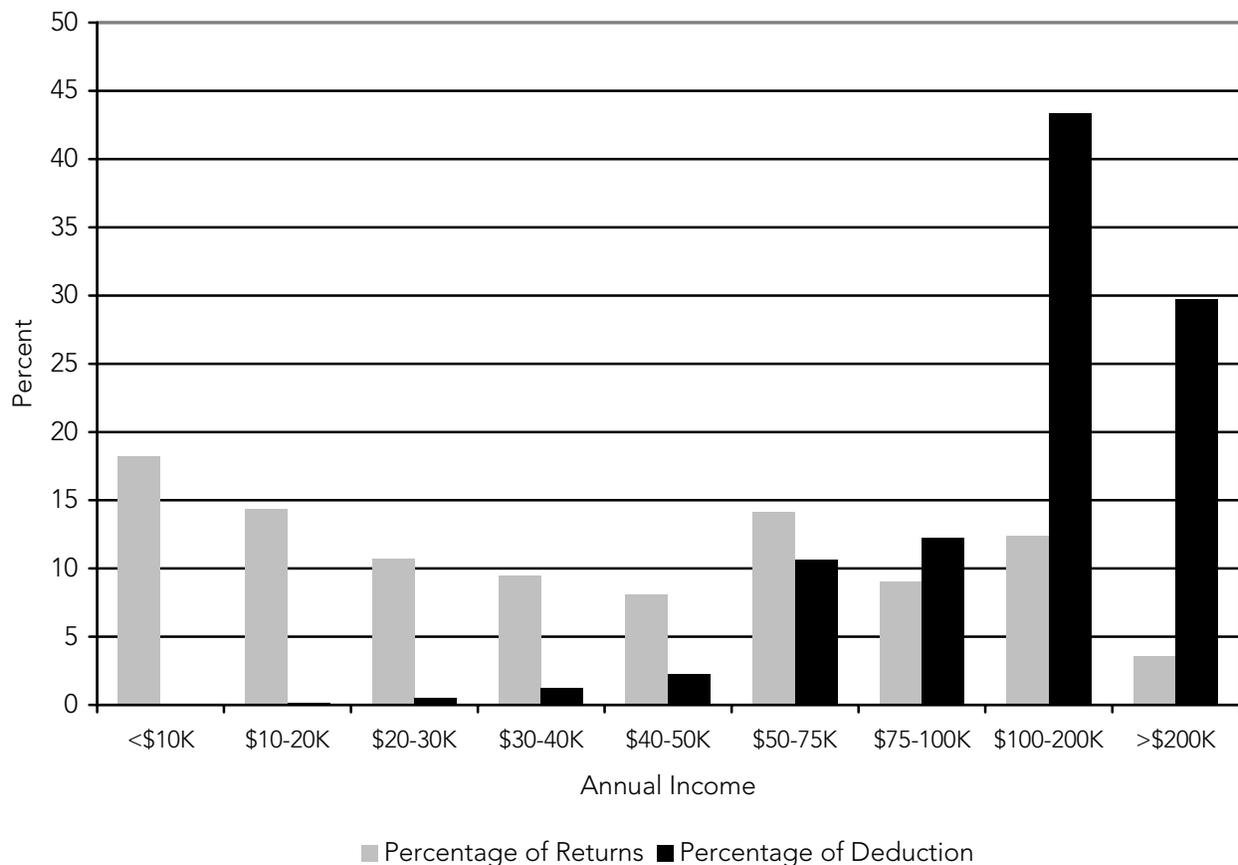
Source: *Joint Committee on Taxation*

# MORTGAGE INTEREST DEDUCTION

## Benefits by Income Level, 2007

Tax expenditures – benefits provided through the tax code – are by and large available only to those who pay federal taxes or, often times, only to the subset of taxpayers who itemize deductions. As a result, the federal subsidies end up providing the most help to those who need the least help.

Take, for example, the mortgage interest deduction – the federal government’s largest program to promote homeownership. In 2007, it cost the federal government \$66.6 billion. Most of that – slightly over 73 percent – went to those who made more than \$100,000. Those who made more than \$200,000 – which comprise only 3.6 percent of all federal tax returns – received just under 30 percent of the benefits. At the other end of the income scale, over 18 percent of tax returns are filed by people with incomes under \$10,000. Their total share of the mortgage interest deduction is less than \$500,000 – a percentage so small it only registers as zero.



Source: IFS Calculations based on data from Joint Committee on Taxation

# FINANCIAL LITERACY: A REVIEW OF THE LITERATURE TO DATE

The term “financial literacy” generally refers to the ability of consumers to make financial decisions in their own best interests in both the short and long term. Low levels of financial literacy have been blamed for what some economists call “mistakes” by many Americans, which contributed to the current sub-prime mortgage situation as well as low or even negative rates of personal savings.

As Professor John Campbell of Harvard notes, the need for financial literacy has been magnified by the increased complexity and proliferation of financial products.<sup>1</sup> Other changes in our society, including the shift from defined benefit to defined contribution pension plans, has placed additional responsibility on individuals to navigate their own futures.

Viable solutions to the problem of financial literacy are in short supply. It is logistically difficult to provide effective financial education to adults, in part because they are hard to reach. While some have advocated for financial education at work, a recent study by Professor Lewis Mandell shows that few employers are motivated to provide effective and disinterested financial education.<sup>2</sup>

As a result, many people now feel that personal finance should become the responsibility of the school system. Both the National Association of State Boards of Education and the President’s Council on Financial Education strongly recommend that financial education be mandated for all students. Currently, three U.S. states require at least one semester devoted to personal finance, and 17 additional states require instruction in personal finance to be incorporated into other subject matters.

Thus far, most mandated instruction in personal finance appears to be at the high school level. The primary rationale is that students completing high school are close to adulthood and have made or are about to make important financial decisions, such as the choice of credit cards, auto insurance, and student loans. Equally important is the fact that high school is the last opportunity society has to mandate required education for students. Few college-age students select courses in personal finance, even when they are available, and many students do not attend college at all.

For more than a decade, the Jump\$tart Coalition has measured financial literacy of high school seniors through biennial national surveys, involving a total of 22,984 students in six surveys. Scores on the standard, 31-question, age-appropriate exam have never exceeded 60 percent and fell to a low of 48.3 percent in 2008. Making matters

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<sup>1</sup> John Y. Campbell. 2006. “Household Finance” *The Journal of Finance* Vol. LXI, No. 4, p. 1591.

