

Longevity Insurance Benefits for Social Security

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Preventing people from falling into poverty as they age is a key goal of Social Security. Longevity insurance is one way to address the income needs of those who have lived longer than they expected and have used up their retirement savings, with only their Social Security benefit remaining. While all annuities provide retirees a degree of longevity insurance, in recent years the term longevity insurance has been used to refer to a particular type of deferred annuity. Longevity insurance is a deferred annuity that starts at an advanced age, such as 82. Longevity insurance annuities provide insurance against outliving one's assets, but only when that risk becomes substantial at advanced ages.

With a longevity insurance benefit, the problem of asset decumulation with uncertain life expectancy is simplified. Instead of planning for an uncertain period, retirees can plan for the fixed period from the date of their retirement to the date at which they start receiving the longevity insurance benefit.

Longevity insurance as an addition to Social Security has been proposed recently in both the United States and Canada. In 2013, a fully funded longevity

insurance benefit starting at age 75 was proposed for the Quebec Pension Plan, the social security plan in Quebec that corresponds to the Canada Pension Plan for the rest of Canada.² In addition, in 2013, President Obama in his initial proposals for his fiscal year 2014 budget included a type of longevity insurance benefit in Social Security. That benefit would offset at older ages some of the benefit reductions caused by introducing a chained consumer price index for adjusting Social Security benefits in payment. The benefit would start at age 76, would phase in for each recipient over a period of 10 years, and when phased in at age 85 would provide a benefit equal to about a 5 percent increase in Social Security benefits. This proposal was not included in the final budget because of lack of support for the idea of the use of the chained CPI.

This article proposes that longevity insurance should be added as a form of benefit provided by Social Security. This type of benefit would be particularly valuable as a part of a reform package that included benefit cuts to restore Social Security's solvency. A social safety net benefit would be needed to offset the effects of Social Security benefit cuts on older retirees.

This article is structured as follows. First, it discusses the role of longevity insurance in the early history of Social Security, and how that role has diminished over time. Second, it describes problems with the provision of longevity insurance by the private sector, and compares the provision of longevity insurance in the private sector to its provision in the public sector. Third, the paper discusses alternative ways that Social Security could provide longevity insurance benefits. Fourth, it offers concluding comments.

1 I received valuable comments from Thomas Prost and other participants at Netspar Pension Day in Utrecht, Netherlands; Michelle Maher and other participants at the Pension Policy Research Group conference in Dublin, Ireland; participants at the Nevin Economic Research Institute (NERI) Labour Market Conference in Belfast, Northern Ireland; participants in the 13th International Workshop on Pensions, Insurance and Savings in Paris, France; and participants at the Fourth International Conference on Social Security Systems in the Light of Economic, Demographic and Technological Challenges in Poznan, Poland. I have also benefited from collaboration on earlier papers with David Blake, Tianhong Chen, Gerard Hughes, Mark Iwry and David McCarthy.

2 Expert Committee on the Future of the Quebec Retirement System, "[Innovation for a Sustainable Retirement System](#)," report (April 2013).

This paper builds on a previous literature analyzing various aspects of longevity insurance in the private sector and for Social Security.³

Longevity Insurance in the Historical Development of Social Security

In 1940, when Social Security benefits were first provided in the United States, the benefit eligibility age was 65. For males age 20 in 1900, their life expectancy was age 62.⁴ Thus, less than half of men entering the workforce survived to receive benefits in the early years of Social Security.

Over time, three changes fundamentally altered the nature of the old-age benefits that Social Security provides. First, the benefit eligibility age has been lowered to age 62.⁴ Second, life expectancy has increased. Third, the average age at which workers enter the labor force has increased. With these three changes, the United States Social Security has transitioned from a longevity insurance program to a program providing old-age benefits for a substantial proportion of the population that entered the workforce in their youth. Now, 87.8 percent of those age 20 survive to age 62.

Longevity Insurance in the Private Sector

This section considers issues relating to the provision of longevity insurance benefits in the private sector. To anticipate the findings, it is seen that the private sector faces disadvantages in providing longevity insurance benefits, presenting a case for the provision of these benefits through Social Security.

