Social Security

Policy Brief

Defined Contribution Pension Plans and the Supplemental Security Income Program

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This policy brief analyzes changes in the employer-sponsored pension system and the relationship of these changes to the Supplemental Security Income (SSI) program's treatment of retirement plans. Because SSI is the federal income support program of last resort in the United States for elderly or disabled individuals, including blind or disabled children, most other income that a person receives counts against the federal SSI benefit payable. Although the basic policy of the SSI program has remained the same since its inception in 1974, other components of U.S. income support programs have been changing in recent years. The increasing prevalence of the defined contribution retirement plan and the decreasing prevalence of the defined benefit plan is one significant change—a trend that has been gaining momentum since the mid-1980s.

SSI does not treat assets in defined benefit and defined contribution retirement plans in the same manner. Beneficiaries of a defined benefit plan must apply for pension benefits when qualifications are met, and those benefits offset the SSI payment, but SSI applicants and recipients are allowed to retain the asset until it can be annuitized. By contrast, holdings in a defined contribution plan must be reduced or eliminated, depending on the amount of the holdings, for the SSI applicant or recipient to be eligible for SSI. The primary difference, then, is that a potential SSI recipient has access to the funds in a defined contribution plan, but a participant in a defined benefit plan has no access to the pension until attaining a specific age.

The three approaches to SSI's treatment of defined contribution retirement funds include: continuing the current policy of treating funds as countable resources if they can be withdrawn, or excluding funds until retirement age, which would encourage the greatest accumulation of retirement funds and could be a work incentive for SSI recipients, or attributing funds as hypothetical annuity income over the period of SSI eligibility.

Introduction

The nature of employer-sponsored pension plans in the United States has changed dramatically in the past 20 years. Specifically, more employees are now participating in defined contribution plans than in defined benefit plans, and participation in any type of employer-sponsored retirement plan has fallen (Bureau of Labor Statistics 2004a). By contrast, the treatment of assets held in retirement plans when determining eligibility for the Supplemental Security Income (SSI) program has not changed since 1974, when the first SSI payments were made.

This policy brief discusses

- the changes in employer-sponsored pension plans,
- the treatment of pension holdings under SSI rules for income and resources,
- the labor force participation of SSI applicants and recipients, and
- several approaches for changing SSI's treatment of pension holdings and the pros and cons of each.

Basics of SSI and Pensions

In a way, the Supplemental Security Income program is the pension plan of last resort in the United States. Enacted in 1972 and making its first payments in 1974, the program establishes an income floor for low-income aged individuals (65 or older) and for low-income blind and disabled persons of any age. In 2006, the program paid a federal benefit of up to $603 a month for an individual and $904 for an eligible couple. Some states pay additional benefits to supplement the federal benefit.

Since SSI is the federal income support program of last resort, most other income that an individual receives counts against the amount of the federal SSI payment. That is, the SSI payment is equal to the difference between the individual's other income and the maximum allowable federal SSI payment. For example, if an SSI applicant receives a pension of $300 per month, he or she will receive an SSI payment of $323 ($20 of the pension does not count against the SSI payment; additional exclusions apply to earned income). In addition to having low income, an SSI applicant must have few countable resources. (Some resources, such as a house occupied by the applicant, do not count.) The regulations define resources as "cash or other liquid assets or any real or personal property that an individual (or spouse, if any) owns and could convert to cash to be used for his or her support and maintenance" (20 CFR 416.1201). The limits on countable resources are $2,000 for an eligible individual and $3,000 for an eligible couple.

The basic policy of the SSI program for treating income and resources has not changed since 1974 when the first payments were made. The same cannot be said for many other components of the U.S. income support program, particularly for the aged. Pension plans in particular are chang-

Table 1.
Percentage of full-time employees in medium and large private firms participating in defined benefit and defined contribution retirement plans, selected years 1985–2004

Year	Defined benefit plans	Defined contribution plans	At least one retirement plan
1985	80	41	91
1986	76	47	89
1988	63	45	80
1989	63	48	81
1991	59	48	78
1993	56	49	78
1995	52	55	80
1997	50	57	79
1999	42	52	72
2000	36	50	70
2003	33	51	65
2004	34	53	67

SOURCE: Adapted from Bureau of Labor Statistics (2004a, 2004b, and 2005).