<sup>2</sup> Lewis Mandell. 2008a. *Financial Education in the Workplace--A Cost-Benefit Analysis*, Washington, D.C.: New America Foundation, (forthcoming).

worse is the consistent finding that full-semester high school classes in personal finance have *not* been shown to have any impact on financial literacy scores.

The Jump\$start findings seriously question the usefulness of mandates to teach financial literacy to all students. Professor Lauren Willis cites the Jump\$start findings in her article, "Against Financial Literacy Education," to conclude that "the search for effective financial literacy education should be replaced by a search for policies more conducive to good consumer financial outcomes."<sup>3</sup>

## Financial Literacy and Financial Behavior

Financial literacy is of interest only if it has an impact on financial behavior. Here, the results are somewhat mixed. Hilgert, Hogarth, and Beverly of the Board of Governors of the Federal Reserve found a positive relationship between adult financial literacy scores and (self-beneficial) financial practices.<sup>4</sup> A study of Dutch adults by Van Rooij, Lusardi and Alessie found that those with low financial literacy are more likely than others to depend on friends and family for financial advice and are also less likely to invest in stocks.<sup>5</sup> Using the 2006 Jump\$start survey, Mandell found that high school seniors who never bounced a check or who balanced their checkbooks had substantially higher financial literacy scores than others with checking accounts.<sup>6</sup>

A well-known study linking behavior directly to financial education was conducted by Bernheim, Garrett, and Maki. It found that those who took a financial management course in high school tended, decades later in middle age, to save a higher proportion of their incomes than others.<sup>7</sup> On the other hand, Mandell found that a well-regarded high school personal finance course had little positive impact on post-high school financial behavior from one to five years after individuals had taken such a course. It also found that self-beneficial behavior did *not* improve with increased age and presumed greater experience.<sup>8</sup> In a forthcoming study on the financial behavior of college students, Mandell found that personal finance courses taken in high school or college had little impact on the financial literacy or the financial behavior of college students.<sup>9</sup>

Studies of adult behavior modification education also produce results with mixed outcomes. Bayer, Bernheim, and Scholz found that employer retirement seminars in-

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<sup>3</sup> Lauren E. Willis. 2008. "Against Financial Literacy Education." *Iowa Law Review*. Vol. 94, 2008, abstract page.

<sup>4</sup> Marianne A. Hilgert, Jeanne M. Hogarth, and Sondra G. Beverly. 2003. "Household Financial Management: The Connection Between Knowledge and Behavior." *Federal Reserve Bulletin*, Vol. 89, Issue 7 pp: 309-322.

<sup>5</sup> Maarten van Rooij, Annamaria Lusardi, and Rob Alessie. 2007. "Financial Literacy and Stock Market Participation," presented at the Italian Congress of Econometrics and Empirical Economics, Rimini, January 25-26.

<sup>6</sup> Lewis Mandell. 2006a. *Financial Literacy: Improving Education Results of the 2006 National Jump\$start Survey*, Washington, D.C.: Jumpstart Coalition.

<sup>7</sup> B. Douglas Bernheim, Daniel M. Garrett, and Dean M. Maki. 2001. "Education and Saving: The Long-Term Effects of High School Financial Curriculum Mandates." *Journal of Public Economics*, Vol. 80, Issue 3, pp. 435-465.

<sup>8</sup> Lewis Mandell. 2006b. "The Impact of Financial Literacy Education on Subsequent Financial Behavior," University at Buffalo Working paper.

<sup>9</sup> Lewis Mandell. 2008c. "The Impact of Financial Education in High School and College on Financial Literacy and Subsequent Financial Decision Making." University of Washington working paper.

creased participation in, and contributions to, voluntary savings plans.<sup>10</sup> Lusardi and Mitchell found that retirement seminars have a positive effect primarily for those with less wealth or education.<sup>11</sup> Duflo and Saez found retirement seminars have a positive effect on participation in retirement plans – but that the increase in contributions was negligible.<sup>12</sup> Choi, Laibson, Madrian, and Metrick<sup>13</sup> as well as Madrian and Shea<sup>14</sup> found that participants in retirement seminars have better intentions than actual follow-through.

Apart from retirement planning, Elliehausen, Lundquist, and Staten found that credit counseling tended to improve borrowing behavior and improve creditworthiness.<sup>15</sup> Hirad and Zorn found that pre-purchase counseling programs for homebuyers lowered delinquency rates.<sup>16</sup>

## What Works?

Although school-based financial education, as currently delivered, has not been proven to be effective in increasing financial literacy or improving financial behavior, there is reason to believe that it can be improved. Three effective variables are teacher training, classroom interactivity, and teacher-induced motivation.

The 2004 Jump\$tart survey found that required high school classes in personal finance taught by experienced teachers trained in the subject resulted in higher financial literacy scores.<sup>17</sup> Unfortunately, only six percent of U.S. high schools required such a course. Moreover, the 2008 Jump\$tart survey found that nearly half the students who took a high school course in personal finance were freshmen, sophomores and juniors rather than seniors who could presumably gain the most from it.

The use of a stock market game has proven to be consistently related to higher financial literacy scores. Starting with the 2000 Jump\$tart survey, students who play a stock market game in class showed a six to eight percent increase in financial literacy. Although reasons for the success of this activity are not clearly known, playing such an interactive game appears to stimulate general interest in personal finance. The survey

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<sup>10</sup> P. L. Bayer, B. D. Bernheim, and I. K. Scholz. 1996. "The Effect of Financial Education in the Workplace: Evidence from a Survey of Employers." (Stanford Economics Working Paper # 96007). Stanford, CA: Stanford University.

<sup>11</sup> A. Lusardi and O. Mitchell. 2006. "Financial Literacy And Planning: Implications For Retirement Wellbeing." Pension Research Council Working Paper 1, The Wharton School.

<sup>12</sup> Esther Duflo and Emmanuel Saez. 2003. "The Role of Information and Social Interactions in Retirement Plan Decisions: Evidence from a Randomized Experiment." *Quarterly Journal of Economics*, 118 pp. 815-842.

