The Retirement Security Project

Removing Barriers to Retirement Saving in Medicaid and Supplemental Security Income

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Introduction

Most low-income families have inadequate retirement savings. They also are much less likely than higher-income households to participate in employer-based retirement savings plans or to have individual retirement accounts (IRAs). Fewer than 8 percent of individuals age 16 through 59 with household income below the poverty line hold a 401(k) retirement account or an IRA.[1] Individuals with extremely low earnings, part-time employees, and employees with less than a high school diploma are especially unlikely to participate in an employer-based retirement plan.[2] Moreover, even when low-income households participate in retirement saving plans, they tend to contribute a smaller share of their income than higher-income households do.

In recent years, policymakers have expressed growing interest in increasing retirement saving by low-income households. For many very low-income households, Social Security benefits — or Social Security benefits plus benefits from the Supplemental Security Income (SSI) program — do not provide even a poverty-level income. In 2004, the typical (or median) household in the bottom fifth of the income scale that had managed to save for retirement had only about $5,000 in its retirement accounts, a fraction of what would be needed on top of Social Security and SSI benefits to avoid poverty in old age.[3] If low-income families can accumulate some retirement savings to supplement their public benefits, fewer of them will be poor in retirement.

Moreover, the federal government provides more than $100 billion in tax benefits each year to encourage retirement saving, primarily through employer-based retirement plans and IRAs.[4] These subsidies disproportionately benefit affluent individuals: in 2004, about 70 percent of the tax benefits from new contributions to 401(k) plans went to the top 20 percent of tax filers.[5] Encouraging low-income households to build some retirement savings could modestly reduce these large inequities.

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Asset Rules in Means-Tested Benefit Programs Create a Barrier to Saving

Many low-income families rely on means-tested programs at times during their working years — for example, during temporary spells of unemployment or at times when their earnings are insufficient to make ends meet. Also, many low-income people who are unable to work for an extended period of time because of a serious disability rely on SSI during such periods. Even with SSI benefits, recipients are quite poor. In 2007, the maximum federal SSI benefit amounted to 73 percent of the poverty line for an individual and 82 percent of the poverty line for a couple.

To qualify for these programs, families and individuals generally must meet an asset test; that is, their total countable assets must not exceed a dollar limit set by the program. In SSI, and in Medicaid for most recipients who are elderly or have serious disabilities, the asset limit is $2,000 for an individual and $3,000 for a couple. These limits are far below the level of retirement savings that a low-income employee would need to stay out of poverty during retirement. If a retiree whose earnings had been consistently low sought to use savings to make up the difference between his or her Social Security benefits and 70 percent of his or her former earnings level (which would put the retiree just over the poverty line), he or she would need approximately $30,000 in savings at the point of retirement.[6]

Moreover, the asset limits in these programs are not indexed to inflation and tend to remain frozen for many years at a time. As a result, the asset limits have shrunk substantially in inflation-adjusted terms over the past several decades and are expected to continue declining in inflation-adjusted terms in the future.

In addition to imposing what amounts to a steep implicit tax on saving, asset tests in means-tested benefit programs treat retirement saving in a confusing and seemingly arbitrary manner. Each program has its own asset policy, so some retirement accounts are counted in certain programs but not in others. And in some programs, a retirement account is counted in some *states* but not in others. As a result, one family may be able to retain its retirement savings when it needs to turn to means-tested benefits, while a similar family that uses a different retirement saving vehicle or lives in a different state may have to deplete its retirement savings or forgo means-tested benefits during a time of need.

One of the most harmful inconsistencies in current policies is that while means-tested programs generally do not count employer-based retirement plans toward their asset tests if they are structured as defined-*benefit* plans (such as traditional pensions), they often do count such plans if they are structured as defined-*contribution* plans (such as 401(k)s). When these asset rules were developed in the early 1970s (or earlier), defined-benefit plans were the norm. Since then, employer-based plans have shifted away from the defined-benefit model, and most employees today do not have access to a defined-benefit plan. Asset policies that treat the two kinds

of plans differently put low-wage workers who do not have access to a defined-benefit plan at a distinct disadvantage.

Research has shown that asset tests can create disincentives for families to save. Studies have found that families likely to receive benefits from means-tested programs tend to save less when asset limits are instituted and save more when asset limits are relaxed.[7]

Moreover, a growing body of evidence suggests that making it easy for low-income families to save, and presenting them with a clear and effective financial incentive to do so, generate significantly higher contributions. For example, 401(k) participation rates among new employees rise substantially when employees are enrolled automatically in a 401(k) plan unless they opt out. In one study, the participation rate among new employees earning less than $20,000 rose from 13 percent to 80 percent when the employer adopted the opt-out approach.[8] Similarly, a Retirement Security Project study showed that the combination of a clear match for saving, accessible savings vehicles, the opportunity to use part of a tax refund to save, and professional assistance could significantly increase retirement saving, even among low- and moderate-income households.[9]

Congress recently adopted legislation making it more attractive for employers to establish automatic enrollment for 401(k)s.[10] In addition, Congress may at some point extend the benefits of the Saver's Credit (a tax credit for low- and moderate-income individuals who save for retirement) to employees who do not earn enough to owe income taxes.[11] Such changes are important. But they will not be fully effective unless policymakers also address the barriers to retirement saving posed by the asset tests in key means-tested benefit programs.

How Do SSI and Medicaid Treat Retirement Savings?

SSI. SSI is a means-tested, federally funded and federally administered program that provides modest cash payments to low-income individuals who are aged, blind, or have serious disabilities. In December 2006, some 7 million individuals received SSI benefits. Approximately 4 million (or 57 percent) of them were aged 18–64 and had disabilities, another 2 million (or 28 percent) were aged 65 or older, and the remaining 1 million (or 15 percent) were children under 18 with disabilities. (Of the elderly SSI recipients, 40 percent had been receiving disability benefits before turning 65.[12])

SSI eligibility rules are set by Congress and the Social Security Administration (SSA), which administers the program. In general, SSI is limited to people who have very low incomes and no more than $2,000 in countable assets for individuals and $3,000 for couples.[13] These limits have not been adjusted, even for inflation, since 1989.

SSI rules are based on the principle that the program is a last resort for meeting an applicant's current needs, and that those current needs outweigh the applicant's future needs. Thus, all sources of available support must be drawn upon before SSI will be provided, even if that means sacrificing future retirement income or paying a penalty.[14] Both IRAs and defined-contribution accounts like 401(k)s generally count toward the SSI asset limit. In contrast,

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payments from defined-benefit plans are counted as income, but the underlying savings are not counted as assets. If an individual is eligible for periodic payments from a retirement account, he or she must apply for such payments in order to be eligible for SSI benefits. If an individual is not eligible for periodic payments but can make a lump-sum withdrawal, SSA counts the entire account toward the asset limit.[15]

If an individual converts his or her defined-contribution retirement account to an annuity, SSA will *not* count it toward the asset limit because the individual has given up the right to the funds. Instead, SSA will reduce the individual's SSI benefits by the amount of the individual's monthly annuity income.[16] Purchasing a lifetime annuity often is not a wise choice for low-income people, however.[17] Purchasing a *fixed-term* annuity, meanwhile, involves significant fees and leaves the individual with neither a guarantee of lifelong income nor a cushion for one-time expenses.

Medicaid. Medicaid is a public health insurance program for low-income individuals and families. In 2004 about 58 million people, including 29 million children, 15 million adults in families with children, 9 million people with disabilities, and 5 million elderly people, obtained health coverage through Medicaid.[18] In most states, anyone who receives SSI is automatically eligible for Medicaid.

