Bennett Social Security Solvency Proposal
Section by Section Summary

SECTION 1: SHORT TITLE

"Sustainable Solvency First for Social Security"

SECTION 2: PROGRESSIVE INDEXING

For an individual who becomes eligible for Social Security retirement benefits in 2012 or later, the bill would use "progressive indexing" – a mix of wage and price indexing -- to determine his or her initial benefit. Those individuals whose lifetime covered earnings are in the lowest 30^{th} percentile of all wage earners retiring in a particular year will not be affected in any way by these changes. Similarly, those individuals currently receiving Social Security benefits or near retirement (age 55 or older) will be held harmless.

Current Law: Current Social Security benefits are calculated under a "wage indexing" formula. Benefits for retired or disabled workers retiring in 2006 and later years will be based on the average level of their indexed wage earnings over their working lifetime that were subject to OASDI payroll taxes up to the annual taxable maximum ($94,200 in 2006).

Several adjustments must be made to those past earnings before a retired worker's initial benefits can be calculated. Upon reaching age 62 or becoming disabled, the actual amount of a worker's previous "covered" earnings must first be converted into average indexed monthly earnings, or ***AIME.*** Earnings for any year before the worker reaches age 60 are wage-indexed to reflect changes in average wage levels (rather than average price levels) in the economy that occurred between the year when the earnings were realized and the year when the worker reaches age 60. Wage indexing means that workers do not lose the value of their past earnings (when money was worth more) in relation to their more recent earnings. It may add an additional productivity "bonus" by indexing past wages to reflect subsequent "real" growth in average wages that exceeds the effects of price inflation alone. Earnings after age 60 are not wage indexed. A retired worker's AIME is then based on the highest 35 years of all covered earnings, divided by 420 (the number of months in 35 years). For disabled workers and the survivors of deceased workers, the AIME can be based on a shorter period (excluding periods when the worker was disabled or deceased).

A progressive formula is then applied to a worker's AIME to calculate his or her primary insurance amount (***PIA***). The PIA is the monthly amount determined either for a worker who begins receiving Social Security retirement benefits at the age at which he or she is eligible for full benefits or for a disabled worker. The formula is designed to ensure that initial Social Security benefits replace a larger proportion of pre-retirement earnings for people with low average earnings than for those with higher earnings. Under the formula, the worker's PIA is determined by applying three separate percentages (90%, 32%, and 15%), known as **PIA factors**, to three different portions of the worker's AIME. The dollar thresholds at which the applicable PIA factor changes (in other words, where the fraction of additional dollars of a particular portion of AIME that becomes part of a worker's PIA changes) are known as "**bend points.**" The Social Security Administration indexes the bend points annually to match the rate of growth of average wages, while the PIA factors never change. This keeps the portion of workers' pre-retirement earnings (AIMEs) that is replaced by each of the respective PIA factors roughly constant for each new retiring cohort.

The PIA formula applicable to any worker, regardless of the age at which he or she actually retires, is the formula in place in the year the worker reached age 62 or became disabled. For example, the PIA formula for workers who first became eligible for retirement benefits in 2005 was the sum of:

- 90% of the first $627 of the worker's AIME,
- 32% of the worker's AIME falling between $627 and $3,779, and
- 15% of the worker's AIME above $3,779.

The amounts $627 and $3,779 were the **bend points** of the 2005 PIA formula.

The initial basic retirement benefit of a worker retiring at the "normal retirement age," or NRA, is based on 100 percent of the PIA. However, if a worker retires at an age earlier than the NRA, he or she faces an "early retirement penalty" which reduces the amount of his benefit. Before the year 2000, the NRA was age 65 and the early retirement penalty, or reduction factor, was 6-2/3 percent of the benefit for each year of early retirement. That is, a worker retiring three years early, at age 62 (the earliest age at which retirement benefits may be claimed), would receive a benefit equal to only 80 percent of the PIA. Beginning in 2000, the "normal" retirement age began to rise from age 65 to age 66, at the rate of 2 months per year for those reaching age 62 between the years 2000 and 2005. The NRA will continue to rise to age 67, at the same rate of 2 months per year, for those reaching age 62 between 2017 and 2022. A worker will still be able to collect benefits beginning at age 62, but the two additional years of early retirement (as fully phased in by 2022) will reduce benefits by an additional 5 percent per year adjustment factor. The age 62 benefit in 2022 and thereafter will fall to 70 percent of the PIA.

Once a worker's basic benefit (PIA adjusted for applicable early retirement penalty) is determined, it is augmented by annual cost of living adjustment (COLA) to offset inflation, if any, from the year the worker reached age 62 until the year of filing for benefits. After a retired worker has received his or her first benefit check, the amount is similarly adjusted upward every January 1 to reflect annual changes in the cost of living, as measured by the consumer price index (CPI). This price indexing of initial retirement benefits, after a retiree has begun to receive them, is a separate procedure from wage indexing a worker's earnings history or the bend points of the benefit formula used to set initial payments to new retirees over time.