<sup>13</sup> James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick. 2006. "Saving for Retirement on the Path of Least Resistance." In Edward J. McCaffrey and Joel Slemrod, editors, *Behavioral Public Finance: Toward a New Agenda*, pp. 304-351, New York: Russell Sage Foundation.

<sup>14</sup> Brigitte Madrian and Dennis Shea. 2001. "Preaching to the Converted and Converting Those Taught: Financial Education in the Workplace." University of Chicago Working Paper.

<sup>15</sup> G. Elliehausen, E. C. Lundquist, and M. E. Staten. 2004. *The Impact of Credit Counseling on Subsequent Borrower Behavior*, Washington, D.C.: Georgetown University.

<sup>16</sup> Abdighani Hirad and Peter Zorn. 2002. "Prepurchase Homeownership Counseling Knowledge is a Good thing." In *Low-Income Homeownership: Examining the Unexamined Goal*, edited by Nicolas P. Retsinas and Eric S. Belsky, pp146-74, Washington, DC, Brookings Institution.

<sup>17</sup> Lewis Mandell. 2004. *Financial Literacy: Are We Improving? Results of the 2004 National Jump\$tart Survey*, Washington, D.C.: Jumpstart Coalition.

results show that students who played a stock market game in class tend to score above average in every subject category, not just in areas related to savings and investments.

Retention of material learned in financial education appears to be based on motivation or the perceived importance of the subject to the students' own lives. Mandell and Klein found that motivated students had higher financial literacy scores than counterparts with less motivation,<sup>18</sup> which implies the need to teach techniques that continually emphasize the importance of financial literacy to students' own futures.

## Starting Younger

The apparent ineffectiveness of financial education in high school has led many educators to suggest that the process begin when children are younger. The rationale is twofold: younger children are less subject to peer pressure to consume than their teenage counterparts; and, good financial practices, such as saving, can be more effectively inculcated as a habit (rather than a cognitive choice) when children are young.

In a study of middle school children in Illinois, Mandell found that an educational intervention on saving increased knowledge by 7.5 percent. However, this increase was 18.8 percent for sixth grade students and just 4.7 percent for eighth grade students<sup>19</sup> – thereby supporting the contention that intervention may have its greatest impact on younger students.

Advocates of child savings accounts often point to the financial literacy benefits of asset ownership among the youngest consumers. This is being tested as part of the Child Trust Fund program in the U.K., which not only provides government-funded accounts for every newborn child, but also includes corresponding financial curriculum to build on that ownership from the earliest grades.

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<sup>18</sup> Lewis Mandell and Linda S. Klein. 2007. "Motivation and Financial Literacy." *Financial Services Review* 16, 106-116.

<sup>19</sup> Lewis Mandell. 2008. "Teaching Young Dogs Old Tricks: The Effectiveness of Financial Literacy Intervention in Pre-High School Grades." In Thomas A. Lucey and Kathleen S. Cooter, *Financial Literacy for Children and Youth*, Digitaltextbooks.biz, 2008.

# CHILD ACCOUNTS: A PATHWAY TO FINANCIAL LITERACY

One of the problems at the core of America's savings crisis is the lack of financial education. Children, young adults, and even older Americans often have very little preparation for important financial decisions in life. And most families have very little, if any, financial cushion to carry them through unexpected emergencies. While many factors contribute to a household's overall financial security, building an effective vehicle for financial education is an important step in the right direction.

**Child Accounts make the learning process *real*.**

Child Accounts provide a hands-on opportunity for teaching financial literacy to both children and their families. Instead of learning about money in the abstract – which research has not yet shown to be effective – children can watch their accounts grow over time and develop a personal stake in their long-term financial security.

**Child Accounts start the learning process at the beginning of life.**

Americans save too little – partly because they start saving too late. Saving, like every other good habit, is best learned at a young age, and an earlier start on saving instills a saving mindset that can persist throughout life.

**Child Accounts can connect individuals to the private sector.**

The private financial services sector has the infrastructure and marketing expertise to develop and promote effective financial education materials. If Child Accounts are housed in the private sector, these materials will help families understand the value of regular contributions and the power of compounding – and will facilitate the policy's hands-on approach to financial education.

**Child Accounts broaden opportunities for existing financial education efforts.**

Since every child will have an account, the education system could incorporate some element of financial education into the curriculum, similar to the U.K.'s national "Money Week" each year for all 7 year-olds. The policy can also leverage the expertise of existing organizations that have successful financial education programs and strong connections to specific communities.

# CHILD ACCOUNT PROPOSALS

## ASPIRE (110th Congress: H.R. 3740; S. 3557)

- All newborn U.S. citizens receive a Child Savings Account and are provided with an initial automatic endowment of \$500. A supplemental \$500 endowment is provided to children born in families with incomes at or below 50 percent of the median income. This supplemental payment is phased out as income increases.
- Private, voluntary contributions to the child accounts are limited to \$2000 per year. For children in households at or below the median income, the government provides a dollar-for-dollar match on the first \$500 of contributions each year.
- Accounts are held in a system modeled after the Thrift Savings Plan for federal employees, with five investment options. When an account balance reaches \$10,000, the account can be withdrawn from the government system and rolled over into a child account provided by a private financial institution.
- Accounts in the government system – even when rolled over into a private account – must maintain at least \$500 until retirement (age 59½).
- Between the ages of 18 and 25, withdrawals can only be made for purposes of post secondary education and training. After age 25, withdrawals can be made for education and a first-time home purchase or saved until retirement (age 59½).
- Earnings in the account are tax free as long as the funds are used for approved purposes when withdrawn.

## Roth IRAs for Children/Kids IRAs (110th Congress: H.R. 2163; H.R. 5497)

- Up to \$5000 per year can be contributed to a Roth IRA for Children/Kids IRA, without regard to current limitations on annual contributions to an IRA or another Roth IRA. Once an individual with a Roth IRA for Children turns 25 (age 26 with a Kids IRA), it converts to a regular Roth IRA and the overall annual contribution limits apply.
- With a Kids IRA (H.R. 5497), a 20 percent tax deduction is provided for individual contributions to all Kids IRAs, up to a maximum tax deduction of \$5000 per year.
- As with existing IRA products, investment options depend on what is offered by the private institution when the account is opened. All account earnings grow tax free as long as the funds are used for approved purposes when withdrawn.
- Permitted withdrawals are the same as with a regular Roth IRA: retirement, the first-time purchase of a home, death, and disability. If funds are withdrawn for any other

reason, the earnings are subject to federal taxation, a 10 percent penalty tax, or both.