States pay an average of 43 percent of Medicaid costs, and they have considerable flexibility over important areas of the program — such as its asset rules. Nearly all states have used this flexibility to eliminate the asset test for children, and most states have eliminated the asset test for pregnant women as well. Most states continue to impose an asset test on parents with children, however, and most of these states count 401(k)s and IRAs toward the asset limit.[19] Similarly, most states impose an asset test on individuals who are elderly or have disabilities, and many of these states count 401(k)s and IRAs toward the asset limit.

Individuals who do not qualify for full Medicaid coverage may qualify for what are known as the "Medicare Savings Programs," under which Medicaid pays the Medicare premiums (and, in some cases, the Medicare deductibles and co-payments) for these individuals, but does not provide coverage for health services that Medicaid covers but Medicare does not. The asset limits for the Medicare Savings Programs are $4,000 for individuals and $6,000 for couples. As in Medicaid, states decide what counts toward the asset limit, and they may use different rules for the Medicare Savings Programs than for Medicaid.

Low-income seniors receiving SSI benefits or Medicaid coverage also qualify for a low-income subsidy for outpatient prescription drugs under the Medicare prescription drug benefit. Medicare beneficiaries who are not enrolled in the SSI or Medicaid programs are eligible for the full low-income subsidy if their income is below 135 percent of the poverty line and their assets are less than $6,000 for an individual or $9,000 for a couple. Medicare beneficiaries who do not meet these criteria but whose incomes are below 150 percent of the poverty line and whose assets are less than $10,000 for an individual or $20,000 for a couple are eligible for a much smaller, but still significant low-income

subsidy.[20] Retirement accounts, including IRAs and 401(k)s, are counted as assets because the program follows the SSI program's rules regarding what counts as an asset and what does not.[21]

Asset Rules Discourage Saving Among Families, People with Disabilities, and Seniors

The SSI and Medicaid asset rules discourage saving among parents who need health insurance through Medicaid, working-age individuals with disabilities, and impoverished seniors, as well as people who anticipate falling into one of these groups.

Families with Children

Often low-income working families need Medicaid temporarily during a recession and then leave the program once the economy recovers and jobs return. But if parents who have fallen on hard times had previously managed to accumulate modest retirement savings, they may have to deplete those savings — sometimes incurring a penalty for early withdrawals — to cover medical expenses if those savings make them ineligible for Medicaid. Such families may be dissuaded from setting earnings aside in a retirement account again. They also may be more likely to need public assistance in their retirement.

People with Disabilities

To qualify for SSI, an individual who is not yet 65 must be very poor and have a disability so severe that it prevents him or her from engaging in any substantial employment and has lasted (or can be expected to last) for a continuous period of at least 12 months, or can be expected to result in death. SSI encourages people who have disabilities to work when possible by disregarding a portion of their earnings in the calculation of their SSI benefits. In 2005, more than 330,000 SSI recipients with disabilities were working. Some 78,000 of them earned enough that they no longer qualified for an SSI cash benefit; instead they participated in a special SSI program that allows their Medicaid coverage to continue.[22]

To qualify for that special SSI program or for SSI cash benefits, an applicant's countable assets must remain below the SSI asset limits of $2,000 for an individual and $3,000 for a couple. This generally means that such an individual cannot take advantage of an employer's defined-contribution retirement plan without risking the loss of SSI benefits, which he or she may need in order to continue working. Even for individuals who are well enough to rely solely on earnings for a period of time, SSI's treatment of retirement accounts may discourage them from participating in their employer's retirement plan while working, since doing so could jeopardize their SSI (and Medicaid) eligibility in the future if their medical condition worsens and forces them to stop working.

Poor Seniors

SSI and Medicaid rules pose problems for poor elderly people as well. Seniors who meet the stringent SSI income eligibility criteria are generally too disabled to have worked consistently, though some of them may have been able to accumulate modest retirement savings during their working years. Approximately 58 percent of aged SSI recipients receive very small Social Security retirement benefits; they

The SSI and Medicaid asset rules discourage saving among parents who need health insurance through Medicaid, working-age individuals with disabilities, and impoverished seniors.

qualify for SSI because their Social Security benefits leave them far below the poverty line. Whether they receive SSI alone or both SSI and Social Security, SSI recipients are quite poor.

Individuals and couples whose low income and small assets would otherwise qualify them for SSI but who have modest retirement savings have several unappealing alternatives. They can forgo SSI, even if this means they must live in deep poverty, in order to retain their modest retirement savings for major unforeseen expenses (such as uncovered medical costs or a major home repair). Alternatively, they can consume their savings quickly and turn to SSI, which will provide them with a monthly income and more complete health coverage but still leave them below the poverty line — and without a financial cushion if an emergency strikes.

Moreover, requiring individuals to liquidate their retirement accounts to qualify for SSI or Medicaid may not generate large savings for these programs. If a person receives a lump-sum payment upon liquidation of a retirement account, SSA will count as an asset whatever portion of that payment has not been spent within the month that the payment is received. This provides an incentive for individuals to use a large part of their lump-sum payment for such immediate purposes as paying off accumulated bills or undertaking deferred home repairs. As a result, these individuals may become eligible for SSI within a few months, at which point the programs' savings would cease.

A third option for individuals is to use their modest retirement savings to purchase a lifetime annuity. But their SSI benefits would then be reduced on a dollar-for-dollar basis to offset their monthly annuity payment, and if that payment exceeds the maximum SSI benefit (which equals only about three-fourths of the poverty line for an individual), they would become ineligible for SSI and in many states, for full Medicaid coverage as well. As a result, the individual could have the same income in retirement (or could even be worse off, if the individual loses important health care coverage) despite having saved for retirement.

While a lifetime annuity ensures that income from retirement savings will not run out before a person dies, purchasing a private lifetime annuity in today's annuity market generally is not a wise investment for low-income individuals, especially those in poor health.[23,24] When a retirement account is converted to a lifetime annuity, the value of the account is reduced to cover the annuity company's marketing expenses, agent commissions, other administrative costs, and profits.[25] The value of the account is further reduced to reflect the fact that people who purchase annuities tend to have longer-than-average life expectancies, and firms that sell annuities price the annuities to reflect that reality.[26]

For these reasons, it is not appropriate for the SSI program to force low-income elderly people who wish to qualify for SSI to choose between purchasing an annuity that might be ill-advised for them and spending most or all of their retirement funds immediately.

Asset limits also pose a growing problem for seniors whose income is just *above* the SSI and Medicaid income eligibility limits and who qualify for the Medicare Savings Programs. These seniors are likely to rely heavily on Social Security

benefits: those benefits provide about 86 percent of the unearned income of seniors in the bottom third of the income distribution.[27] But over time, as Social Security's full retirement age increases, Social Security benefits for new retirees will replace a smaller share of previous earnings, and these retirees will need to rely more heavily on their own retirement savings to supplement their Social Security benefits and avoid poverty.[28] Since the asset limits for the Medicare Savings Programs ($4,000 for individuals and $6,000 for couples) are not adjusted for inflation, they will fall increasingly below the levels that seniors will need to maintain their standard of living in retirement.

SSI Rules Should Be Reformed to Enable Recipients To Protect Their Surviving Spouses from Poverty in Old Age

This paper focuses on reforms in SSI's and Medicaid's treatment of retirement savings that have not been converted to an annuity. However, SSI's treatment of retirement savings that *are* annuitized also warrants reform.

