AMERICAN ACADEMY *of* ACTUARIES

August 26, 2011

Representative Sam Johnson
Chairman, Social Security Subcommittee
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, D.C. 20515

Representative Xavier Becerra
Ranking Member, Social Security Subcommittee
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, D.C. 20515

Re: July 8, 2011, Hearing on Social Security's Finances

Dear Chairman Johnson and Ranking Member Becerra:

I am pleased to respond to your request for further comments regarding my July 8 testimony on increasing the Social Security retirement age. I spoke of how the Social Security system could better reflect longevity improvements, including alternatives for increasing the retirement age. The American Academy of Actuaries[1] has advocated, for purposes of sustaining the financial solvency of the system, increasing the retirement age to reflect increases in life expectancy among American workers. We view adjusting Social Security benefits for life expectancy as part of a package of changes to resolve the deficit between future benefits and future income.

You have asked for elaboration on several alternatives:

1. Raising the retirement age to maintain the same number of years a person receives benefits.
    - An increase in life expectancy by one year would mean that full retirement benefits would be delayed by one year.[2]
2. Raising the retirement age to keep the ratio of working years to retirement years the same.
    - An increase in life expectancy by one year would mean that full retirement benefits would be delayed by a portion of one year.
    - If the base ratio of working years to retirement years is 2 to 1, then an increase in life expectancy by one year would mean that full retirement benefits would be delayed by eight months.
3. Changing the benefit formula—specifically and presumably indexing the Primary Insurance Amount (PIA) formula for longevity.

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[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States

[2] An increase in life expectancy by one year from 2011 amounts is estimated to take 12 years for males and seven years for females using period life expectancy at age 65 and the intermediate assumptions in the 2011 Trustee Report.

- An increase in life expectancy by one year would mean that Social Security benefits for someone retiring at full retirement age would decrease by a small percentage.
- If the ratio of increased life expectancy to current life expectancy increased by 5 percent, benefits would decrease by approximately 5 percent.

If adjusting benefits for increases in life expectancy is part of a package of changes adopted, we recommend that the change be based on design principles. In comparing the three alternatives, I'll focus my comments on these principles:

- Signaling—the degree to which the change may influence a worker's retirement behavior—meaning signal to workers that they should plan to work longer and retire later.
- Social adequacy—the degree to which the change is consistent with the goal of maintaining an adequate floor of income protection for low earners.
- Individual equity—the degree to which the change maintains an appropriate relationship between taxes paid in and potential benefits received by a worker of average life expectancy.
- Sustainable solvency—the degree to which the system achieves actuarial balance over the next 75 years along with a positive projected future trend in the 75th year.

Signaling

Alternatives 1 and 2 both would offer direct and powerful signals to American workers that they should plan to work longer and retire later.

Signals associated with Alternative 3 are indirect at best. The primary message to workers instead would be that they should rely less on Social Security and more on other available financial resources to replace their preretirement income. The incentive to work longer and retire later most likely would stem from more tailored individual financial analysis.

Social Adequacy

Alternatives 1 and 2 are most easily implemented on an across-the-board basis. The implication of these two alternatives is that the impact would be felt most severely by low-earners for whom Social Security is a more critical component of their retirement security. Alternative 1 would most negatively impact socioeconomic groups whose life expectancy did not experience the same gains in life expectancy as the population as a whole.

Alternative 3 can be much more easily implemented in a way that avoids across-the-board impact. For example, the longevity indexing could be tied to the upper wage bands, minimizing or even eliminating the impact on low earners.

Individual Equity

Individual equity is best maintained by Alternative 2, which, by virtue of preserving the ratio of working years to expected retirement years, does relatively more than the other alternatives to preserve the balance between taxes paid in and expected benefits paid out.

Individual equity likely is most challenged by Alternative 3, where for someone retiring at full retirement age, taxes are maintained and benefits reduced. This effect, in fact, is exacerbated by longer working careers.

Alternative 1 challenges individual equity in a fashion similar to Alternative 3, but in not quite so severe a manner because there is no inherent reduction in the PIA.