### **Aspen IFS Child Accounts**

- All newborn U.S. citizens receive a \$500 voucher to open a Child Account at a participating private financial institution. If a parent does not open the account after one year, an account is opened automatically and assigned to a provider.
- Voluntary contributions to the accounts can be made each year, up to a maximum of \$2000 annually. For children in families with incomes below 200 percent of poverty, the government provides a dollar-for-dollar match of the private contributions, up to \$1000 each year. The match is deposited directly into the child's account.
- Accounts are held by private financial institutions, but investment options are limited to either a target-date investment account (where investment risk declines as the child nears age 18) or a principal protection account. In addition, account fees are capped.
- All earnings grow tax free.
- No withdrawals are allowed before the child reaches age 18, after which the funds may be used for any purpose.

### **PLUS Accounts**

- The federal government opens a PLUS Account for all newborn U.S. citizens and provides every child's account with an initial \$1000 deposit. The government also opens a PLUS Account for all workers who were born prior to the effective date and therefore did not receive an account at birth.
- Voluntary contributions of up to \$5000 per year can be contributed to the account. Once a child enters the workforce, one percent of pay is automatically withheld and deposited into the account, and employers are required to match that one percent. The employer contribution is considered taxable income. Taxes on account earnings are deferred – that is, owed when the funds are withdrawn.
- PLUS Accounts are housed in the Department of Treasury in a system modeled after the Thrift Savings Plan (TSP) for federal employees, which has five different investment options.
- No withdrawals are allowed until a person reaches age 65. Between the ages of 18 and 25, an individual may borrow money from his or her PLUS Account, provided that the loan does not exceed the value of their own contributions and earnings on those contributions.

# IMPACT OF CHILD ACCOUNTS

## National and State-by-State Results

To assess the impact of a Child Account program in the United States, the Aspen Institute Initiative on Financial Security (IFS) developed an economic model to determine how much such a program would cost, how much money individuals would have in their accounts, and how much overall would be saved in the accounts. The results of that model are included here – both national results and state-by-state results.

Although this model shows the results of only one proposal – the IFS Child Account proposal – it is being provided for illustrative purposes to demonstrate the general parameters of the impacts of Child Accounts. Different proposals, or modifications to the original IFS proposal (or even different assumptions used in the model), might show different results.

Savings in Individual Child Accounts				
Type of Saver	Monthly Contributions	Year 5	Year 10	Year 18
Non-Savers	\$0	\$692	\$925	\$1,274
Low-Income Moderate Savers	\$20, matched 1:1	\$3,156	\$6,967	\$14,018
Middle-Income Moderate Savers	\$50	\$3,829	\$8,617	\$17,475
Middle-Income Aggressive Savers	\$100	\$6,966	\$16,309	\$33,676
High-Income Aggressive Savers	\$167 (\$2,000/year)	\$11,148	\$26,565	\$55,277

Total Savings in All Child Accounts				
	Year 1	Year 5	Year 10	Year 18
Children Born in First Year of Program (billions)	\$2.7	\$8.6	\$18.1	\$35.4
Cumulative Savings in Child Accounts (billions)	\$2.7	\$28.4	\$101.3	\$336.0
Total Number of Accounts (millions)	4.0	20.5	41.7	77.5

Government Outlays (Billions)				
	Year 1	Year 5	Year 10	Year 18
Annual Cost for \$500 Endowment	\$2.0	\$2.1	\$2.1	\$2.3
Annual Cost for Matching Contributions	\$0.1	\$0.4	\$1.0	\$1.8
Cumulative Cost	\$2.1	\$11.4	\$25.6	\$54.7

## State-by-State Child Account Impact

<u>State</u>	<u># of Children in First Year of Program</u>	<u># of Children over 18 Years (millions)</u>	<u>Total Savings After 18 Years (billions)</u>
Alabama	60,453	1.2	\$4.6
Alaska	10,459	0.2	\$1.0
Arizona	96,199	1.8	\$7.9
Arkansas	39,208	0.8	\$2.9
California	548,882	10.6	\$49.1
Colorado	68,944	1.3	\$6.0
Connecticut	41,718	0.8	\$4.0
Delaware	11,643	0.2	\$1.0
D.C.	7,971	0.2	\$0.7
Florida	226,240	4.4	\$18.4
Georgia	142,200	2.7	\$11.7
Hawaii	17,924	0.3	\$1.6
Idaho	23,062	0.4	\$1.8
Illinois	179,020	3.4	\$15.5
Indiana	87,193	1.7	\$6.9
Iowa	39,311	0.8	\$3.1
Kansas	39,888	0.8	\$3.2
Kentucky	56,444	1.1	\$4.3
Louisiana	60,937	1.2	\$4.7
Maine	14,112	0.3	\$1.1
Maryland	74,980	1.4	\$7.2
Massachusetts	76,865	1.5	\$7.2
Michigan	127,706	2.5	\$10.6
Minnesota	70,919	1.4	\$6.2
Mississippi	46,046	1.0	\$3.4
Missouri	78,618	1.5	\$6.2
Montana	11,583	0.2	\$0.9
Nebraska	26,145	0.5	\$2.1
Nevada	37,268	0.7	\$3.1
New Hampshire	14,420	0.3	\$1.3
New Jersey	113,776	2.2	\$11.0
New Mexico	28,835	0.6	\$2.2
New York	246,351	4.8	\$21.6
North Carolina	123,096	2.4	\$9.8
North Dakota	8,390	0.2	\$0.7
Ohio	148,388	2.9	\$12.0
Oklahoma	51,801	1.0	\$4.0
Oregon	45,922	0.9	\$3.7
Pennsylvania	145,383	2.8	\$12.0
Rhode Island	12,697	0.2	\$1.1
South Carolina	57,711	1.1	\$4.5
South Dakota	11,462	0.2	\$0.9
Tennessee	81,747	1.6	\$6.4
Texas	385,915	7.4	\$31.5
Utah	51,556	1.0	\$4.2
Vermont	6,295	0.1	\$0.5
Virginia	104,555	2.0	\$9.4
Washington	82,703	1.6	\$7.1
West Virginia	20,836	0.4	\$1.5
Wisconsin	70,984	1.4	\$5.8
Wyoming	7,239	0.1	\$0.6