In addition to the COLA, a recipient's benefit may increase if the individual continues to work after first becoming eligible to draw benefits. If subsequent earnings in a later year exceed any of the indexed yearly earnings initially used to determine the worker's initial benefit at age 62, Social Security will automatically substitute the new earnings for the lowest ones in the worker's earnings history, recalculate the worker's PIA, and increase the worker's future benefits.

The current structure of the formula presents an inherent problem. Because average wages generally grow faster than prices over time, the current benefit formula essentially guarantees that future retirement benefit levels will grow faster in "real" dollar value from generation to generation. Hence, the actual purchasing power of the Social Security benefit of a person retiring in 2005, for example, is greater than for a person who retired in 1995.

Bennett Bill: The current benefit formula would remain essentially the same, except that, for new cohorts of retirees beginning in 2012, the upper-two PIA factors (32 percent and 15 percent) used to calculate their PIAs would be adjusted lower annually by the Social Security Administration in order to slow the future growth of initial retirement benefits. Those benefit levels would increasingly reflect the levels of price growth, rather than average wage growth, that occurred during the course of most workers' careers. For those individuals whose AIMEs were above the 30th percentile of workers retiring in a given year, their initial retirement benefit would be indexed based upon a "progressive blend" of wage and price changes. The slowest rate of growth in future retirement benefits would be for workers with steady maximum taxable earnings. Future benefit levels for workers who earned higher wages over their working careers would rise at a lower rate than benefit levels for workers with lower lifetime earnings.

Moreover, those workers most dependent on Social Security for retirement income would be fully protected from the changes. Individuals whose career-average indexed monthly earnings were in the lowest 30 percent of all career-average wage earners retiring in a particular year would continue to have their initial benefits calculated using the current law formula and they would, therefore, be held harmless entirely from the PIA factor adjustments. Those workers who were age 55 or older on January 1, 2005 also would not be affected by this change in the benefit formula. Current law benefits for young survivors, as well as disability benefits, would remain unchanged.

The progressive indexing provisions of the bill would operate first by establishing a new second bend point in the benefit formula. It would be set above the current-law first bend point (below which the first 90-percent PIA factor would continue to apply). The current-law 32-percent PIA factor would continue to operate up to this new second bend point. The new bend point would be determined to be at about the 30th percentile of AIME for those newly eligible for social security retirement benefits in 2012. (The calculation relies on the latest available statistics for AIME of workers first becoming eligible for retired worker benefits in 2001 through 2003 and updates them to 2012 using the intermediate assumptions of the 2005 Trustees Report). The future levels at which this new bend point would apply beyond 2012 would be wage-indexed, as is done for the other two bend points in current law.

For workers eligible to retire in 2012 and beyond with portions of AIME above the level of this second new bend point, further progressive indexing adjustments would be made to the other two remaining marginal PIA factors (32 percent and 15 percent, respectively) under current law. The objective is to gradually reduce those two PIA factors by the same proportional amount over time, in a manner that would reflect the relative difference between using price indexing and using the current law practice of wage indexing to determine the benefits for a career-maximum earner (a worker always earning annual wages at or above the maximum amount subject to OASDI payroll taxes). The percentage by which those upper-two PIA factors are reduced in a given year, however, must be somewhat greater than that ratio alone, because it must be applied to a smaller base of career earnings. (Initial retirement benefits derived from the portion of any worker's AIME below the 30th percentile are held harmless from the progressive indexing adjustments). Hence, the new benefits formula adjusts those 15-percent and 32-percent PIA factors by multiplying them by (1) the difference of the maximum CPI-indexed benefit amount for a given year after 2011 over the benefit amount determined for an individual whose AIME is equal to the hold-harmless 30th percentile level at the second new bend point divided by (2) the difference of the maximum wage-indexed benefit amount for the same year over the benefit amount determined for an individual with AIME at the 30th percentile level.

Over time, as the original 15 percent and 32 percent PIA factors are reduced incrementally in line with the difference between price growth and average wage growth, higher earning workers will have relatively smaller shares of their total AIME converted into retirement benefits. Growth in future retirement benefits for relatively lower earning workers, with a greater share of total AIME affected by the unchanged lower-two PIA factors, will be slowed at a lesser "blended" rate.

The progressive indexing reduction of the upper-two PIA factors would not continue indefinitely if the financial status and outlook of the Social Security system improved and returned to sustainable solvency. Whenever the Chief Actuary of the Social Security Administration certifies that, for a calendar year after 2080, the combined balance of the Old-Age and Survivors Trust Fund and the Disability Insurance Trust Fund is positive and not less than 100 percent for that calendar year, and it is projected to remain stable and grow in the future, further adjustments to the PIA factors would be frozen and the upper-two PIA factors would remain at their level of the preceding year. Additional adjustments would resume in any later calendar year during which the combined balance dropped below 100 percent. This stabilizing provision may cause the incremental effects of progressive indexing to be added only intermittently in calendar years after 2080.