Under most lifetime annuity arrangements, a married employee can receive either a monthly payment that ends when he or she dies (a "single life annuity") or a somewhat lower monthly amount that is payable until the employee dies and is followed by (further reduced) monthly payments to the employee's surviving spouse until the spouse's death. This "joint and survivor annuity," under which payments continue to the surviving spouse, has long been recognized as the approach that public policy should favor, as it reduces poverty among elderly widows — especially those who live to a very old age.

Federal law governing tax-qualified pension plans goes to great lengths to encourage joint and survivor annuities. A qualified plan can lose its tax-favored status if it fails to make the joint and survivor annuity the default mode of payment, or if it fails to give the spouse a veto over an employee's choice of whether to take a single-life annuity (or a lump-sum payment) instead of a joint and survivor annuity. This policy is considered so important that the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) of 1974, as amended, require a spouse's consent to the employee's waiver of the joint and survivor annuity to be notarized or witnessed by a plan representative.

SSI rules, however, are contrary to this policy and push individuals to take annuities that end with their own death — and consequently leave their widows (or widowers) with nothing. Under these rules, if an SSI recipient who has a pension or retirement fund has the choice of a single-life annuity or a joint and survivor annuity, *the recipient must take the single-life annuity and eliminate the spouse's ability to receive payments after his or her death*. SSI rules specifically state that SSA staff must "[a]dvise the SSI claimant/recipient that he/she must elect the higher current benefit to retain SSI eligibility. Election of the lower benefit will result in the loss of SSI eligibility until such time as the election is changed or the option for change is no longer available" (See SSA POMS SI § 00510.001.D.3).

SSI rules do state that SSA will not require the SSI applicant or recipient to take the higher monthly payment if the spouse refuses to waive his or her right to a spousal survivor benefit. But recipients and their spouses often will not know that this right exists. SSA rules do not require SSA staff to inform SSI applicants and recipients that a spouse may refuse to waive his or her right to a spousal survivor benefit and that such a choice will not jeopardize SSI eligibility.

To ensure that surviving spouses' right to a pension is protected, SSA should eliminate the requirement that recipients elect the higher current annuity payment. SSA should also encourage SSI recipients to opt for a joint and survivor pension benefit.

The treatment of retirement savings in SSI and Medicaid needs to be reformed to address the disincentives to retirement savings.

What Changes Are Needed in SSI and Medicaid to Promote Retirement Saving?

The treatment of retirement savings in SSI and Medicaid needs to be reformed to address the disincentives to retirement savings these programs create for families with children, people with disabilities, and poor seniors. This section describes specific policy changes that would remove those disincentives and allow poor individuals who have accumulated modest retirement savings to benefit from having saved; a discussion of more detailed policy design questions is in the Appendix. The changes presented here do not represent the only workable policy design, however, and could be modified as long as they continue to adhere to the principles of equity and simplicity.

Encouraging Non-Elderly, Low-Income Individuals to Save for Retirement

Proposal:

For non-institutionalized individuals under 65 years of age, exclude savings in qualified retirement accounts from the asset limits used to determine SSI and Medicaid eligibility and eliminate the requirement that such individuals apply for periodic payments from retirement accounts.

Changing the SSI and Medicaid rules for low-income, working-age adults could reduce poverty among those individuals in old age, modestly reduce inequities in government subsidies for retirement savings, and establish more equitable treatment of different types of retirement saving within and across means-tested programs. Such changes would primarily affect two groups: adults with serious disabilities who qualify for SSI benefits (and, as a result, Medicaid coverage) and parents who, along with their children, qualify for Medicaid for temporary periods during their working years.

Excluding retirement savings when determining SSI eligibility for non-elderly individuals would allow people with serious disabilities who are able to work at times to set aside some of their earnings for retirement without jeopardizing their SSI eligibility. Moreover, because many SSI recipients' Medicaid eligibility is based on their receipt of SSI, such a change would allow the individual to retain Medicaid coverage as well. The loss of health insurance coverage can constitute a significant blow to people whose disabilities are serious enough to qualify them for SSI, so the prospect of losing Medicaid may act as a disincentive to save for retirement. Allowing working-age individuals with disabilities to retain their retirement savings would remove this disincentive. A working-age person with a disability who is able to work periodically ought to be encouraged to do so, and ought to be able to use his or her retirement account as a savings mechanism for retirement.

A number of states already are moving in this direction in their "Medicaid buy-in" programs, under which people with disabilities who are working and need health care but would not otherwise qualify for Medicaid can "buy into" Medicaid coverage. States have substantial flexibility in setting the income and asset rules in these programs. Of the 32 states that offer them, 18 do not count retirement accounts as assets.[29]

To make the exclusion meaningful, the requirement that non-elderly individuals

apply for periodic payments from their retirement accounts would need to be eliminated. Many SSI applicants would qualify for periodic payments from their retirement accounts as a result of their disability, but if they take such payments they often would deplete their savings before retiring. SSI applicants should be given the choice whether to apply for periodic payments, which would be counted as income and reduce their monthly SSI benefits, or to retain their savings to draw upon during retirement.[30]

Excluding retirement savings when determining eligibility for the regular *Medicaid* program for non-elderly people would enable parents who managed to accumulate modest retirement savings but have fallen on hard times to avoid the choice of forgoing needed health services or depleting their retirement savings to pay for that care before they can qualify for Medicaid. This change would be particularly important for low-income working families that need Medicaid temporarily during a recession and will leave the program once the economy recovers and jobs return.

Because only a limited number of low-income families have retirement savings, excluding these savings from the Medicaid asset test is unlikely to lead to substantial enrollment increases. In most states the Medicaid income limit for parents is at or below the poverty line,[31] and among families below the poverty line, only *6 percent* of adults in the 16-49 age bracket have any savings in a 401(k) or IRA.[32]

Moreover, the states that have gone further and eliminated the Medicaid asset test for parents (as 21 had done as of July 2006) generally report that this change has helped them streamline the eligibility determination process and reduce administrative costs, while easing the enrollment process for families.[33]

In sum, excluding retirement savings when determining SSI and Medicaid eligibility for working-age, non-institutionalized individuals would allow them to accumulate modest retirement savings during periods in which they are able to work. That would give them an additional source of income that could reduce or eliminate their need for SSI and/or Medicaid in old age.

Eliminating Penalties on Seniors with Retirement Savings

Proposal:
This proposal consists of three related parts:

1. For non-institutionalized individuals age 65 or older, exclude savings in qualified retirement accounts below a specified ceiling (indexed for inflation), such as $10,000 for an individual and $15,000 for a couple (or $15,000 for all households), when applying the asset tests used to determine SSI and Medicaid eligibility and eliminate the requirement to apply for periodic payments from retirement accounts.

2. Reduce SSI benefits by $2 for every $3 in unearned income from qualified retirement accounts, rather than on a dollar-for-dollar basis.

3. Treat savings in qualified retirement accounts in excess of the above ceiling either as an asset that counts against the Medicaid and SSI asset limits or, alternatively, as an assumed income stream based on the individual's age and the amount in the individual's retirement account at the time of application for Medicaid or SSI.

Excluding retirement savings when determining SSI and Medicaid eligibility for working-age, non-institutionalized individuals would allow them to accumulate modest retirement savings during periods in which they are able to work.

In 2007, an individual relying solely on the federal SSI benefit would have income at 73 percent of the poverty line; a couple relying solely on the federal SSI benefit would have income at 82 percent of the poverty line.

Seniors who managed to set aside retirement savings while they were working should benefit from having saved. But they also should be expected to rely on their own savings to some extent, and should receive reduced SSI benefits accordingly. It is important to note that this proposal would *not* apply to people in long-term care and thus would *not* enable someone with substantial retirement savings to obtain Medicaid coverage for long-term care.