# CURRENT STATISTICS AND TRENDS IN HOMEOWNERSHIP

- There is a steeply decelerating housing supply. Between October 2007 and October 2008:
  - Housing completions fell 25.6 percent;
  - Housing starts fell 38.0 percent;
  - Building permits fell 40.1 percent.
- The U.S. homeownership rate in the third quarter of 2008 was 67.9 percent – its lowest rate since 2001. The homeownership rate by race:
  - Non-Hispanic Whites: 75.1 percent;
  - Blacks: 47.8 percent;
  - All Others: 59.0 percent.
- Foreclosure rates have increased dramatically:
  - From the third quarter 2007 to third quarter 2008: Up 71 percent;
  - From October 2007 to October 2008: Up 25 percent;
  - From September 2008 to October 2008: Up 5 percent.
- U.S. median home prices have fallen 9.1 percent since the third quarter 2007. The decline has been even more dramatic in certain areas of California:
  - Los Angeles: Down 35.1 percent;
  - Riverside: Down 39.4 percent;
  - San Diego: Down 36 percent;
  - San Francisco: Down 25.3 percent.
- The projections for 2009 do not show any signs of improvement:
  - 2,164,000 sub-prime foreclosures are projected to occur between late 2008 and the end of 2009;
  - 40.6 million homes are predicted to suffer price declines because of nearby foreclosures;
  - Overall gross loss in home values is anticipated to be \$352 billion, with an average decrease of \$8,667 per unit affected.

# The Case for Home Accounts

*This is an excerpt from a forthcoming publication.*

## The Significance of Homeownership

Homeownership has long been thought of as an integral part of achieving the American Dream. In the United States, home ownership is an important goal and represents, for many, the ideal for a successful and secure life.<sup>2</sup> Moreover, owning a home is an important milestone in adulthood. Beyond satisfying the basic human need for shelter, becoming a homeowner helps establish solid membership in the American middle class.

Equity in a home is a financial asset that can be a springboard to the acquisition of other life goals such as a college education for children, opening a small business, and a secure retirement. In addition, assets in the form of home equity represent greater financial security. For the American population as a whole, the value of assets in a primary residence exceeds the value of retirement accounts.<sup>3</sup> The average homeowner holds about 50% of their net worth in home equity.<sup>4</sup> Lower-income and minority Americans have lower rates of homeownership, however, and lag far behind in this key component of financial well-being.

**Positive effects on families and communities.** Studies of the behavioral effects of homeownership indicate that it can convey important social benefits. For example, one influential review of research on this issue found that “strong and consistent evidence indicates that homeowners are more likely to: a) be satisfied with their homes and neighborhoods; b) participate in voluntary and political activities; and c) stay in their homes.”<sup>5</sup> In addition, homeownership appears to have a positive effect on children’s development and outcomes.<sup>6</sup> Advocates for homeownership policies argue that

Children of homeowners score better on academic tests, graduate at a higher rate, have fewer behavioral problems, and enjoy a better social environment. Living in an owned home is also a predictor of future success, as homeowners’ children earn more than renters’ children, are less likely to be on welfare, and are more likely to become homeowners themselves.<sup>7</sup>

**Importance as a financial asset.** Home equity is an important financial asset, comprising a substantial portion of total wealth. Although the effects of the current housing crisis on future trends are unclear, researchers report consistent findings that household wealth is more unevenly distributed than income. A recent study of household wealth using 2004 Survey of Consumer Finances data illustrates these findings. It reports that, in 2004, the top quartile in the annual household income distribution made 65% of all earned income—more than five times as much as the lower-middle quartile, and more than sixteen times as much as the lowest quartile.<sup>8</sup> Figure 1 shows that in terms of wealth, the top quartile (the wealthiest 28 million households) held 87% of all net wealth, while the bottom 28 million households held zero assets once their debt was netted out<sup>9</sup>.

According to a recent study by the Joint Center on Housing Studies at Harvard University, growth in home equity accounts for much of the increase in wealth between 1995 and 2004. Between 1995 and 2005, 85% of households who bought units and 75% of households who already owned homes experienced an increase in wealth. Only 50% of renters experienced any increase in wealth.<sup>10</sup>

**Persistent racial disparities in wealth and homeownership.** Researchers also report a persistent wealth gap between whites and minorities. As Figure 2 indicates, in 1995, the median minority household had a net wealth of \$19,021, while the median net wealth of a white household stood at \$94,352. And as the economy expanded over the following decade, this gap grew even wider. By 2004, the median white household net wealth climbed up to \$136,750, a 45 percent increase, while the median household net wealth of minorities only grew 22 percent to \$23,200.<sup>11</sup>

There are also significant disparities in homeownership rates between white Americans and minority groups. As Figure 3 indicates, an analysis of the Housing Vacancy Survey by the Joint Center for Housing Studies of Harvard University showed that in 2007 the homeownership rate for minorities in America was 50.9%, while the white homeownership rate stood at 75.2%.<sup>12</sup> Hispanic and black Americans, the two largest ethnic minority groups, continue to lag even further behind with about 50% of households owning their home. Although homeownership rates grew among all racial

groups in America from 1994 to 2007, there still exists a large gap between those of white and minority households.

# PENSION PROTECTION ACT OF 2006

## Provisions Regarding the Saver's Credit and Automatic Enrollment

### Saver's Credit

The Economic Growth and Tax Relief Reconciliation Act of 2001 established what has been popularly called the "Saver's Credit." This provides a tax credit for contributions of up to \$2,000 to certain employer-sponsored retirement plans or to Individual Retirement Accounts (IRAs). The credit applies both to individual contributions and to contributions made by an employer. It was set to expire in 2006.

*The Pension Protection Act made the Saver's Credit permanent.*

Income eligibility thresholds for the Saver's Credit are indexed annually for inflation. The following table shows which taxpayers are eligible for the Saver's Credit in 2009 and the value of that credit.