Sustainable Solvency

The impact of any of these alternatives on the system's sustainable solvency will be dependent on the precise manner of implementation. Relevant variables include the timing of the change, the phase-in period if any, workers included in the change, and specific parameters.

An attachment to this letter organizes and summarizes specific proposals that align with these three general alternatives. For the most part, the implementation proposals, on their own, are projected to close approximately 20 percent to 30 percent of the 75-year actuarial imbalance. These financial projections are based on figures prepared by the Social Security Office of the Actuary in conjunction with the 2010 Trustees Report. We anticipate that estimates based on the 2011 Trustees Report would provide similar results.

For further discussion of issues related to increasing Social Security's retirement age, please refer to the Academy's October 2010 issue brief.[3]

The American Academy of Actuaries appreciates the opportunity to provide the subcommittee with these comments and would welcome the opportunity to assist in any further exploration of these issues. Please contact Jessica M. Thomas, the Academy's senior pension policy analyst (202-785-7868; thomas@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

Thomas S. Terry, FSA, FCA, MAAA, EA
Chairperson, Public Interest Committee
American Academy of Actuaries

[3] http://www.actuary.org/pdf/socialsecurity/Social_Sec_Retirement_Age_IB_FINAL_10_7_10_2.pdf

Reform Proposals to Adjust Social Security Benefits for Increases in Life Expectancy using Method 2 — Keeping the ratio of retirement years to working years the same.

Proposal/Sponsor	Description of Proposal	Change in Actuarial Balance/ (Deficit)	Percentage of 2010 Deficit of -1.92% Solved
Social Security Personal Savings Guarantee and Prosperity Act of 2008 (H.R. 6110) by Rep. Paul Ryan And Title IV of H.R. 4529 introduced on January 27, 2010 by Rep. Paul Ryan	• This proposal would start and end the transition to Normal Retirement Age (NRA) of 67 one year earlier than current law such that an age 67 NRA is reached for those attaining age 62 in 2021. • For those attaining age 62 in 2022 and later, future increases in NRA would be determined as the ratio of life expectancy at NRA to the difference between NRA and 20. • The NRA index would be produced based on life expectancy with a three-year lag. • The increase in NRA for 2022 over the level used in 2021 would be computed using the ratio for 2019 compared to the ratio for 2018. • Under intermediate assumptions, this would result in an approximate increase of one month approximately every other year.	.44%	23%
A Reform Proposal to Make Social Security Financially Sound, Fairer, and More Progressive by Mark Warshawsky	• This proposal would start the increase in NRA from 66 to 67, five years earlier than under current law. • The earliest eligibility age (EEA) for retired worker and aged spouse benefits would increase to maintain EEA at four years younger than NRA. • Maximum age to receive increases for life expectancy would increase to maintain delayed retirement credit (DRC) at four years older than NRA. • For those attaining age 62 in 2017 and later, future increases in NRA would be determined as the ratio of life expectancy at NRA to the difference between NRA and 20. • Apply increases in EEA to disabled widow(er) and aged widow(er) benefits. • Under intermediate assumptions, this would result in an approximate increase of one month about every other year to EEA, NRA, the maximum DRC age, and eligibility age for widow(er) benefits.	.54%	28%
Several Social Security Reform Options by John Gist and Sara Rix at AARP Public Policy Institute	• This proposal would assume current law NRA for anyone attaining age 62 in 2022 and earlier. • Beginning in 2023, NRA would increase by one month in every other year .	.41%	21%

Per the Trustees Report, Actuarial Balance/(Deficit) is the present value of future income minus benefits, expressed as a percentage of the present value of taxable wages. Proposal and costs are summarized from the Social Security Office of the Actuary website http://www.ssa.gov/OACT/solvency/provisions/index.html

Reform Proposals to Adjust Social Security Benefits for Increases in Life Expectancy using Method 2—
Keeping the ratio of retirement years to working years the same (continued)

<table>
<tr><th>Proposal/Sponsor</th><th>Description of Proposal</th><th>Change in Actuarial Balance/ (Deficit)</th><th>Percentage of 2010 Deficit of -1.92% Solved</th></tr>
<tr><td>Financial Effects on Social Security by the National Commission on Fiscal Responsibility and Reform by Co-Chairs Erskine Bowles and Alan Simpson</td><td>