1. Exclude Retirement Savings Below a Certain Ceiling

There are two principal reasons to exclude a certain amount of elderly individuals' retirement savings from consideration as an asset or as income when determining their SSI and Medicaid eligibility. First, this would allow low-income elderly people to retain a modest cushion of savings to cover substantial one-time expenses that may arise (such as out-of-pocket medical expenses or home repairs) or to supplement their monthly SSI benefits, which leave many beneficiaries below the poverty line. Second, it would allow a very poor and vulnerable group of seniors to benefit from SSI without establishing a complicated policy that could be burdensome for both SSA and beneficiaries.

Most SSI recipients have incomes well below the poverty line, even counting their SSI benefits. In 2007, an individual relying solely on the federal SSI benefit would have income at 73 percent of the poverty line; a couple relying solely on the federal SSI benefit would have income at 82 percent of the poverty line.[34] (Some states supplement SSI benefit amounts.)

Seniors who qualify for SSI are generally too disabled to have worked consistently in their younger years. (Seniors who did work consistently, even at low wages, generally do not qualify for SSI because their Social Security benefits put them over the SSI income limit.) For seniors who receive SSI as a supplement to modest Social Security benefits, their combined federal SSI and Social Security benefits put them at 76 percent of the poverty line for an individual and 84 percent for a couple. Some of these individuals may have been able to accumulate modest retirement savings during the periods in which they were able to work.

The Need to Update SSI's Unearned Income Disregard

In general, Social Security benefits reduce SSI benefits on a dollar-for-dollar basis. The only exception is that SSI has a $20 unearned income disregard, which means that the first $20 a month in income from other sources (such as Social Security benefits) is disregarded in the calculation of an individual's SSI benefit. Thus, an individual receiving both Social Security and SSI can receive combined federal benefits that equal $20 more per month than the maximum federal SSI benefit. In 2007, monthly Social Security and federal SSI benefits combined did not exceed $643 for an individual and $954 for a couple.

The $20 disregard was intended in part to ensure that SSI recipients with a significant past work history (as evidenced by their eligibility for Social Security) would have higher total incomes than SSI recipients with little or no work history. But this $20 disregard, first established in 1974, has *never* been adjusted for inflation. As a result, there is now virtually no difference between what people with an extensive work history receive from Social Security and SSI combined and what people with little or no work history receive from SSI alone. Adjustment of this and certain other SSI eligibility and benefit parameters that have been heavily eroded by inflation is overdue.

Because of their extreme poverty, SSI recipients often have little ability to cover one-time expenses such as out-of pocket medical costs, significant home repairs, or funeral and burial expenses. Poor seniors who qualify for Medicaid often still incur significant out-of-pocket costs for dentures, private duty nursing, personal care services, podiatry services, mental health treatment, and certain medical equipment. In 2003, out-of-pocket health care costs for seniors with full Medicaid coverage averaged $525.[35]

In addition, funeral and burial expenses can be out of reach for poor seniors. SSI allows a beneficiary to exclude up to $1,500 in burial expenses for herself or a spouse, as long as the funds are segregated from other savings.[36] This amount has been frozen for 25 years and is now far below actual funeral costs. According to the National Funeral Directors Association, an average funeral cost $6,500 in 2004 — more than four times SSI's excludable amount.[37]

How much retirement savings SSI should exclude is open to debate. The important point is that seniors who are poor enough to qualify for SSI but have managed to accumulate modest retirement savings should be able to benefit from those savings, either to supplement their income or to cover one-time expenses that may unexpectedly arise. In addition, the amount of retirement savings that is excluded should be indexed to inflation so it does not erode over time.

When determining the appropriate exclusion ceiling, it is important to keep in mind that retirement savings are meant to last for a number of years. Savings amounts that may sound high at first blush would contribute only a small amount of income if drawn down in regular monthly installments throughout an individual's retirement. One analysis found that if *Medicare* beneficiaries' total countable assets — not just their retirement savings — were drawn down in monthly installments over their expected lifespan (based on age and gender), 90 percent of beneficiaries who otherwise have income below the poverty line would *still* have income below the poverty line.[38]

The exclusion ceilings proposed here — $10,000 for an individual and $15,000 for a couple, or alternatively, $15,000 for all households — were chosen for several reasons.[39] For individuals, the exclusion level should be sufficient to enable them to bring their monthly income closer to the poverty line or to cover some one-time costs, such as repairing a roof or furnace. Also, the ceiling should be significantly above the amount of retirement savings most SSI applicants have, in order to minimize the number of applicants for whom SSA has to secure detailed asset information. A $10,000 or a $15,000 level seems appropriate for these purposes. If anything, these levels may be too low.

For example, if a 65-year old SSI recipient wanted to draw on retirement savings to bring her monthly income up to the poverty line over the course of her expected lifespan, she would need more than $28,000 in savings; even an 80-year old SSI applicant would need more than $17,000 in savings for this purpose. Exclusion ceilings of $10,000 or $15,000 would not be overly generous, as they would not even be sufficient to allow an SSI recipient to live at the poverty line. Somewhat higher ceilings, such as $20,000 for individuals and $30,000 for couples, would allow poor individuals with modestly more retirement savings

Seniors who are poor enough to qualify for SSI but have managed to accumulate modest retirement savings should be able to benefit from those savings.

Under current SSI rules, poor individuals who have managed to save for retirement have no higher income in old age than they would if they had not done so.

to come much closer to the poverty line, and could also be considered. (Legislation approved by the House of Representatives in 2007 would have raised the overall asset limits for the Medicare Savings Programs and the low-income subsidy for the Medicare drug benefit to $17,000 for individuals and $34,000 for couples in 2009, indexed for inflation in subsequent years.)

Most poor retirees with retirement savings have savings well *below* the $10,000 and $15,000 levels, so this exclusion would likely reduce SSA's workload in considering assets. If an SSI applicant or recipient has less than the ceiling in retirement savings, no further information or computations would be needed, and the individual's retirement savings would be monitored as they are under current law. Data from the Census Bureau's Survey of Income and Program Participation indicate that fewer than *4 percent* of individuals aged 65-69 with incomes below the poverty line have retirement savings that exceed $10,000.[40]

For seniors to have a meaningful choice as to whether to supplement their income or retain their savings for one-time expenses, the current requirement that individuals apply for periodic payments from their retirement accounts would need to be eliminated. The tax code already requires seniors to make withdrawals from 401(k) accounts or traditional IRAs upon reaching 70½ years of age.[41] The SSI program should not impose additional requirements on seniors. The SSI program should allow seniors who are eligible to make withdrawals to decide when to make such withdrawals and how much to withdraw, subject to the requirements of the tax laws. Some seniors may wish to live on somewhat less income each month in order to have a cushion for one-time costs, while others may choose to make monthly withdrawals to increase their income modestly above the SSI level.[42]

2. Disregard Only a Portion of Withdrawals From Retirement Accounts

Under current SSI rules, regular payments from retirement accounts (including payments under a defined benefit plan or from a 401(k)) are counted as unearned income. The first $20 a month in unearned income is disregarded, but for individuals who receive both small Social Security benefits and SSI (as most elderly SSI recipients do), the $20 disregard is used up on the recipients' Social Security income. As a result, regular payments from retirement savings generally reduce SSI benefits on a dollar-for-dollar basis.

This treatment amounts to a *100 percent tax rate on retirement savings.* It means that poor individuals who have managed to save for retirement have no higher income in old age than they would if they had *not* done so.