Saver's Credit, 2009				
Adjusted Gross Income by Filing Status			Saver's Credit	
Joint Filers	Heads of Households	Singles	Credit Percentage	Maximum Credit (\$2000 contribution)
\$0-\$33,000	\$0-\$24,750	\$0-\$16,500	50%	\$1000
\$33,001-\$36,000	\$24,751-\$27,000	\$16,501-\$18,000	20%	\$400
\$36,001-\$55,500	\$27,001-\$41,625	\$18,001-\$27,750	10%	\$200
Over \$55,500	Over \$41,625	Over \$27,750	0%	\$0

To fully realize the potential of the Saver's Credit, policy makers should consider the following changes:

- *Make the Saver's Credit refundable and deposit it directly into the retirement account.* The Saver's Credit has two flaws. It does not reward retirement saving by lower-income households that have no income tax liability. Making the credit refundable would change that. Second, the credit is paid to savers, not deposited into accounts. To increase the amount in the accounts – thus helping to ensure the accounts are more adequate upon retirement – the Saver's Credit should be deposited directly into the retirement account.
- *Eliminate the "cliff effect."* The current Saver's Credit has sharp drops in the credit percentage as income increases. This, in effect, creates penalties for wage increases or for taking a new job that pays more. Instead, the Saver's Credit should be 50 percent for all taxpayers now eligible for the credit, with a gradual phase-out for couples with incomes up to about \$75,000. This would have the added benefit of encouraging saving by more middle-income taxpayers.

## Automatic 401(k) Features

**Auto-Enrollment.** Most 401(k) pension plans are “opt-in” plans. That is, an employee does not participate in the plan unless he or she takes an affirmative step to participate – to agree to have some portion of wages withheld each month and deposited in his or her 401(k) account instead. Some research has shown that more people would participate in 401(k) plans – and thus save more for retirement – if the plans were “opt-out” plans. That is, an employee would be automatically enrolled in the pension plan – unless he or she took an affirmative step to decline to participate.

While nothing has prohibited employers from establishing “opt-out” 401(k) plans, many employers have been concerned about their liability under such arrangements. Some employers feared that some state “anti-garnishment” laws precluded automatic enrollment systems. Such laws prohibit involuntary deductions from an employee’s pay.

*The Pension Protection Act makes it clear that federal pension law overrides those state laws, clearing the way for opt-out 401(k) plans. In these plans, the employer decides what the initial default contribution rate will be for employees who don’t choose on their own.*

**Auto-Escalation.** In addition to participation in a plan, some plans provide that default contribution rates for 401(k) plan participants will automatically rise – “escalate” – with each additional year or so of service. Unless a plan participant opts out, the percentage of pay that he or she contributes each year will increase, thus increasing the amount saved for retirement.

*The Pension Protection Act authorizes these automatic escalation features.*

**Default Investments.** Federal law provides some relief from fiduciary liability for employers when participants choose how their 401(k) accounts will be invested. Research has shown that many potential participants fail to contribute to a 401(k) plan because choosing investments can be a difficult task, and employers did not want to take on the responsibility for them because of the potential fiduciary liability. Some employers were also reluctant to institute automatic enrollment for this same reason: they would have to choose the investment option for the plan participants who were automatically enrolled.

*The Pension Protection Act directed the Department of Labor to define “default investments” that could be used in a 401(k) plan for those who were automatically enrolled or who otherwise failed to make an investment decision. By using these default investments when making investment decisions on behalf of employees, employers would be shielded from liability. The Department finalized those regulations in October 2007.*

**Safe Harbor.** Federal law requires 401(k) plan sponsors to follow non-discrimination rules. The tax-preferred benefits provided to higher-paid employees are limited in proportion to pension contributions made by lower-paid employees.

*The Pension Protection Act creates a “safe harbor” automatic-features plan. If employers follow the requirements of this plan – automatic enrollment, automatic escalation in contributions, matching or other contributions to participants’ accounts, and coverage of all new hires – the plan is exempt from the 401(k) nondiscrimination rules.*

To fully realize the potential of automatic enrollment and automatic escalation, policy makers should consider the following changes:

- *Cover all employees in the automatic enrollment system.* The Senate version of the Pension Protection Act required coverage of all employees – both new hires and existing workers. In a compromise with the House of Representatives, which applied the law only to new hires, the final version of the bill covered some current employees and exempted others. All employees should be covered by automatic enrollment; they still retain the ability to individually opt out.
- *Require matching or other employer contributions in auto-enrollment plans.* Employers are only required to contribute to an employee’s 401(k) account if they adopt the safe harbor plan created in the Pension Protection Act. In other plans – even those with automatic features – employers continue to have the option of contributing, and many do not. Even though auto-enrollment and auto-escalation will likely increase the number of workers who save, it is not clear that participant savings alone will result in meaningful levels of assets at retirement. Extending the employer contribution requirement to all automatic plans should be considered. Many participants, particularly low- and moderate-income participants, would benefit from matching contributions that help grow accounts more quickly. Employer contributions also would result in significant increases in the savings available at retirement to all participants.

# SELECTED PENSION LEGISLATION

## 110<sup>th</sup> Congress

### Automatic IRA Act (H.R. 2167; S. 1141)

- Employers that do not offer an employer-sponsored pension plan to their employees – or do not cover all employees – must offer to make payroll deductions and direct deposits into an employee’s Individual Retirement Account (IRA). Certain small businesses and start-up businesses are exempt from this requirement.
- Employers are allowed to establish IRAs for their employees with a single provider or use the newly-created TSP II, which is a government program modeled after the Thrift Savings Plan (TSP) for federal employees. (In other words, employers do not have to make direct deposits to several different institutions that may hold their employees’ IRAs, nor are employees required to open an IRA on their own prior to receiving the direct deposits.) In such cases, however, employees would be allowed to transfer their funds to another IRA without penalty or cost.
- Employers with fewer than 100 employees receive a tax credit for the costs associated with establishing the automatic payroll withholding and IRA deposit.

### Retirement Savings for Working Americans Act (H.R. 2724)

- The Saver’s Credit is made refundable, to allow individuals with no or little federal income tax liability to receive the credit.
- The phase-out of the credit is changed as follows: individuals with incomes under \$30,000 and couples with incomes under \$60,000 are eligible for the maximum 50 percent credit; the credit is then phased-out for singles with incomes up to \$35,000 and couples with incomes up to \$70,000.
- Any credit claimed under the Saver’s Credit is deposited directly by the government into an individual’s designated account.
- Deposits to a state 529 college tuition plan and a Coverdell IRA (for education expenses) qualify for the Saver’s Credit.