NOTE: Before 1988, data included establishments with 50, 100, or 250 or more workers, depending on industry, and coverage in the service industries was limited. Beginning in 1988, data included establishments with 100 or more workers in all private industries, a category that excludes agriculture and private households.

ing, even more rapidly in recent years. One of the most significant changes has been the increasing prevalence of the defined contribution plan and the decreasing prevalence of the defined benefit pension plan.

In a defined benefit pension plan, the employer promises the employee a specific monetary benefit at a specific age (for example, age 60 or 65) that is based on factors such as salary and length of service. The employer is responsible for setting aside the money to fund the defined benefit pension, and the employee cannot draw a pension until he or she meets certain requirements, such as being retired from the firm and being the required age.

In a defined contribution plan, the employer (and, often, the employee as well) makes specific contributions to an employee's pension fund, and the amount of the benefit depends on the amount saved and how well the employee's fund investments (stocks, bonds, and so on) perform. These plans, most of which are 401(k) plans (named after the section of the tax law that authorizes them), are attractive to employers for a variety of reasons: employers believe that defined contribution plans are more appealing to workers who change jobs often; defined contribution plans are cheaper and easier to administer; sponsors may want to shift investment risk for retirement to the workers; sponsors believe that defined contribution plans require less regulation and oversight, and so forth (Gale, Papke, and VanDerhei 1999).

This overall trend toward defined contribution plans is borne out by studies done by the Bureau of Labor Statistics, as shown in Table 1.

In addition to employer-sponsored retirement funds such as 401(k)s, SSI applicants may also hold retirement funds in tax-favored accounts known as individual retirement accounts (IRAs). These accounts are established and funded by the employee and do not involve an employer match; depending on the employee's income level, however, they may be funded from pretax earnings.

SSI's Treatment of Retirement Plans

The Supplemental Security Income program does not treat assets in defined benefit and defined contribution plans in the same way. For SSI recipients who have a defined benefit plan and are receiving benefits from that plan, those pension benefits are countable income (section 1612(a)(2)(B) of the Social Security Act) and reduce their SSI payments. By contrast, for those who have a plan but are not receiving pension benefits (for example, because they have not attained the minimum age required), the present value of the future pension benefits has no effect on their SSI payments. Of course, in this case the individual has no access to the pension benefits until attaining the required age. Once an SSI recipient is old enough to qualify for the pension benefit, he or she is required to file for the pension benefit in order to continue receiving SSI payments.

The case is different with 401(k)-type and IRA defined contribution retirement plans. Typically these plans can be accessed at age 59½ without a tax penalty and earlier than that with a tax penalty. In the case of disability, as would be the situation for SSI applicants who are under the age of 65, there is no tax penalty for withdrawal. For the purpose of determining SSI eligibility, the funds in these plans are considered resources because they are not specifically excluded by section 1613 of the Social Security Act and because they meet the definition of a resource in the Code of Federal Regulations (20 CFR 416.1201). Therefore, if the funds in a defined contribution plan exceed the resource limit for SSI eligibility (either by themselves or when added to other countable resources), then the applicant will be ineligible for SSI payments. A low-income applicant can become eligible by withdrawing funds in a defined contribution plan and spending these funds down to an amount below the applicable SSI resource limit. Alternatively, an applicant may be able to use the defined contribution account to purchase an annuity, thereby

converting the asset into an income stream that would be treated the same as pension income for the purposes of the SSI income limits.

Given these options, an applicant who has not reached retirement age arguably must act against the intent of the retirement plan law to satisfy the SSI requirements. The question for working-age SSI applicants and recipients then becomes weighing the objective of defined contribution plans (saving for one's retirement) against that of SSI (providing a last-resort source of income after other available resources have been used).

Appropriateness of SSI's Treatment of Retirement Plans

As indicated above, the SSI program treats defined benefit plans differently from defined contribution plans. Although individuals who have a defined benefit plan must apply for pension benefits when they qualify, and those benefits offset their SSI payment, these individuals are in effect permitted to retain the asset until the pension can be annuitized. By contrast, a defined contribution plan, even though earned in a similar occupation over a comparable period of time, must be disposed of in whole or in part (depending on the size of the accumulation) in order to obtain SSI eligibility. A key difference, then, between the treatment of defined benefit and defined contribution plans results from the fact that a potential SSI recipient has access to the funds in a defined contribution plan even though the money has been set aside for the purpose of providing retirement income, but a participant in a defined benefit pension plan has no access to the pension until attaining the required age.

