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BANKING ON RETIREMENT SECURITY: A GUARANTEED RATE OF RETURN

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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BANKING ON RETIREMENT SECURITY: A GUARANTEED RATE OF RETURN

Thursday, June 23, 2005

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Biggert, Tiberi, Feeney, Hensarling, Pearce, Neugebauer, Pryce, McHenry, Sanders, Maloney, Moore of Kansas, Frank, Crowley, Baca, Green, Moore of Wisconsin and Clay.

Also present: Representative Sessions.

Chairman BACHUS. Good morning. The Subcommittee on Financial Institutions and Consumer Credit will come to order. Today's hearing is on banking on retirement security, a guaranteed rate of return. And at this time I am going to recognize Mr. Feeney, a Member from Florida, for an opening statement.

Mr. FEENEY. Thank you very much, Mr. Chairman, and thank you for having these hearings that will provide important discussions about some options for long-term retirement savings for Americans.

Mr. Chairman, we have got a number of distinguished guests here today. I have read all of the testimony and appreciate all of our witnesses. We have got a number of Floridians here today. I will be introducing one of those when he speaks in a moment or two.

I did want to recognize a longtime friend going back 12 years now, Mike Brown, from the American Community Bankers. It has been great to work with him in my capacity in Tallahassee. It is great to see him visiting Washington. And when I get a chance, I will be introducing Mr. Roberts for his testimony.

Mr. Chairman, one of the goals of the House Financial Services Committee is to bring to light the importance of retirement savings. This has become more important than ever because we have all heard about the situation that Social Security is in and the long-term challenges or crises, depending on the way you prefer to describe it.

Today Social Security is collecting more money than it needs to pay benefits, but by the year 2017 or so, it will start running a deficit, collecting less in taxes than it pays in benefits, and that deficit

will get worse every year. Already 78 percent of families pay more in payroll taxes than in income taxes. There are fewer workers per retiree today than ever before, and that ratio gets worse as we go along. When Social Security started, we had some 42 workers paying into the system for every beneficiary. By the year 2030, the ratio will be two people paying for the benefits of every retiree.

Americans need to know they have no legal right to any part of the money they have paid into Social Security. In the 1960 Supreme Court case *Fleming* v. *Nestor*, the Supreme Court decided that Americans have absolutely no ownership rights to the money that they have paid into Social Security. The Government has absolutely no contractual obligation to pay any set level of Social Security benefits.

Yesterday, certain members of the Republican Conference introduced a proposal which would move us toward some real reform by allowing Social Security surplus, instead of being spent every year by Congress, to be put into personal retirement accounts. I think that both as a practical matter and politically, hopefully we will lose some of the obstructionism and allow the Social Security surplus to be used for what it was always intended to be used for; that is, individual retirement savings for future seniors.

Personal accounts would provide ownership of one's retirement savings. Some argue that personal accounts are very risky. They point to things like Enron, which there is no proposal by any Member of Congress to suggest that people ought to be able to put all of their retirement savings in any stock, let alone their own company's stock.

Having said that, completely avoiding all risk is difficult and actually has the guaranteed problem of underperforming inflation. So one thing we know is that if you avoid all investment risk, you will be worse off as inflation eats into your long-term retirement savings. Most investors are aware that you must take some risk to achieve higher returns, and that, over the long term, riskier investments have provided much higher rates of return.

But individual investors also need to know that there are some very conservative choices that they can make as part of any retirement portfolio. As has been mentioned, some 15 Members have joined me in proposing, in a letter to Chairman Thomas, that we have what has been referred to as a community bank option that would be included in any personal savings account, and that is what we are here to discuss today.

Mr. Chairman, I again thank you. I look forward to hearing from our witnesses not just in terms of what opportunities that they provide to their current investors, but how maybe they can solve the long-term retirement challenges that face Americans.

Chairman BACHUS. Thank you, Mr. Feeney.

Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman. And I am glad to be with our friends in the independent bankers, community bankers, and credit union communities, who do a great deal. And let me say at the outset there was a statement in the credit union testimony which had noted that CUNA has taken no position on whether or not there should be private accounts, but that if there are, there

would be equity among financial institutions. And I very much agree with that.

Let me give you an analogy. I think this latest proposal that we should spend countless tens of billions of dollars to send people to Mars is the height of foolishness. But if we were to send people to Mars, I would certainly want no discrimination against those who could be sent. So I have a similar approach here. I don't think much of the idea, but I certainly agree that if we were to do this, I would be for full equity for the smaller institutions, and I will—in the questioning, I think this does get to a point where I have agreed which is that we should be raising deposit insurance. I think we would agree that doing this without raising the deposit insurance limit would be a problem there, and this shows what I think is the inequity of current law, which reinforces the economic problems that smaller banks face by the inadequate level, it seems to me, of deposit insurance.

But I then do want to talk—the gentleman from Florida mentioned this newest proposal, and I am struck. There was a recent proposal that said individuals should now be given ownership in their share of the surplus, and they can put that in a private account.

First, up until recently, I had understood the President to be pooh-poohing the notion that there was a real surplus. I mean, the President had said when he went to, I think, West Virginia, well, this is just paper in here. So first—and here is what has happened. First people really denigrated the notion that there was a tangible Social Security surplus as a way to argue that we need to reduce benefits. In fact, if Social Security, as we know, is credited with its current surplus, and with the surplus that will build up until 2018, and with the interest that should be accruing on that, then Social Security is fully funded until sometime in the 2040's.