### Women’s Retirement Security Act (H.R. 5543; S. 1288)

- The Saver’s Credit is made refundable, with an expanded phase-out of the credit (in a manner similar to that in the Retirement Savings for Working Americans Act) and a requirement that the credit be deposited directly into a retirement account.
- Includes the provisions of the Automatic IRA Act mentioned above.

- Employees may transfer up to \$500 of unspent funds in a Flexible Spending Account to a retirement plan.
- Long-term, part-time employees – those who have worked at least 500 hours a year for three years – must be allowed to participate in their employer’s 401(k) plan.
- Small businesses that have 25 or fewer employees and that have not offered a pension plan in the previous three years can take a 50 percent tax credit for pension plan contributions, up to a contribution equal to three percent of an employee’s pay. This credit is available for the first three years the pension plan is in existence, at which time it reverts to a deduction (which is the existing law).

# LIFE ANNUITIES: THE BASICS

## What is an annuity?

There are several different types of annuities. But for the purposes of this discussion, we will be talking about an immediate life annuity. This is where an individual pays an insurance company a set, lump-sum amount of money and in exchange receives periodic payments – usually monthly – for the rest of his or her life.

One way to think about annuities is to think of them as being the opposite of a life insurance policy. With most types of life insurance, you make monthly premium payments and when you die, a lump-sum payment is made to a designated beneficiary. With an immediate life annuity, you pay a lump-sum payment to guarantee that you will receive a monthly payment until you die.

Another way to think about annuities is to think about Social Security benefits. Social Security is a form of an annuity. Based in part on the amount of money you contributed to the system while you were working, you are guaranteed a certain monthly payment until you die. You cannot outlive your Social Security benefits.

Traditional pension plans – known as “defined benefit plans” – also pay benefits in the same way an annuity does: a guaranteed monthly check for life.

## How do life annuities work exactly?

When you purchase an annuity, the insurance company calculates your life expectancy and the expected rate of return it can make. Then, based on how much you pay the insurance company – your lump-sum amount – it determines how much you will be paid every month for the rest of your life. There are several options that affect the amount of this payment. For example, you could purchase spousal protection, in which case your annuity benefit will be less each month, but those payments will continue to be made to your spouse after you die. (This is similar to the way Social Security works.)

Unlike Social Security, however, life annuities do not provide for an annual cost-of-living increase to protect your benefit against inflation. Thus, while you are guaranteed a monthly payment for the rest of your life, the purchasing power of that monthly benefit will become less and less the longer you live.

On the other hand, unlike Social Security, many annuity contracts have provisions guaranteeing that you will receive a minimum amount from the annuity. If you have a cash refund annuity, for example, and you die prematurely, your designated beneficiary will get the amount of your purchase price minus the payments you received. Some annuities also promise payments for a certain period, say 5 or 10 years, so your beneficiary will receive payments for any time remaining in the guaranteed period after you die.

## What are examples of annuity payments and benefits?

Monthly Annuity Benefits <sup>1</sup>				
	Single Annuity		Annuity with Spousal Protection	
Purchase Price →	\$50,000	\$150,000 <sup>2</sup>	\$50,000	\$150,000
Regular Annuity	\$304	\$911	\$266	\$799
Cash Refund Annuity <sup>3</sup>	\$285	\$856	\$264	\$791
Inflation Protected Annuity <sup>4</sup>	\$213 @ start \$278 in 10 yrs.	\$640 @ start \$835 in 10 yrs.	\$179 @ start \$233 in 10 yrs.	\$536 @ start \$699 in 10 yrs.

<sup>1</sup>Figures from Thrift Savings Plan annuity calculator. Assumes annuity purchase at age 60, just after being eligible to withdraw funds from a 401(k) account. In the case of spousal protection, assumes the spouse is also age 60.

<sup>2</sup>About the average 401(k) account balance in 2006 for individuals in their 50s who had accounts for at least 8 consecutive years.

<sup>3</sup>Provides that if the individual dies prior to receiving total annuity payments at least equal to the purchase price, the balance is paid out in a lump-sum to a designated beneficiary.

<sup>4</sup>Not currently available in the private annuities market.

## Why are annuities important?

Social Security – while an important financial foundation – is not enough to ensure financial security in retirement. You need more. That is why many people spend their working lives saving for retirement – in a pension and/or on their own. But, once you retire, you are going to start tapping those savings. And without a life annuity, the money may run out before you die. Then you will be left with only your Social Security benefits. The bottom line: you do not want to outlive your savings. This issue has become particularly acute as more Americans live longer – and live longer in retirement.

Many working Americans used to rely on pension benefits to supplement their Social Security for life. They had what is known as a “defined benefit” plan. In exchange for being paid less during their working years, they were guaranteed a monthly pension check during their retired years – and it was guaranteed for life. In other words, the pension plan defined the *benefit* a worker received in retirement. The plan itself was even guaranteed by the federal government, so if your employer went bankrupt, you didn’t lose all of your pension. However, fewer and fewer Americans are covered by defined benefit plans – only about a third of households now participate in such plans.

Today, if a worker has a pension plan, it is more likely than not to be what is known as a “defined contribution” plan. You contribute a certain percentage of your pay to a plan, such as a 401(k), and the amount of money you have at retirement depends entirely on investment performance. In other words, the pension plan defines the *contribution* you make while working, but there is no guarantee of how much you will have in retirement. Furthermore, this money is like a savings account when you retire: the money is yours and if you are not careful, you may run out of money and be forced to rely solely on Social Security.

## If annuities are so important, why don’t more people buy them?

It is not entirely clear why people choose not to purchase annuities with private savings or lump-sum disbursements from 401(k) plans. Even when offered easy access to annuitization, such as in the Thrift Savings Plan for federal employees or in the TIAA-CREF system (two plans that, by the way, have a more highly educated and higher paid pool of participants than average), few choose the annuities option. Part of the answer involves comfort: people just don't understand annuities enough to feel comfortable with them. Also, many people underestimate how long they will live, believing that there is a bigger financial risk in purchasing an annuity than in not purchasing one. Whatever the reason, we do know that it is a highly personal one. The academic literature suggests that deciding when to purchase an annuity – and how much of an annuity to purchase – depends on many individual, highly-variable factors.