Generally, the resources of an individual's ineligible spouse or, in the case of a disabled child, the child's ineligible parents, are considered to be available for the applicant's or recipient's support, whether or not they are actually available (a process known as deeming). However, the rule that counts a defined contribution plan as a resource to the applicant or recipient does not apply to defined contribution plans owned by ineligible spouses and parents.

An existing regulation (20 CFR 416.1202) excludes pension fund resources from deeming, and both defined contribution plans and IRAs meet the definition of pension funds in this regulation. The August 12, 1987, preamble to this regulation states "We believe it is inequitable to jeopardize the future of a person whose resources are deemed so that another individual's current needs can be met." Later, the same preamble states "It is fair and correct to count the pension funds of an applicant/recipient because SSI is a current needs-based program. Consequently, the individual's own current needs must outweigh his or her future needs."

For example, a disabled SSI applicant with $1,500 in a bank savings account and a $2,500 401(k) balance would be found ineligible. The applicant could establish eligibility by spending $2,000 of the 401(k) balance. By contrast, a disabled child whose parent had $3,500 in a bank savings account and a $2,500 401(k) balance would be eligible, because only $1,500 (after subtracting excluded resources of $2,000 for the parent) of the bank savings would be deemed to be the child's resources.

From the point of view expressed in the regulation's preamble, the current treatment of these plans is appropriate because SSI is a taxpayer-funded support program of last resort, under which the SSI payment is generally supposed to supplement other sources of support. Requiring applicants to tap these retirement accounts before becoming eligible for SSI is consistent with this philosophy.

From another point of view, an inconsistency arises in excluding retirement accounts from resources that are deemed, although the regulation's preamble presents a reasonable explanation for this inconsistency. As seen in the example, the program rules do not exclude some other funds, such as savings accounts, from deeming.

Also, unlike holdings such as trusts, 401(k)s are not well suited for sheltering assets from consideration. To acquire a 401(k), one must work for some period of time for a firm that provides its employees with these benefits, elect to participate in the plan, and accumulate funds over (usually) a protracted period of time. Applicants are unlikely to have been farsighted enough to accumulate funds in a 401(k) in anticipation of needing a shelter for assets in light of their planned future SSI application.

Labor Force Participation of SSI Applicants and Beneficiaries

The significance of this issue is, of course, related to the extent of pension plan holdings among SSI applicants and recipients, which in turn depends on the extent of the applicant or recipient's involvement in the labor force. Compared with other cross sections of society, the SSI population is and has been little involved in paid employment in the United States.

Of the 6.9 million SSI recipients as of December 2003, 14 percent had never been part of the labor force because they were under the age of 18. Of the 5.9 million adult SSI recipients, only 2.3 million were entitled to Social Security (Old-Age, Survivors, and Disability Insurance) benefits. About 1.6 million (27.1 percent of

adult SSI recipients) were entitled as retired or disabled workers; the remainder were receiving auxiliary or survivor benefits (Social Security Administration 2004, Table 16). In other words, for about 73 percent of adult SSI beneficiaries, their own work activity was not sufficient to establish insured status for Social Security benefits. (An SSI beneficiary is required to file for Social Security benefits if he or she may be entitled, even if such benefits would be reduced for age.)

Only 59,739 SSI recipients had income from pensions in December 2003 (Social Security Administration 2004, Table 7). Although published data do not reveal how many SSI applicants were denied eligibility because of 401(k) holdings (or had to spend down to gain eligibility), these applicants may be most similar to SSI recipients with pension income in that both groups had to have worked in order to build holdings in a retirement account.

To gain additional perspective on the expected incidence of retirement funds among potential SSI applicants, we examined data from the November 1999 interviews of the 1996 Survey of Income and Program Participation (SIPP) for individuals with earned income who reported having IRA, Keogh, 401(k), or federal Thrift Savings Plan accounts. The results of the interviews are summarized in Table 2.

Not surprisingly, much smaller percentages of persons below the poverty level, who are more likely applicants for SSI, have retirement accounts. Persons who are at least age 65, both above and below the poverty level, are less likely to have retirement accounts than those under age 65.