In contrast, SSI disregards 50 percent of earned income, so every $2 in earned income reduces SSI benefits by only $1. Poor individuals who have some earnings thus have a higher monthly income — when SSI benefits and earnings are combined — than poor individuals with no earnings.

Our proposal would treat seniors' payments from retirement savings more generously than other unearned income but less favorably than earned income. Specifically, this proposal is to reduce SSI benefits by $2 for each $3 in income from a retirement account.

This 33 percent disregard of withdrawals would be applied to payments from defined-benefits plans, payments from annuities, and withdrawals from a retirement savings account that is excluded as a resource because the amount of savings is below the exclusion ceiling at the time of application. This change to the treatment of payments from defined-benefit plans and annuities should have little impact on SSI costs, since few SSI recipients receive defined-benefit or annuity payments; in 2006, fewer than 2.5 percent of SSI recipients age 65 or older had any income from pensions.[43] But while only a small portion of recipients would be affected, extending the 33 percent disregard to payments from defined-benefit plans and annuities is necessary to treat income from all types of retirement accounts consistently.

3. Treat Savings Above the Exclusion Ceiling as an Asset or a Source of Annuitized Income

Although the vast majority of low-income seniors have less than $10,000 or $15,000 in retirement savings, reforms to SSI's and Medicaid's asset rules must address how to treat retirement savings above this level.

One approach, referred to here as Option A, is to count any retirement savings above the exclusion ceiling toward the asset limit. This approach is simple for applicants to understand and for caseworkers to administer. But it retains two key disadvantages of the current rules.

First, this approach retains an eligibility "cliff." If an applicant has retirement savings modestly over the excludable amount, he or she could lose eligibility for SSI and Medicaid entirely (if the amount of retirement savings that exceeded the exclusion limit brought the applicant's total countable assets above the SSI and Medicaid asset limit). Such a cliff would create a disincentive to save more than the excludable amount. It also could lead low-income elderly individuals who have retirement savings somewhat above the excludable amount, but who cannot make ends meet on a monthly basis, to draw down significant retirement savings rapidly so that they could qualify for SSI and Medicaid.

Another concern is that because SSI and Medicaid do not count annuities as assets, Option A could encourage individuals to purchase an annuity rather than retain their retirement account and draw from it, even when an annuity is an unwise investment. (While SSI and Medicaid count monthly annuity payments as income, the income stream for some seniors would be low enough that they would still qualify for those programs.) Annuities can be a sound approach to stabilizing retirement income for some seniors, but treating annuities differently than other retirement savings in the context of SSI raises significant equity concerns. Moreover, as explained above, purchasing an annuity is not always a wise financial choice for a low-income individual.

To address these shortcomings, Option B would treat any retirement savings above the exclusion ceiling *as though* they were used to purchase a lifetime annuity. Specifically, SSI and Medicaid would exclude the "excess" retirement savings as an asset, but count an assumed (or imputed) monthly stream of payments from them as *income* that reduces SSI benefits. The assumed income stream would represent the amount, based on the individual's age and the amount of

Although the vast majority of low-income seniors have less than $10,000 or $15,000 in retirement savings, reforms to SSI's and Medicaid's asset rules must address how to treat retirement savings above this level.

Seniors who otherwise qualify for Medicaid should not be disqualified solely because they have a modest retirement account.

retirement savings above the ceiling, that could be drawn monthly from the retirement savings account over the course of the individual's remaining expected lifespan.

A standard actuarial table would be used, such as that developed by the Thrift Savings Plan. The assumed monthly amounts would be counted as unearned income, and amounts above SSI's $20 monthly disregard of unearned income would reduce SSI benefits on a dollar-for-dollar basis.[44] Actual withdrawals (as distinguished from the assumed income stream) would not be counted as income and would not affect SSI benefits. If an individual outlived the expected lifespan used to calculate the assumed income stream, the counting of the assumed monthly amounts would end.[45]

To illustrate how Option B would work, consider a 65-year-old woman who has $20,000 in retirement savings but otherwise qualifies for SSI to supplement her Social Security benefits (her only other source of income). If the exclusion ceiling were $15,000, her additional $5,000 in retirement savings would not disqualify her from receiving SSI and Medicaid, but would reduce her SSI benefits. Using the Thrift Savings Plan annuity calculator, her assumed monthly income stream would be $37, and her SSI benefits would be reduced by this amount.[46] She could then use her retirement savings to bring her monthly income closer to the poverty level or to cover one-time expenses.

Even under Option B, low-income seniors with modest retirement savings would be able to maintain only a relatively meager standard of living. For instance, if the woman in the above example used her $20,000 in retirement savings to bring her monthly income to the poverty level, her savings would be depleted before she turned 72.

Option B does raise significant policy design questions regarding how to treat individuals in differing circumstances fairly and how to avoid creating incentives to liquidate retirement savings rapidly. (See the Appendix.) Once such decisions were made and the policy was designed, it should not be too complicated to administer. SSI caseworkers would have a table on which they would simply look up the amount of the assumed monthly income stream, based on the applicant's age and amount of retirement savings.

On the other hand, if policymakers decided that greater simplicity should override other factors and sought an approach that did not entail the use of an assumed income stream for people 65 and over Option A would serve that purpose.

Implementation Issues

Seniors who otherwise qualify for Medicaid should not be disqualified solely because they have a modest retirement account. For seniors who qualify for Medicaid based on SSI receipt, changes to the SSI rules are sufficient to ensure that modest retirement savings won't disqualify them from Medicaid. But to ensure that the more reasonable treatment of retirement savings proposed here applies to *all* seniors who otherwise qualify for Medicaid, two groups of seniors need special consideration — those who receive Medicaid but not SSI and those who live in "209(b) states."

In some states, some non-institutionalized seniors can qualify for Medicaid on grounds other than being an SSI beneficiary. For example, some states provide Medicaid to seniors with incomes between the SSI income limit

and the poverty line. This coverage can be important. AARP estimated that in 2003, non-institutionalized Medicare recipients age 65 and older spent an average of $3,445 annually on out-of-pocket medical costs, nearly three-quarters of which went for items other than prescription drugs.[47] Medicaid coverage can substantially reduce out-of-pocket costs.

Such seniors should not be left out of the improved treatment of retirement accounts proposed here. Nor should they be induced to liquidate the account quickly so they can qualify for Medicaid, as that would leave them with little or no savings for their remaining years. Accordingly, these proposed changes should apply to non-institutionalized Medicaid applicants age 65 or older who qualify for Medicaid for reasons other than SSI receipt. Because the Medicaid asset rules generally track the SSI asset rules automatically, no change to the Medicaid rules would be needed to ensure that non-institutionalized seniors who qualify for Medicaid on grounds other than SSI receipt benefit from the proposed treatment of retirement accounts.

In addition, the reforms proposed here should be designed so they apply to Medicaid in *all* states, including what are known as "209(b) states." While most states provide Medicaid coverage automatically to all SSI recipients, states have the option of providing coverage only to those SSI recipients who meet the state's Medicaid income and asset tests as those tests stood in 1972, before SSI was created. States that apply this option are known as 209(b) states. There are 11 such states: Connecticut, Hawaii, Illinois, Indiana, Minnesota, Missouri, New Hampshire, North Dakota, Ohio, Oklahoma, and Virginia.[48]

Poor elderly individuals in these 11 states should not be left out of the improved treatment of retirement accounts proposed here. Specifically, they should not be denied Medicaid coverage solely because of their retirement savings if those savings would *not* disqualify them for Medicaid in a non-209(b) state. Because Medicaid asset rules do not automatically track SSI asset rules in those states, changes to the Medicaid rules would be needed to ensure that the reforms described here apply to seniors who seek or secure SSI in *all* states.