Beyond the individual factors, however, there are also structural and legal barriers standing in the way of a wider acceptance of annuities. Although it would make a great deal of sense for 401(k) plans to offer participants an annuity option upon retirement, doing so imposes additional legal liability on plan sponsors. As a result, only about 25 percent of 401(k) plans offer a life annuity. In addition, most annuity experts believe that the market for life annuities remains underdeveloped and that the prices are often unattractive for many individual consumers, especially when combined with the high fees, taxes, and expenses under some state laws.

There is also a very legitimate question about what happens to an annuity if the company that sold it and is paying benefits becomes insolvent. State-based guarantee funds were designed to cover such a circumstance, but questions remain about whether they would cover all claims and all consumers. What happens, for example, if an individual purchased an annuity while a resident of one state but is now retired in another state – would the original state's guarantee fund cover the loss?

Indeed, this state-by-state uncertainty, as well as the state-by-state patchwork quilt of laws and regulations (an immediate life annuity is considered an insurance product and is therefore regulated at the state level), may even be keeping some insurance companies from entering the market, promoting the product, and educating consumers about the benefits of annuities.

# ANNUITY LEGISLATION

## 110<sup>th</sup> Congress

### Retirement Security for Life Act (H.R. 2205; S. 1010)

- Half of an individual's income received from an individually-purchased life annuity – up to a maximum of \$20,000 per year – is not considered income for federal tax purposes.
- If life insurance death benefits are paid in the form of a life annuity, the same exclusion from income for federal tax purposes applies.

### Lifetime Pension Annuity for You Act (H.R. 4150)

- Same provisions as the Retirement Security for Life Act, except the maximum exclusion per year is \$5000.
- If a life annuity is provided through a 401(k) plan, 25 percent of income from that annuity is not considered taxable income, again with an annual limit of \$5000.
- Employer-provided longevity insurance – an insurance policy that pays monthly benefits after an individual reaches age 85 – is permitted, notwithstanding current rules requiring that pension benefits be available to employees at an earlier age.

### Treasury Annuity Study Act (H.R. 2921)

- Requires the Secretary of the Treasury to study the feasibility of the Treasury Department creating and selling life annuities with the backing of the full faith and credit of the United States Government.
- The possible annuity product would be designed to “serve as an industry benchmark” with the goal of “enhancing private markets.”

# ADDITIONAL RESOURCES

## Saving and Asset Policy

[www.assetbuilding.org](http://www.assetbuilding.org)

Created by the New America Foundation, this is the most comprehensive site for articles, reports, research, and other publications related to asset policy. It also provides links to recent news articles.

[www.cfed.org](http://www.cfed.org)

The Corporation for Enterprise Development (CFED) is a Washington-based organization focused on expanding economic opportunities for all Americans, including building assets. This is perhaps the best site for extensive information on Individual Development Accounts (IDAs). Also helpful is the organization's *Assets and Opportunity Scorecard*, which provides a state-level snapshot of how the country is performing in key areas of economic opportunity.

[www.gwbweb.wustl.edu/csd](http://www.gwbweb.wustl.edu/csd)

The Center for Social Development (CSD) – based at Washington University in St. Louis and headed by the founder of the assets movement, Professor Michael Sherraden – is a leading academic center of theory and research on asset building. CSD is a prolific publisher of research in the field. All publications, as well as research data, are available on the site.

[www.aspenifs.org](http://www.aspenifs.org)

The Initiative on Financial Security (IFS) is the policy program of the Aspen Institute focused on saving and asset policy. This site contains all IFS publications and information about its proposals on child accounts, homeownership, and retirement.

## Housing

[www.jchs.harvard.edu](http://www.jchs.harvard.edu)

The Joint Center for Housing Studies (JCHS), based at Harvard University, analyzes the relationships between housing markets and economic, demographic, and social trends. The site contains the extensive work of the organization, including its reports, working papers, conference proceedings and research notes.

[www.nhc.org/index/chp-index/](http://www.nhc.org/index/chp-index/)

The Center for Housing Policy (CHP) is the research arm of the National Housing Conference. Its goal is to broaden understanding of the nation's housing challenges and to examine the impact of housing policies and programs.

## Retirement and Employee Benefits

[www.nasi.org](http://www.nasi.org)

The National Academy of Social Insurance (NASI) focuses on social insurance issues. This is one of the best sites for information and analysis on Social Security and Medicare.

[www.ebri.org](http://www.ebri.org)

The Employee Benefit Research Institute (EBRI) provides objective data on all aspects of employer-provided benefits. For raw data – and more data than you can ever imagine – there is no better site than this one.

[www.retirementsecurityproject.org](http://www.retirementsecurityproject.org)

The Retirement Security Project focuses on public policies to increase retirement savings and the financial well-being of retired Americans. It is a joint project of Georgetown University's Public Policy Institute, the Brookings Institution, and the Heritage Foundation.

[crr.bc.edu/](http://crr.bc.edu/)

The Center on Retirement Research at Boston College does extensive original research on retirement- and pension-related issues. All publications, as well as general data, are available at this site.

[www.planetnow.com](http://www.planetnow.com)

This site is focused on the academic literature regarding employee benefit policies. Compiled and maintained by Pamela Perun, Policy Director of the Initiative on Financial Security, it has an extensive database of recent research publications on employee benefit issues, executive compensation, Social Security, pensions, and health care.

[www.pensionresearchcouncil.org](http://www.pensionresearchcouncil.org)

Based at the Wharton School, the Pension Research Council conducts research and issues reports on key pension and employee benefit issues.

## Financial Literacy

[www.ncee.net](http://www.ncee.net)

The National Council on Economic Education (NCEE) is a nationwide network that promotes economic and financial education in the schools. The website contains educational materials and other information relating to school curriculum.

[www.mymoney.gov](http://www.mymoney.gov)

Created by the Financial Literacy and Education Commission, this site serves as a clearinghouse of information on financial education and point of entry to the federal government's programs and grants on financial literacy.