

Let Social Security Sell Supplementary Annuities up to \$250,000

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MarketWatch Blog by Alicia H. Munnell



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By lowering annuity costs, this approach could encourage more people to buy them

The baby boom is retiring with increasing amounts of their retirement resources in 401(k)s instead of the traditional pensions that their parents received. As a result, they risk spending their accumulated monies either too quickly and running out or too slowly and depriving themselves of necessities. Annuities could help – either traditional single premium immediate annuities, where individuals pay a single premium and receive an income for life or an Advanced Life Deferred Annuity (ALDA), also known as longevity insurance, where they pay a premium at, say, 65 and receive income starting at 85.

Private insurers offer these products, but few retirees buy them. Economists have developed a sub-specialty to explain why the demand for annuities is so low, but one of the many reasons is that they are expensive. Annuities are expensive for the average person because to date they have been priced for the typical purchaser – an individual who lives longer than average – and,

being complicated, they require substantial marketing costs, which creates high fees.

Experts acknowledge that “buying” an annuity from Social Security by deferring claiming is **the best way to get additional annuity income**. Social Security has the best-designed and cheapest annuities in town. The income is indexed for inflation. And they are cheaper than commercial annuities because they don’t have marketing, management, and risk-bearing costs that must be added to the price; they are priced for the average individual, not for the long-lived; and they are not affected by today’s low interest rates, which greatly raise the price of private sector annuities. So if people have to stop working at, say, 62 because of health or lack of employment opportunities, it may make sense to use a portion of their 401(k)/IRA assets to delay claiming.

But why not go beyond allowing people to increase their annuity income by delaying claiming and let people purchase annuities outright from Social Security? Yes, that’s right. Put Social Security in the annuity business. Social Security is perfectly positioned to provide such a product. It can take on mortality risk, the possibility that people live longer than anticipated. It can provide inflation adjustments, a feature currently available in the private market for single premium immediate annuities but not for ALDAs. It can keep costs constant over time so that the well-being of future retirees does not depend on interest rates when they stop working. And it can provide people with confidence that they will receive their promised stream of income.

So, the proposal is to allow individuals to purchase up to \$250,000 of annuity income from Social Security, over and above that which they receive from their Social Security benefits. The cap is required so that the program is

focused on helping middle-class Americans rather than providing a cheap product to the rich.

A potential concern is that the program would only attract individuals who would otherwise purchase annuities from insurance companies. These individuals are likely to live longer than average, so the Social Security product – which is priced on the basis of average life expectancy – would be advantageous to them. Selling such a product, however, would represent a cost to Social Security. But the immediate annuity market is small, and the market for inflation-indexed annuities even smaller, so the cost implications would be modest. Moreover, to the extent that the migration of existing purchasers caused new people to buy annuities, the overall annuitization rate could increase dramatically. Since the new purchasers would likely have shorter life expectancies than existing purchasers, the cost to the Social Security program would be less.

The private sector should not object too much. The annuity business is a tough slog. Moreover, such an initiative might stimulate interest in annuities and spur sales in the private sector for wealthier individuals who wanted to annuitize more than \$250,000.

People are going to need annuities in one form or another. So if we can overcome one point of resistance – namely, high costs – let's do it.