Reforms Will Also Help Seniors Afford Prescription Drugs[49]

Since 2006, Medicare has provided partial coverage for outpatient prescription drugs. Most Medicare beneficiaries have to pay a substantial amount in monthly premiums, annual deductibles, and co-payments. Medicare provides, however, for subsidies to defray part of these costs for: 1) those low-income Medicare beneficiaries who are also enrolled in Medicaid (including beneficiaries who do not receive full Medicaid coverage, but for whom Medicaid pays their Medicare premiums); 2) Medicare beneficiaries who receive SSI but not Medicaid; and 3) Medicare or SSI beneficiaries who are not enrolled in Medicaid but whose incomes and assets are below certain levels.

There are several tiers of these subsidies for low-income seniors. People who are covered by Medicaid or SSI, or whose income is below 135 percent of the poverty line and whose assets are less than $6,000 for an individual or $9,000 for a couple, qualify for the largest subsidies. Medicare beneficiaries who do not meet these criteria but whose incomes are below 150 percent

Encouraging low-income families to save for retirement would enhance their future independence and living standards.

of the poverty line and whose assets are less than $10,000 for an individual or $20,000 for a couple will be eligible for a much smaller, but still significant subsidy. Individuals who are not receiving Medicaid or SSI and have assets of more than $10,000 for an individual or $20,000 for a couple are not eligible for a subsidy.[50]

The law establishing the Medicare prescription drug low-income subsidy requires that the definitions used in determining what income and assets are counted be modeled on SSI program rules. The Social Security Administration has issued regulations spelling out the specific rules to be followed.[51] The SSA regulations state that for purposes of the low-income subsidy, assets will be counted if they are liquid resources (defined as those that can be converted to cash within 20 workdays), including "retirement accounts (such as individual retirement accounts (IRA), 401(k) accounts), . . . and similar items."

In 2005, the Kaiser Family Foundation conducted a detailed study of the estimated effects of the asset test for these subsidies.[52] The study estimated that the asset test for the low-income drug subsidies will disqualify about 2.4 million of the 14 million Medicare beneficiaries whose incomes are low enough to otherwise qualify for the subsidies. About half of those whom the asset test will disqualify have assets that exceed the limit by $35,000 or less, the study reported.

The study also found that approximately 70 percent of the individuals whom the asset test will disqualify have incomes below 135 percent of poverty. (The others have incomes between 135 percent and 150 percent of poverty.)

The study reported that those who will meet the income criteria for the subsidies but be disqualified by the asset test "are disproportionately older widows who live alone."[53] In addition, the study found that 13 percent of the assets of those who meet the income criteria but not the asset test are in 401(k)s, IRAs, Keoghs, or similar retirement accounts

These problems will be eased if the modifications regarding the treatment of retirement accounts under the SSI asset test were adopted since they will apply to the asset test for the low-income Medicare drug subsidies as well.

Conclusion

Encouraging low-income families to save for retirement would enhance their future independence and living standards. An important step in this effort is to remove the barriers to retirement saving created by the asset tests in means-tested programs. The proposals outlined here — to exclude retirement accounts from the SSI and Medicaid asset tests for non-elderly applicants, and treat the retirement accounts of elderly applicants more reasonably — would do just that.

Appendix: Calculating SSI Benefits on the Basis of an Assumed Income Stream

The proposal outlined here for SSI and Medicaid applicants who are age 65 or older would (1) exclude retirement savings below a certain ceiling, (2) disregard 33 percent of withdrawals from retirement accounts below the ceiling, and (3) either treat retirement savings above the ceiling as an asset or count an assumed monthly stream of payments from these savings as income that reduces SSI benefits.

The latter approach to part 3 of the proposal — Option B in the text — is preferable on pure policy grounds. By eliminating the eligibility "cliff," it would allow for more equitable treatment of retirees who have retirement savings that modestly exceed the exclusion ceiling. It also would avoid giving preferential treatment to the conversion of retirement accounts to annuities, which may be unwise for many seniors with very low incomes.

This approach, however, is more complicated because it would introduce an assumed income stream into SSI benefit calculations, and it would require decisions on several related policy questions. This appendix briefly considers some of the questions that would have to be addressed when crafting an assumed income policy.

What would happen to individuals who outlived their life expectancy?

Once people's SSI benefits have been reduced over the course of their expected lifespan (on the basis of the assumed stream of payments from their retirement savings), no further reductions should be imposed if they live *beyond* their expected lifespan.

This is necessary in order to treat older retirees equitably. Otherwise, individuals who had drawn steadily upon their retirement savings to supplement their SSI benefits could eventually run out of savings on which to draw and face a decline in their already meager standard of living, simply because they lived longer than had been assumed.

What would happen to individuals whose withdrawals bring their retirement savings below the exclusion ceiling of, for example, $10,000 or $15,000 before the end of their expected lifespan?

For such individuals, the assumed income stream should continue to be applied — and should continue to result in a dollar-for-dollar reduction in their SSI benefits. If the assumed income stream were eliminated as soon as a beneficiary's retirement savings fell below the exclusion ceiling, an SSI recipient could increase his or her lifetime SSI benefits by quickly spending any retirement savings that exceeded the exclusion ceiling and securing higher monthly SSI benefits as a result.

What kind of actuarial table would be used to calculate the assumed income stream?

A gender-neutral actuarial table, such as that developed by the Thrift Savings Plan, could be used to compute the assumed income stream for a single-life annuity. Such a table has the advantage of simplicity but makes no distinction based on the different life expectancies

of women and men. It also implicitly assumes that an individual's savings are not intended to be available to support his or her spouse in retirement. Alternatively, separate tables could be used for single women, single men, and married couples.

Under what circumstances would the assumed income stream be recalculated?

Because the size of the assumed income stream would be based on an individual's life expectancy, the stream calculated at the first eligibility determination for an SSI applicant who is age 65 or older should generally remain in effect until the individual reaches his or her expected lifespan. Frequently recalculating the income stream would reward individuals who spent their retirement savings more quickly than assumed (their assumed income would decrease and their SSI benefits would rise), while punishing individuals who lived more frugally in order to preserve more of their savings for unforeseen costs (their assumed income stream would increase and their SSI benefits would fall).

Under the following limited circumstances, however, a recalculation of the assumed income stream would be appropriate:

- If an SSI recipient's retirement account balance has suffered capital losses of more than 20 percent (or some other percentage specified in law or regulations) as a result of market performance, he or she should be permitted to request a recalculation at the next SSI eligibility redetermination. This would protect individuals who suffer substantial losses as a result of market forces. Otherwise, SSI would essentially be treating the individual as though he or she had access to savings that are no longer available, even though the savings were never spent. (This situation is distinct from one in which an individual *has* withdrawn funds from the account and gotten the benefit of the savings.)

  The capital loss would be computed by taking the account balance at the time of the original calculation, subtracting the withdrawals made since then, and comparing the result to the current account balance. If the current balance is more than 20 percent below the original balance minus withdrawals, a new calculation of assumed income would be made at recertification, upon request, based on current age, life expectancy, and savings.

- If there has been a break in SSI benefit receipt of at least three months (or, alternatively, at least six months), an applicant would be permitted to request a new calculation of the assumed income stream, based on current age, life expectancy, and retirement savings. If there has been a longer break in benefit receipt, such as one year or more, a new calculation of assumed income would be done automatically.

