

MEMO# 10004

June 11, 1998

BIPARTISAN COMMISSION SUPPORTS INDIVIDUAL ACCOUNT COMPONENT TO SOCIAL SECURITY

[10004] June 11, 1998 TO: BOARD OF GOVERNORS No. 39-98 FEDERAL LEGISLATION MEMBERS No. 12-98 PENSION COMMITTEE No. 35-98 PRIMARY CONTACTS - MEMBER COMPLEX No. 50-98 PUBLIC INFORMATION COMMITTEE No. 22-98 RE: BIPARTISAN COMMISSION SUPPORTS INDIVIDUAL ACCOUNT COMPONENT TO SOCIAL SECURITY

The bipartisan National Commission on Retirement Policy, chaired by Senators Judd Gregg (R-NH) and John Breaux (D-LA), and Representatives Jim Kolbe (R-AZ) and Charles Stenholm (D-TX), recently issued its report on retirement security issues. The Commission placed the Social Security issue in the context of broader retirement system reform and recommended “broad simplification of the pension system,” including: (1) establishing a “universal” income limit for participation in all IRAs (i.e., deductible and Roth IRAs) and raising these limits; (2) indexing the current \$2,000 IRA limit; (3) establishing a single type of salary reduction retirement plan—a universal 401(k) plan—available to all employers and enabling (but not requiring) employers to convert their existing 403(b) and 457 plans into 401(k) plans; (4) enhancing portability among different plan types; and (5) establishing a defined benefit plan equivalent to the SIMPLE plan for small employers. With respect to Social Security reform, the proposal includes a provision to invest two percentage points of the current 12.4% OASDI tax into “Individual Savings Accounts” (ISAs). The Commission also proposed that individuals be permitted voluntarily to save up to an additional \$2,000 per year in their ISAs. The accounts would be modeled on the current Federal Thrift Savings Plan. Investors could choose among stock and bond index funds, an index fund that blends both stocks and bonds, and a government securities fund. Wage-earners under age 45 who failed to specify an investment fund would, by default, be invested 50 percent each in the stock index fund and Treasury bonds; older wage-earners would be placed into the Treasury bond option. The Commission proposal envisions the number of investment options increasing at a later time. The Commission also recommended that Congress consider permitting individuals to roll over contributions into “broadly diversified low-administrative-cost funds” managed in the private sector. Individuals would have access to funds only at retirement and would be required to annuitize distributions. The Commission considered the administrative costs of the ISAs. The recordkeeping burden would be assumed by the Social Security Administration, with the administrative costs distributed proportionally among individual accounts. The Commission estimated the administrative costs of the system to be 10 basis points, after certain start-up costs are paid and the system reaches a size at which economies of scale are obtained. The Commission noted, however, that there were “significant” administrative challenges and that implementation

must be conditioned on administrative feasibility. The Commission also recommended a series of changes to the traditional Social Security benefit that would reduce the benefit over time. These recommendations include: (1) raising the retirement age; (2) reducing amounts paid to aged spousal beneficiaries; (3) increasing the number of computation years; and (4) modifying the formula on which benefits are calculated. It is expected that these proposals will be introduced in legislative form in both the House and Senate shortly. We will keep you informed of further developments. Matthew P. Fink President Attachment

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