Annuities provided through employer-provided retirement plans in the United States must calculate benefits on a unisex basis. Thus, employer-sponsored pension plans are required to use the same mortality rates for men and women when calculating benefits, despite the fact that at typical retirement ages women on average live about three years longer than men.⁵

The gender difference in life expectancy is considerably greater at older ages than for people in their early 60s. The U.S. life tables for 2009 show that women age 62 are 35 percent more likely than men that age to survive to age 85.⁶ At age 85, women's life expectancy is 17 percent longer than that of men. When priced using gender-based mortality rates, women's single life longevity insurance annuities purchased at age 62 with payments beginning at age 85 would cost considerably more than those for men, perhaps as much as 50 percent more. Thus unisex longevity insurance annuities provided by pension plans in the private sector would be a bad deal for men.⁷

Problems with the provision of longevity insurance annuities in the private sector also include that adverse selection may be more of an issue in that longevity insurance annuities presumably would only be purchased by people with really long life expectancies. Further, potential purchasers may be concerned with the risk of life insurance company insolvency over a long time period, with government reinsurance not providing adequate protection, a concern that may in actuality be overstated.

3 Moshe Milevsky, "[Real Longevity Insurance with a Deductible: Introduction to Advanced-Life Delayed Annuities \(ALDA\)](#)," *North American Actuarial Journal* 9, no. 4 (2005): 109–22; Anthony Webb, Guan Gong and Wei Sun, "[An Annuity That People Might Actually Buy](#)," Center for Retirement Research at Boston College, Issue in Brief No. 7-10 (July 2007); J. Mark Iwry and John A. Turner, "Automatic Annuitization: New Behavioral Strategies for Expanding Lifetime Income in 401(k)s," in *Automatic: Changing the Way America Saves*, ed. William G. Gale et al. (Washington, DC: Brookings Institution Press, 2009); John A. Turner, *Longevity Policy: Facing Up to Longevity Issues Affecting Social Security, Pensions, and Older Workers* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2011); John A. Turner, "Providing Longevity Insurance Annuities: A Comparison of the Private Sector versus Social Security," *The Journal of Retirement* 1, no. 2 (Fall 2013): 125–30; John A. Turner and David D. McCarthy, "Longevity Insurance Annuities in 401(k) Plans and IRAs," *Benefits Quarterly* 29 (First Quarter 2013): 58–62; Katharine G. Abraham and Benjamin H. Harris, "[Better Financial Security in Retirement? Realizing the Promise of Longevity Annuities](#)," *Economic Studies at Brookings* (November 2014): 1–20; David Blake and John A. Turner, "Longevity Insurance Annuities: Lessons from the United Kingdom," *Benefits Quarterly* 1 (2014): 39–47, <http://www.ifebp.org/inforequest/0165164.pdf>; Tianhong Chen and John A. Turner, "Longevity Insurance Annuities: China Adopts a Benefit Innovation from the Past," *International Social Security Review* 68, no. 2 (2015), doi:10.1111/issr.12063.

4 James W. Glover, [United States Life Tables: 1890, 1901, 1910, and 1901-1910](#) (U.S. Bureau of the Census, Washington, DC: U.S. Government Printing Office, 1921).

5 Elizabeth Arias, "[United States Life Tables, 2009](#)," *National Vital Statistics Reports* 62, no. 7 (January 6, 2014).

6 Ibid.

7 Turner and McCarthy, "Longevity Insurance Annuities."

Another reason longevity insurance annuities are not provided by pension plans relates to the administrative issues involved in providing them. Because a survivor's benefit is the default for annuities, employers need to obtain a notarized statement from the spouse waiving the survivor's benefit if that option is not chosen. Employer concern about issues relating to the verification of the waiver of survivor's benefits may be another reason employers generally do not provide annuities of any type through pension plans.

