Personal Retirement Accounts

"As we fix Social Security, we also have the responsibility to make the system a better deal for younger workers. And the best way to reach that goal is through voluntary personal retirement accounts."

President George W. Bush
State of the Union Address
February 2, 2005

- **The President believes personal retirement accounts must be part of a comprehensive solution to strengthen Social Security for the 21st century.**

- **Under the President's plan, personal retirement accounts would start gradually. Yearly contribution limits would be raised over time, eventually permitting all workers to set aside 4 percentage points of their payroll taxes in their accounts.** Annual contributions to personal retirement accounts initially would be capped, at $1,000 per year in 2009. The cap would rise gradually over time, growing $100 per year, plus growth in average wages.

- **Personal retirement accounts offer younger workers the opportunity to build a "nest egg" for retirement that the government cannot take away.**

  - **Personal retirement accounts provide ownership and control.** Personal retirement accounts give younger workers the opportunity to own an asset and watch it grow over time.

  - **Personal retirement accounts could be passed on to children and grandchildren.** The money in these accounts would be available for retirement expenses. Any unused portion could be passed on to loved ones. Permitting individuals to pass on their personal retirement accounts to loved ones will be particularly beneficial to widows, widowers, and other survivors. According to the non-partisan analysis by the Social Security Administration's Office of Retirement Policy, the ability to inherit personal accounts provides the largest gains to widows and other survivors.

  - **Personal retirement accounts help make Social Security better for younger workers.** A personal retirement account gives a younger worker the chance to save a portion of his or her money in an account and watch it grow over time at a greater rate than anything the current system can deliver. The account will provide money for the worker's retirement in addition to the check he or she receives from Social Security. Personal retirement accounts give younger workers the chance to receive a higher rate of return from sound, long-term investing of a portion of their payroll taxes than they receive under the current system.

- **Personal retirement accounts would be voluntary.** At any time, a worker could "opt in" by making a *one-time* election to put a portion of his or her payroll taxes into a personal retirement account.

    - Workers would have the flexibility to choose from several different low-cost, broad-based investment funds and would have the opportunity to adjust investment allocations periodically, but would not be allowed to move back and forth between personal retirement accounts and the traditional system. If, after workers choose the account, they decide they want only the benefits the current system would give them, they can leave their money invested in government bonds like those the Social Security system invests in now.

    - Those workers who do not elect to create a personal retirement account would continue to draw benefits from the traditional Social Security system, reformed to be permanently sustainable.

- **Personal retirement account options and management would be similar to that of the Federal employee retirement program, known as the Thrift Savings Plan (TSP).** A centralized administrative structure would be created to collect personal retirement account contributions, manage investments, maintain records, and facilitate withdrawals at retirement. The structure would be designed to facilitate low costs, ease of use for new investors, and timely crediting of contributions. This centralized investment structure would help minimize compliance costs for employers.

    - Contributions would be collected and records maintained by a central administrator. Similar to the TSP, private investment managers would be chosen through a competitive bidding process to manage the pooled account contributions.

    - The central administrator would answer questions from account participants and distribute periodic account statements.

    - The central administrator would also facilitate withdrawals and the purchase of annuities with account balances.

    - Like TSP, we expect participants to have easy access to investment information and to their accounts. Participants could easily check account balances and adjust investment allocations.

- **Personal retirement accounts would be invested in a mix of conservative bonds and stock funds.** Guidelines and restrictions would be put in place to provide sound investment choices and prevent individuals from spending the money in these accounts on the lottery or at the race track. Workers would be permitted to allocate their personal retirement account contributions among a small number of very broadly diversified index funds patterned after the current TSP funds.

- Like TSP, personal retirement accounts could be invested in a safe government securities fund; an investment-grade corporate bond index fund; a small-cap stock index fund; a large-cap stock index fund; and an international stock index fund.

- In addition to these TSP-type funds, workers could choose a government bond fund with a guaranteed rate of return above inflation.

- Workers could also choose a "life cycle portfolio" that would automatically adjust the level of risk of the investments as the worker aged. The life cycle fund would automatically and gradually shift the allocation of investment funds as the individual neared retirement age so that it was weighted more heavily toward secure bonds.