Due to the small numbers involved, the SSI program's policy on retirement funds may be most important as a statement of principle.

Table 2.
Individuals with retirement accounts in 1999, by income level and age

Age	All individuals	With retirement accounts	
		Number	Percentage of total
Income below poverty level			
18–64	46,707,800	6,092,100	13.0
65 or older	8,490,400	845,400	10.0
Income at or above poverty level			
18–64	121,959,900	50,934,700	41.8
65 or older	23,997,500	7,058,000	29.4

SOURCE: November 1999 interviews from the 1996 Survey of Income and Program Participation.

Three Approaches to SSI's Treatment of Pension Plan Holdings

This section examines three approaches to SSI's treatment of retirement funds.

- Continue the current policy of counting retirement funds as liquid resources for the SSI applicant or recipient if those funds can be withdrawn or annuitized.
- Exclude retirement funds from countable resources until retirement age.
- Attribute retirement funds as income over the life of the SSI applicant's entitlement, regardless of whether the accounts are withdrawn or annuitized.

The arguments for and against each approach are discussed below.

Continue to Count Retirement Funds as Resources

Continuing current practice is consistent with the philosophy that SSI is a program of last resort and reflects the fact that defined contribution funds are available for use for the applicant or recipient's support. An applicant can spend down balances in retirement accounts to establish eligibility for SSI.

Exclude Retirement Funds from Resources Until Retirement Age

Under this approach, defined contribution funds would be excluded from countable resources until retirement age to preserve them for their intended purpose of providing income in retirement. This policy would harmonize the treatment of defined contribution plans with the current treatment of defined benefit plans and would encourage saving for retirement. It would also help SSI beneficiaries who leave the program because of employment, in that it would permit them to retain retirement funds to add to later. It would not be susceptible to use as a shelter for assets, because other funds could not be transferred into these accounts shortly before entitlement. This alternative would require follow-up with the recipient at retirement age. It might produce some program savings in the long run; the goal of the policy is to preserve the income-producing assets (and not spend down balances in retirement accounts to establish eligibility), and the later production of income could lead to a reduction in the amount of SSI payments. Such a policy, however, would probably add to program costs, at least in the short run, by easing the financial eligibility rules for some applicants.

This alternative could also be seen as a work incentive. Some current SSI recipients may not try to work or,

if they are working, may not participate in retirement plans out of concern that doing so might affect their eligibility. It also would encourage the greatest accumulation of retirement funds, which could facilitate the purchase of the most advantageous annuities at appropriate times.

Attribute Retirement Funds as Income to the Recipients While They Are Eligible for SSI

Under this approach, the Social Security Administration would calculate an annuity amount for applicants on the basis of life expectancy and the balance of retirement funds when the applicants become eligible for SSI, then count that as monthly income for the remainder of the applicant's SSI eligibility. A provision along these lines was contained in the Pension Preservation and Savings Expansion Act of 2003 (H.R. 1776), which was not enacted. This policy avoids the "cash-out or no benefits" approach of the current policy but at the cost of adding considerable administrative complexity to the program. In addition to the hypothetical annuity computation, new notices explaining the policy would be sure to generate inquiries. The policy would introduce additional complexity because it would be completely different from other policies for treating resources.

Some additional policy questions would have to be resolved, such as the effect of breaks in eligibility (that is, does the Social Security Administration go through the hypothetical annuity calculation with every new period of eligibility, or does the imputed income carry over from prior periods?).

Discussion

The current approach, which is stricter than the alternatives in terms of requiring SSI applicants to use up other sources of support first, treats the resources differently, depending on whether the resource owner is an SSI applicant or a relative of the applicant whose resources are subject to deeming. Although the two alternatives do not contemplate changing this rule, they would more explicitly recognize the purpose of tax-sheltered retirement savings laws. The first alternative (excluding funds until retirement age) takes steps to acknowledge ongoing changes in the overall nature of retirement funds while avoiding significant additional administrative complexity. The second alternative (calculating a hypothetical annuity as income) also acknowledges the ongoing changes but adds significant administrative complexity to the processing of SSI cases involving retirement funds. The two alternatives attempt to avoid defeating the purpose of retirement fund law while still maintaining the "last resort" rationale of the SSI program. By contrast, the current approach makes that rationale paramount in importance, even to the extent of overruling the intent of statutes that encourage saving for retirement.

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