In the United States, longevity insurance annuities can be purchased privately (not through an employer-provided pension plan) on a gender basis, taking into account the longer life expectancy of women. New York Life⁸ expressed the opinion that pure longevity insurance annuities would have limited appeal in the United States, but that those annuities combined with another benefit payment feature, in particular a death benefit, would be marketable. While such a benefit would reduce the income provided by the annuity, it would nonetheless provide some longevity insurance benefits.

Longevity Insurance Annuities Provided by Government

The government has several advantages over the private sector in providing longevity insurance annuities. First, the government has a hedge against increases in the liability due to unexpectedly large improvements in life expectancy to the extent that people work longer (and pay more taxes) due to improvements in health at older ages. Currently, no asset exists for the private sector to invest in that provides a full hedge against increased annuity costs arising due to unexpected improvements in life expectancy.

Second, the government does not have the problem of adverse selection because it provides the benefit to a preselected group. In the private sector, insurance companies would provide longevity insurance to people who self-select, in part based on their subjective expectation of long life expectancy.

Policy Proposal

This section provides an example of how a longevity insurance benefit in the United States might be structured as part of Social Security. This proposal could be part of a package that otherwise reduced the generosity of Social Security benefits and raised the payroll tax rate to restore solvency.

The target population for this Social Security reform proposal is people age 82 or older. Age 82 is chosen as approximately the life expectancy at age 62.⁹ Women outnumber men by roughly two to one in this age group.¹⁰ Thus, this proposal particularly would benefit women at advanced ages.

While longevity insurance benefits can be provided in different ways, as an example, we present a specific proposal. We propose that starting at age 82, everyone receiving a Social Security benefit would receive an additional \$50 a month. That amount would be increased to \$100 a month at age 87 and to \$150 a month at age 92. These benefits would be price indexed.

These benefits would be the same for everyone within an age bracket. Because of the taxation of Social Security benefits for higher income persons, the after-tax benefit would be slightly progressive in absolute terms and, of course, would be progressive in terms of the percentage increase in benefits that people at different income levels received. The benefits would be financed out of the Social Security Old-Age and Survivors Insurance (OASI) Trust Fund, and thus benefit cuts or payroll tax rate increases at younger ages would be needed to finance them.

Recognizing this enhanced insurance protection, U.S. Social Security OASI could be renamed Old-Age, Survivors and Longevity Insurance (OASLI). The renaming would help inform people about the benefit. It would positively frame the benefit, rather than the benefit being thought of as antipoverty assistance.

Conclusions

With a longevity insurance benefit, the problem of asset decumulation with uncertain life expectancy is

8 New York Life, [comment letter on IRS REG 115809-11](#), Longevity Annuity Contracts, May 3, 2012.

9 Arias, "United States Life Tables, 2009."

10 Denise Smith, "[The Older Population in the United States: March 2002](#)," U.S. Census Bureau report P20 546 (April 2003).

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simplified. Instead of planning for an uncertain period, retirees can plan for the fixed period from the date of their retirement to the date at which they start receiving the longevity insurance benefit.

While adding longevity insurance as a new benefit when Social Security is already facing a financing deficit would be problematic, reintroduction of a longevity insurance benefit as part of Social Security in a reform package that involved benefit cuts could be an important policy innovation. Longevity insurance benefits are deferred annuities that begin payment at advanced older ages. This benefit is generally not provided by the private sector.

The government has several advantages over the private sector in providing longevity insurance annuities. First, the government has a hedge against the liability to the extent that people work longer (and pay more taxes)

due to improvements in health at older ages or due to raising the eligibility age for Social Security benefits. Currently, no assets exist for the private sector to invest in to provide a hedge against unexpected improvements in life expectancy. Second, the government does not face adverse selection because it provides the benefit to a preselected group. In the private sector, by comparison, insurance companies would face adverse selection because they provide longevity insurance to people who self-select, in part based on their subjective expectation of long life expectancy.

While longevity insurance benefits initially were a major aspect of Social Security in the United States, over time the role of those benefits has declined as benefit eligibility ages have been reduced and life expectancy has increased. This paper argues in favor of reintroducing those benefits into Social Security as part of a reform package.

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