➢ **Personal retirement accounts would be protected from sudden market swings on the eve of retirement.** To protect near-retirees from sudden market swings on the eve of retirement, personal retirement accounts would be automatically invested in the "life cycle portfolio" when a worker reaches age 47, unless the worker and his or her spouse specifically opted out by signing a waiver form stating they are aware of the risks involved. The waiver form would explain in clear, easily understandable terms the benefits of the life cycle portfolio and the risks of opting out. By shifting investment allocations from high growth funds to secure bonds as the individual nears retirement, the life cycle portfolio would provide greater protections from sudden market swings.

➢ **Personal retirement accounts would not be eaten up by hidden Wall Street fees.** Personal retirement accounts would be low-cost. The Social Security Administration's actuaries project that the ongoing administrative costs for a TSP-style personal account structure would be roughly 30 basis points or 0.3 percentage points, compared to an average of 125 basis points for investments in stock mutual funds and 88 basis points in bond mutual funds in 2003. (*www.ici.org/issues/fee/fm-v13n5*).

- The low costs are made possible by the economies of scale of a centralized administrative structure, as well as limiting investment options to a small number of prudent, broadly diversified funds.

- Most of these administrative costs are for recordkeeping which would be done by the government, not investment management done by Wall Street. (*Report of the 1994-1996 Advisory Council on Social Security*, p. 171 & January 31, 2002 Memorandum from the Social Security Actuary in the *Final Report of the President's Commission on Social Security*, p. 19).

➢ **Personal retirement accounts would not be accessible prior to retirement**. American workers who choose personal retirement accounts would not be allowed to make withdrawals from, take loans from, or borrow against their accounts prior to retirement.

➢ **Personal retirement accounts would not be emptied out all at once, but rather paid out over time, as an addition to traditional Social Security benefits.** Under a system of personal retirement accounts, procedures would be established to govern how account balances would be withdrawn at retirement. This would involve some combination of annuities to ensure a stream of monthly income over the worker's life expectancy, phased withdrawals indexed to life expectancy, and lump sum withdrawals. Individuals would not be permitted to withdraw funds from their personal retirement accounts as lump sums, if doing so would result in their moving below the poverty line. Account balances in excess of the poverty-protection threshold requirement could be withdrawn as a lump sum for any purpose or left in the account to accumulate interest. Any unused portion of the account could be passed on to loved ones.

- **Personal retirement accounts would be phased in.** To ease the transition to a personal retirement account system, participation would be phased in according to the age of the worker. In the first year of implementation, workers currently between age 40 and 54 (born 1950 through 1965 inclusive) would have the option of establishing personal retirement accounts. In the second year, workers currently between age 26 and 54 (born 1950 through 1978 inclusive) would be given the option and by the end of the third year, all workers born in 1950 or later who want to participate in personal retirement accounts would be able to do so.

- **The President's personal retirement account proposal is fiscally responsible.** The President's proposal is consistent with his overall goal of cutting the deficit in half by 2009. Based on analysis by the Social Security Administration Actuary, the Office of Management and Budget estimates that the President's personal retirement account proposal will require transition financing of $664 billion over the next ten years ($754 billion including interest). This transition financing will not have the same effect on national savings, and thus the economy, as traditional government borrowing. Personal retirement accounts will not reduce the pool of savings available to the markets because every dollar borrowed by the Federal government to fund the transition is fully offset by an increase in savings represented by the accounts themselves. Moreover, the transition financing for personal retirement accounts should be viewed as part of a comprehensive plan to make the Social Security system permanently sustainable. Publicly released analysis by the Social Security Administration has found that several comprehensive proposals including personal accounts would dramatically reduce the costs of permanently fixing the system. (*www.ssa.gov/OACT/solvency/index*).

- **Establishing personal retirement accounts does not add to the total costs that Social Security faces.** Personal retirement accounts effectively pre-fund Social Security benefits already promised to today's workers and do not represent a net increase in Federal obligations. The obligation to pay Social Security benefits is already there. While personal retirement accounts affect the timing of these costs, they do not add to the total amount obligated through Social Security.