SECTION 3: LONGEVITY INDEXING

Initial Social Security benefits would be adjusted to more accurately account for increases in worker life expectancy.

Current Law: A worker's initial retirement benefit is price indexed annually to adjust for increases in the cost-of-living, as measured by the CPI-W. No further adjustments in benefits are made for changes in average life expectancy for any given cohort of retirees.

Bennett Bill: In 2018 and later years, initial benefits for future retirees would be adjusted annually by the Social Security Administration to account for changes in the expected average life expectancy, at age 67 (the age of normal retirement for future retirees). This would be done by multiplying the PIA factors by a life expectancy ratio calculated by the Chief Actuary, using final and complete actual data that is available for a given calendar year. It would represent the ratio of the period life expectancy based on computed death rates for 2013 of an individual at age 67 to the period life expectancy of an individual at that age based on the computed death rates for the fourth calendar year preceding the calendar year for which the life expectancy ratio is determined.

Those persons who are currently age 55 and older or who are young survivors would not have their benefits impacted by this adjustment.

The bill would also require the Social Security Commissioner to conduct a study on the feasibility of determining life expectancies for disabled beneficiaries. A report on the study would be due no later than one year after the date of enactment of the bill.

SECTION 4: TREATMENT OF DISABLED BENEFICIARIES

With regard to the disabled, the bill would not affect those receiving Social Security disability benefits while they are disabled.

Current Law: Upon reaching normal retirement age, the social security benefits for disabled beneficiaries are no longer paid by the Disability Insurance Trust Fund, and disabled beneficiaries become eligible for retiree benefits financed by the Old-Age and Survivors Trust Fund. Disability benefits are computed similarly to retirement benefits, but they are calculated as if the worker attained the full retirement age in the year he or she became disabled.

Bennett Bill: At the time of conversion by disabled beneficiaries to retired worker status, their retirement benefits would be calculated using a blend of two formulas. The current law benefit formula would continue to apply proportionately for the relative period of time during their potential working lifetime (between age 22 and age 62) when they were disabled. Future changes in current law benefits due to progressive indexing and longevity indexing would apply proportionately to the relative period of time when they were able to engage in covered employment

SECTION 5: ACCELERATION OF PRESENT-LAW NORMAL RETIREMENT AGE CHANGES

The age of normal retirement, for full Initial Social Security benefits, would be adjusted to more accurately account for increases in worker life expectancy.

Current Law: The age at which a worker becomes eligible for full Social Security retirement benefits – the normal retirement age, or **NRA**, is currently scheduled to increase incrementally from age 66 to age 67 for those workers first reaching age 62 in 2017 or later. The NRA depends on the worker's year of birth and, correspondingly, when he or she becomes age 62 and first eligible for retirement benefits. For people born before 1938, the NRA is 65. For workers born between 1938 and 1943, the NRA already began to increase by two months per birth year. Hence, the NRA now is 66 for people born in 1943 or later. It will remain at that level until 2017, when it again begins to increase at the rate of two months per birth year, beginning with people born in 1955. By 2022, the NRA will be 67 for workers born in 1960 or later.

Retirement benefits are still available at age 62, but with greater reduction as the NRA increases to age 67. For example, a worker retiring at age 62 in 2022 will have their initial benefits reduced by 30 percent. A worker who retired at age 62 in 2005 would have received benefits reduced by only 20 percent.

Bennett Bill: The current-law increase in the NRA from age 66 to age 67 would begin 5 years sooner, starting in the year 2012 (for those born in 1950) rather than in the year 2017. Hence, the NRA would be increased by two months each year thereafter until it reached age 67 in 2017, for those born in 1955 and later.

SECTION 6: MAINTENANCE OF ADEQUATE BALANCES IN THE SOCIAL SECURITY TRUST FUNDS

The bill would ensure that benefits are not cut automatically in future years due to the combined OASDI Trust Fund becoming insolvent (trust fund assets insufficient to cover the entire costs of the programs).

Current Law: According to the latest projections by the Chief Actuary, the Old-Age and Survivor Trust Fund will be insolvent in the year 2041. Under current law, if assets are insufficient to pay for benefits in a particular year, the benefits of all beneficiaries are reduced proportionately to make up for the shortfall. Hence, the Chief Actuary currently projects that in 2042, benefits will be reduced by roughly 30%.

Bennett Bill: This bill would ensure that for years in which there would not otherwise be sufficient assets in the trust fund to pay out scheduled benefits, the gap would be filled by the appropriation of funds from general revenues. This failsafe general revenue transfer provision would ensure that a sufficient financial cushion remains to provide payment of all benefits promised under the bill. However, it primarily operates as a fiscal placeholder that indicates the annual amount of increased revenue, or reduced expenditures, required to maintain an annual combined trust fund balance ratio of no less than 100 percent. It remains neutral as to which fiscal method, or combination of methods, is used to achieve this objective.