This proposal would assume current law NRA for anyone attaining age 62 in 2022 and earlier.
For those attaining age 62 in 2023 and later, future increases in NRA would be determined as the ratio of life expectancy at NRA to the difference between NRA and 20.
The NRA index would be produced based on life expectancy with a three-year lag.
The EEA would increase to maintain EEA at five years younger than NRA.
Under intermediate assumptions, this would result in an approximate increase of one month in NRA and EEA about every other year.
Increases to NRA and EEA would be modified for those with 25 or more years of coverage before age 62 and AIME at less than 400 percent of the Federal Aged Poverty Level as follows:

<table>
<tr><th>AIME as a % of indexed poverty level</th><th>% of full increase in EEA and NRA applicable</th></tr>
<tr><td>< 250%</td><td>0%</td></tr>
<tr><td>250%–300%</td><td>25%</td></tr>
<tr><td>300%–350%</td><td>50%</td></tr>
<tr><td>350%–400%</td><td>75%</td></tr>
</table>
</td><td>.34%</td><td>18%</td></tr>
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Per the Trustees Report, Actuarial Balance/(Deficit) is the present value of future income minus benefits, expressed as a percentage of the present value of taxable wages. Proposal and costs are summarized from the Social Security Office of the Actuary website http://www.ssa.gov/OACT/solvency/provisions/index.html

Reform Proposals to Adjust Social Security Benefits for Increases in Life Expectancy using elements of Method 1 and Method 2 — Maintaining the same number of years a person receives benefits and keeping the ratio of retirement years to working years the same.

Proposal/Sponsor	**Description of Proposal**	**Change in Actuarial Balance/ (Deficit)**	**Percentage of 2010 Deficit of -1.92% Solved**
The Social Security Solvency and Sustainability Act by Sens. Lindsey Graham, Rand Paul and Mike Lee	• This proposal would increase NRA three months per year beginning with individuals attaining age 62 in 2017 until the NRA reaches age 70 beginning with individuals reaching age 62 in 2032. • For those attaining age 62 in 2033 and later, future increases in NRA would be determined as the ratio of life expectancy at NRA to the difference between NRA and 20. • The EEA would increase to from 62 to 64 at the same time the NRA increased from age 67 to age 69. • Maximum age to receive increases for life expectancy would increase to provide delayed retirement credit (DRC) for up to four years older than NRA. • Under intermediate assumptions, this would result in an approximate increase in NRA of one month about every other year.	1.36%	71%

Per the Trustees Report, Actuarial Balance/(Deficit) is the present value of future income minus benefits, expressed as a percentage of the present value of taxable wages. Proposal and costs are summarized from the Social Security Office of the Actuary website http://www.ssa.gov/OACT/solvency/provisions/index.html

Reform Proposals to Adjust Social Security Benefits for Increases in Life Expectancy Method 3 — Changing the Benefit Formula.

Proposal/Sponsor	**Description of Proposal**	**Change in Actuarial Balance/ (Deficit)**	**Percentage of 2010 Deficit of -1.92% Solved**
Financial effects on Social Security for the Bipartisan Policy Center's Debt Reduction Task Force by Co-Chairs Alice Rivlin and Pete Domenici	• This proposal would assume current law NRA for anyone attaining age 62 in 2022 and earlier. • For those attaining age 62 in 2023 and later, the current PIA formula factors of 90%, 32%, and 15% would be indexed to longevity by the ratio of life expectancy at age 67 for 2018 to life expectancy at age 67 for the 4th year prior to initial benefit eligibility. • This would apply to disabled workers at the time of conversion to retired worker status at NRA in proportion to the percentage of years not disabled from ages 22 to 61. • Under intermediate assumptions, this change in life expectancy is projected to result in an average annual reduction in benefit levels of 0.3% per year.	.48%	25%

Per the Trustees Report, Actuarial Balance/(Deficit) is the present value of future income minus benefits, expressed as a percentage of the present value of taxable wages. Proposal and costs are summarized from the Social Security Office of the Actuary website http://www.ssa.gov/OACT/solvency/provisions/index.html