  An optional recalculation after a relatively short break in benefit receipt would protect individuals who needed to draw heavily upon their savings to cover a major expense. Consider an individual who has been drawing steadily upon his or her retirement savings

at the assumed income rate to compensate for receiving reduced SSI benefits but then has a major uncovered medical expense or has to make a significant home repair. This individual may have consumed a sizeable share of his or her retirement savings and thus might not be able to continue drawing upon the remaining savings at the previously assumed rate. Such an individual could forgo SSI benefits and live exclusively off retirement savings for a number of months, then reapply for SSI and request a recalculation of the assumed income stream.

After a longer break in benefit receipt, an automatic recalculation seems more appropriate than an optional one. SSA would be completing a new eligibility determination anyway in such circumstances, and under this approach, the beneficiary would not need to know that he or she may request a recalculation.

1 By contrast, among all individuals aged 16 to 59, about 30 percent held a 401(k) account or an IRA. Retirement Security Project analysis of 2001 data from the Survey of Income and Program Participation.

2 Peter Orszag and Robert Greenstein, "Toward Progressive Pensions: A Summary of the U.S. Pension System and Proposals for Reform," prepared for Washington University's "Inclusion in Asset Building: Research and Policy Symposium," September 2000, pp. 6 and 10.

3 See Adam Carasso and Signe-Mary McKernan, "The Balance Sheets of Low-Income Households: What We Know about Their Assets and Liabilities," The Urban Institute, The Center for Social Development, and The New America Foundation, November, 2007, Appendix Exhibit 1, http://www.urban.org/UploadedPDF/ 411594_low-income_balance_sheets.pdf.

4 See Budget of the United States Government for Fiscal Year 2008, Analytical Perspectives, Table 19-1, http://www.whitehouse.gov/omb/budget/fy2008/pdf/spec.pdf.

5 See Leonard E. Burman *et al.*, "Distributional Effects of Defined Contribution Plans and Individual Retirement Accounts," Urban Institute-Brookings Institution Tax Policy Center, Discussion Paper No. 16 (August 2004), http://www.taxpolicycenter.org/UploadedPDF/311029_TPC_DP16.pdf.

6 Many financial planners suggest that a comfortable standard of living during retirement requires about 70 percent of pre-retirement income. This suggested "replacement rate" is less than 100 percent for various reasons, including that retirees have no work-related expenses and often have time to shop for lower-priced goods and services. In the example here, "consistently low earnings" is defined as earnings over the course of a career that average about 45 percent of the Social Security average wage index; this is the illustrative measure of low earnings used by the Social Security actuaries. In 2006, this would have meant average earnings of approximately $17,427. See "The 2007 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors' Insurance and Disability Insurance Trust Funds," May 2007, Tables V.C1 and VI.F10, http://www.ssa.gov/OACT/TR/TR07/tr07.pdf.

7 For a more detailed discussion of this body of research, see Gordon McDonald, Peter R. Orszag, and Gina Russell, "The Effect of Asset Tests on Saving," The Retirement Security Project, June 2005, http://www.cbpp.org/6-21-05socsec-meth.pdf. For a recent contribution to the research, see Signe-Mary McKernan, Caroline Ratcliffe, and Yunju Nam, "The Effects of Welfare and IDA Program Rules on the Asset Holdings of Low-Income Families," The Urban Institute, Center for Social Development, and The New America Foundation, September 2007, http://www.urban.org/UploadedPDF/411558_ida_program.pdf.

8 Brigitte Madrian and Dennis Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Saving Behavior," *Quarterly Journal of Economics* 116, No. 4 (November 2001).

9 Esther Duflo *et al.*, "Saving Incentives for Low-Income and Middle-Income Families: Evidence from a Field Experiment with H&R Block," *Quarterly Journal of Economics* 121, No. 4 (2006).

10 The Pension Protection Act of 2006 was designed to encourage 401(k) plan sponsors to adopt automatic features, including automatic enrollment. For a more detailed discussion of the legislation and automatic 401(k) plan features, see William G. Gale, J. Mark Iwry, and Spencer Walters, "Retirement Savings for Middle- and Lower-Income Households: The Pension Protection Act of 2006 and the Unfinished Agenda," The Retirement Security Project, January 2007, http://www.retirementsecurityproject.org/pubs/File/RSP_PPAAuto401kvF4.pdf.

11 The Retirement Savings for Working Americans Act, introduced June 14, 2007 and sponsored by Representatives Emanuel, Ramstad, and Welch, would make several changes to the Saver's Credit, one of which would effectively make the credit available to individuals who do not earn enough to owe income taxes.

12 Social Security Administration. "SSI Annual Statistical Report, 2006," Table 7, http://www.socialsecurity.gov/policy/docs/statcomps/ssi_asr/2006/sect02.html#table7.

13 SSI distinguishes between an "asset" and a "resource." Resources are assets that are considered accessible to the individual and thus count against the resource limit (unless they are explicitly excluded); assets that are *not* resources are not counted against the limit. This paper uses the term "asset" to refer to both assets and resources; it uses the term "asset limit" to refer to what is known as the "resource limit" in SSI, because these terms are more commonly understood outside the program.

14 This principle, the ways in which it conflicts with the objectives of defined-contribution retirement plans, and the shift in retirement plans from defined-benefit plans to defined-contribution plans are discussed in the Social Security Administration's, "Defined Contribution Pension Plans and the Supplemental Security Income Program," Policy Brief No. 2006-01, March 2006, http://www.ssa.gov/policy/docs/policybriefs/pb2006-01.pdf.

15 See SSA POMS SI §§ 01120.210 and 00510.001.

16 As explained in this paper, SSI disregards the first $20 a month of an individual's unearned income (annuity payments are considered unearned income) and then reduces SSI benefits on a dollar-for-dollar basis for all unearned income after that.

17 This issue is discussed in more detail on page 7.

18 See enrollment data reported by each state through the Medicaid Statistical Information System, available at http://www.cms.hhs.gov/MSIS/.

19 For the most recent compilation of state Medicaid policies with regard to retirement savings held by families with children, see Zoë Neuberger, Robert Greenstein, and Eileen Sweeney, "Protecting Low-Income Families' Retirement Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving," The Retirement Security Project, June 2005, Appendix A, http://www.cbpp.org/6-21-05socsec.pdf.

20 The asset limits were set at these levels in 2006 and will be adjusted for inflation each year.

21 The treatment of retirement accounts in the Medicare prescription drug subsidy program is discussed in more detail beginning on page 18.

22 See "2006 SSI Annual Report," Table V.E1, http://www.socialsecurity.gov/OACT/SSIR/SSI06/tables.html.

23 In contrast, annuities that are paid from a defined-benefit plan are much more likely to be a wise investment, as the attendant costs and fees are likely to be lower.

24 See Cassio M. Turra and Olivia S. Mitchell, "The Impact of Health Status and Out-of-Pocket Medical Expenditures on Annuity Valuation," University of Michigan Retirement Research Center, Research Brief 2005-079, January 2005, http://www.mrrc.isr.umich.edu/publications/briefs/pdf/rb079.pdf.

25 This reduction has been estimated as 3 to 5 percent of the value of the retirement account. See Jeffrey Brown, Olivia Mitchell, and James Poterba, "Mortality Risk, Inflation Risk, and Annuity Products," National Bureau of Economic Research, Working Paper 7812, July 2000, http://www.nber.org/papers/w7812.pdf?new_window=1.

26 This reduction has been estimated as roughly an additional 10 percent of the value of the retirement account. *Ibid*.

27 See Alicia H. Munnell *et al.*, "Households 'At Risk': A Closer Look at the Bottom Third," The Aspen Institute, October 2007, Figure 7, http://escholarship.bc.edu/cgi/viewcontent.cgi?article=1139&context=retirement_papers.

28 *Ibid*., pages 4-6.

29 The 18 states are Arizona, California, Connecticut,

Indiana, Iowa, Kansas, Louisiana, Michigan, Minnesota, Missouri, New Jersey, New Mexico, Oregon, Utah, Vermont, Washington, West Virginia, and Wisconsin. (In Vermont, only retirement accounts based on earnings after January 1, 2000, are excluded. In West Virginia, only retirement accounts initiated after enrollment in the buy-in program are excluded. Washington has no asset test in its buy-in program.) See Allen Jensen, "State Medicaid Buy-In Program Design Features," Work Incentives Project, George Washington University, September 4, 2003, draft, http://www.uiowa.edu/~lhpdc/work/III_Framework/2003_MedBuyInProgramDesc.doc.

30 If an individual elects periodic payments, 33 percent of such payments should be disregarded as income, as described in the section beginning on page 15. This treatment would allow for consistent treatment of payments from retirement accounts for all SSI recipients.

31 In fact, in the median (or typical) state, the Medicaid income limit stands at just 63 percent of the poverty line. For more detail on state Medicaid income eligibility rules, see Donna Cohen Ross, Aleya Horn, and Caryn Marks, "Health Coverage for Children and Families in Medicaid and SCHIP: State Efforts Face New Hurdles — A 50 State Update on Eligibility Rules, Enrollment and Renewal Procedures, and Cost-Sharing Practices in Medicaid and SCHIP in 2008," Center on Budget and Policy Priorities and Kaiser Commission on Medicaid and the Uninsured, January 2008, http://www.kff.org/medicaid/upload/7740.pdf.

32 Among families with incomes below *200 percent* of the poverty line, fewer than 10 percent of adults in this age bracket have any savings in a 401(k) plan or an IRA. Retirement Security Project analysis of 2001 data from the Survey of Income and Program Participation.

33 See Vernon Smith *et al.*, "Eliminating the Medicaid Asset Test for Families: A Review of State Experiences," Kaiser Commission on Medicaid and the Uninsured, April 2001, http://www.kff.org/medicaid/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=13750.

34 For more information on SSI eligibility criteria and how SSI benefits alleviate poverty for people who are elderly or have disabilities, see Eileen P. Sweeney and Shawn Fremstad, "Supplemental Security Income: Supporting People with Disabilities and the Elderly Poor," Center on Budget and Policy Priorities, revised August 17, 2005, http://www.cbpp.org/7-19-05imm.htm.

35 AARP Public Policy Institute, Data Digest, "Out-of-Pocket Spending on Health Care by Medicare Beneficiaries Age 65 and Older in 2003," http://assets.aarp.org/rgcenter/health/dd101_spending.pdf. The Medicare prescription drug coverage enacted since then may have reduced this figure somewhat, but the difference (if any) is likely to be modest because these seniors already had prescription drug coverage through *Medicaid*. Moreover, under the Medicare prescription drug coverage, poor seniors sometimes have to pay out-of-pocket for specific medications prescribed by their doctor but not covered by their plan; they also pay small co-payments for covered drugs.

36 A penalty is paid if the funds are used for other purposes. See SSA POMS SI § 01130.410. The value of a burial space is also excluded. See SSA POMS SI § 01130.400.

37 See http://www.nfda.org/nfdafactsheets.php. This figure includes the cost of a casket, which may be excluded as a burial space under SSI rules.

38 See Marilyn Moon (The Urban Institute) and Robert Friedland and Lee Shirley (Georgetown University's Center on Aging Society), "Medicare Beneficiaries and Their Assets: Implications for Low-Income Programs," The Henry J. Kaiser Family Foundation, June 2002, Exhibit 5, http://www.urban.org/UploadedPDF/1000249_MedicareBeneficiaries.pdf.

39 SSI uses a 1:1.5 ratio for individuals and couples in its benefit levels and income and asset limits; exclusion ceilings of $10,000 for an individual and $15,000 for a couple would be consistent with that approach. Also, SSI generally uses a single dollar level for income and asset exclusions, and a $15,000 exclusion ceiling for all households would be consistent with that approach.

40 Retirement Security Project analysis of 2001 data from the Survey of Income and Program Participation.

41 A senior reaching age 70½ who withdraws less in a year than the minimum withdrawal amount specified in the tax code must pay taxes as though the minimum amount had been withdrawn, as well as a tax penalty. (The penalty equals half of the difference between the actual withdrawal and the minimum required withdrawal.) These tax provisions have the practical effect of requiring seniors to withdraw the minimum amount specified. (There is an exception for a senior who reaches age 70½ and is still working for the employer who maintains the worker's 401(k) account; such an individual is not required to make withdrawals until he or she retires. Such individuals generally would have income too high to qualify for SSI, anyway.)

42 In accordance with other recommendations made in this paper, we recommend that 33 percent of withdrawals and periodic payments from retirement accounts be disregarded as income. As discussed in the next section of the paper, this treatment would allow for consistent treatment of payments from retirement accounts and annuities.

43 Social Security Administration, "SSI Annual Statistical Report, 2006," Table 7, http://www.socialsecurity.gov/policy/docs/statcomps/ssi_asr/2006/sect02.html#table7.

44 Note that the assumed income would be treated as unearned income and would reduce SSI benefits on a dollar-for-dollar basis. The assumed income stream would not be given the more generous treatment proposed for withdrawals from smaller retirement accounts — those below the exclusion ceiling — so that SSI benefits remain targeted on those with more modest retirement savings.

45 Actual withdrawals of retirement savings by individuals who have outlived their expected lifespan would be subject to the 33 percent disregard of retirement savings described in the previous section.

46 The Thrift Savings Plan annuity calculator may be found at http://calc.tsp.gov/annuityCalculators/annuity.cfm. The amount in this example was calculated in November 2007 based on an annuity interest rate index of 5.25 percent.

47 AARP Public Policy Institute, Data Digest, "Out-of-Pocket Spending on Health Care by Medicare Beneficiaries Age 65 and Older in 2003," Figure 1, http://assets.aarp.org/rgcenter/health/dd101_spending.pdf.

48 Five of these states — Connecticut, Indiana, Missouri, New Hampshire, and Ohio — have Medicaid asset limits that are lower than the SSI asset limits of $2,000 for an individual and $3,000 for a couple.

49 This section is an updated version of material that was originally published in Zoë Neuberger, Robert Greenstein, and Eileen Sweeney, "Protecting Low-Income Families' Retirement Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving," The Retirement Security Project, June 2005, http://www.cbpp.org/6-21-05socsec.pdf, pp. 22-23.

50 The asset limits were set at these levels in 2006 and will be adjusted for inflation each year.

51 See 20 C.F.R. 418.3405.

52 See Thomas Rice and Katherine A. Desmond, *Low-Income Subsidies for the Medicare Prescription Drug Benefit: The Impact of the Asset Test*, The Henry J. Kaiser Family Foundation, April 2005, http://www.kff.org/medicare/7304.cfm.

53 I*bid*., p. 21.

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Mission Statement

The Retirement Security Project is dedicated to promoting common sense solutions to improve the retirement income prospects of millions of American workers.

The goal of The Retirement Security Project is to work on a nonpartisan basis to make it easier and increase incentives for middle- and lower-income Americans to save for a financially secure retirement.

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