We have been told by people, well, wait a minute, that the surplus isn't really there. It has been spent, the President said, in a variety of ways. So now what we see is a kind of a reversal of position. We have apparently gone on the part of some from a denial that there was this surplus that we could use to an assertion that there is a surplus. But it is apparently now not to be used to pay the benefits, and that is what puzzles me. If we fully credit the surplus that is there and that will grow for 13 years, and the interest on it, we do not have a problem fully funding existing Social Security benefits until sometime in 2041. That doesn't mean we shouldn't consider what we should be doing. It doesn't seem to me to be a short-term crisis.

But, in fact, what we are now told is, oh, no, there is this surplus, but instead of using it to fully fund the benefits, let us put it into private accounts, and then that coerces you into reducing the benefits.

So I have a great deal of difficulty understanding how that pivot came about, and as I said, if there is a surplus, then we should use it for funding the benefits.

Now, it is true that there is, according to the courts, no legal ownership in that surplus, but it is a matter of public policy. We can, in fact, take action to make sure that that surplus is used to fully fund benefits. And again, I want to stress what we have here

is a kind of a double game going on, on the one hand a denigration of the reality of surplus, to argue, I think inaccurately, that there is a crisis and that we don't have enough money to pay the benefits. But having made that argument, people then turn to say, yeah, there is a surplus, but we are not going to use it, and this is the issue. Instead of using the surplus as it was intended to be used, to pay the legally mandated level of benefits, people say, no, let us take that and put it into private accounts, thereby creating precisely the problem that would exist if did you that with fully funding the benefits.

So it just does seem to me—people have said, well, what is your proposal for Social Security? And let me just say, this recognition that there is a surplus is part of it. The problem, of course, is that this surplus has been used to pay for tax cuts, it has been used to pay for the war in Iraq, and it has been used to pay for a lot of other things. And this reinforces to me what is the short-term answer, even the intermediate-term answer to Social Security to the President and to the Majority. This surplus in Social Security that has been used for tax cuts, that has been used for the war in Iraq, that has been used for other programs, put the money back. If we put the money back, Social Security benefits can be fully paid until sometime in 2041 or 2042. That gives us years to decide what other adjustments we should make, and that would be the answer.

But I do want to close by agreeing that if we are, in fact, going to go private accounts, which I think would be a very grave error, that I certainly do not want to see discrimination against small financial institutions. I have been worried, let me just say in closing. When I came on this committee, it was called the Banking Committee. In Massachusetts, in our legislature, the equivalent committee is called the committee on banks and banking. And somebody said, do you ever think they will change the name back here like to the committee on banks? And I said, well, I am afraid by the time we get to that, it will be called the committee on "the" bank, because there may only be one in America. Maybe there will be one in Germany, maybe there will be one in Japan. I don't think anybody wants to see that.

I think the smaller institutions, the credit unions, and the community banks play a very important function. They are often preferred by consumers, not just individual consumers, but smaller business people, and so I certainly would not want to see anything done that would further the already unfortunate set of disadvantages they face.

Chairman BACHUS. I thank Mr. Frank and assure him that if we make a list for folks going to Mars, that we will actually give preference to the Democratic side.

Mr. FRANK. I thank you. But, Mr. Chairman, let me just say, only if we have reinstated proxy voting by that time.

Chairman BACHUS. Without objection, the gentleman from Texas, Mr. Sessions, will be permitted to participate in today's hearing. And I had already—Mr. Franks graciously consented. So, Mr. Sessions, I would like to recognize you. And I would like to also recognize the work that you and Congressman Feeney did in requesting this hearing and also in introducing H.R. 209 expressing the sense of the House of Representatives that any plan to reform Social Se-

curity and, I guess, include personal accounts would include the Social Security option. So at this time I am going to recognize you for an opening statement.

Mr. SESSIONS. Thank you, Mr. Chairman. I have missed my years of—when I originally was here some 10 years ago, the service over here was a lot of fun, and I see that the humor has not stopped. And I appreciate and respect that, as well as the way it was accepted by the gentleman from Massachusetts in the spirit of fun.

Mr. Chairman, I appreciate the opportunity to address the House Committee on Financial Services on the important issue of retirement security. I would also like to take this opportunity to thank you for your leadership vision that you have demonstrated on this issue for the American people.

As Congress examines its options for providing long-term solvency of Social Security, I believe that there is one essential element that must be a part of comprehensive reform, and it is what we call the banking option. The banking option would allow workers to put part of their Social Security benefits in a product similar to a federally insured certificate of deposit, a CD, and to receive what is known as a guaranteed rate of return.

I must say that much of what this hearing is about today, about safety and soundness that exists in the marketplace today, avenues by which people who need to make sure that they have regular rate of return, as well as the security involved, is important.

I would also note to this committee, to this subcommittee, that today railroad, coal, fire, police, and teachers include those other workers across the United States that have their own private accounts that include many of these same options.

Perhaps more importantly, the banking option would give risk-averse workers the opportunity to own a safe personal account that would guarantee a set rate of return greater than what is offered by Social Security, and one that is just as safe as any money in the bank.

While studying measures that can serve as components of the comprehensive Social Security reform, I believe that Congress should pay particular attention to measures that have already been created and implemented in what we call field laboratories at the local level throughout America. Fortunately, one such laboratory for studying the real-world effects of the banking option already exists in Galveston County, Texas. It really is the birthplace of the banking model.

Over 20 years ago, county employees in Galveston voted overwhelmingly to create an alternative to the Social Security system that gives retirees control of their own money at virtually no risk to the beneficiary. The results have been extraordinary, and Galveston County employees have average annual returns of 6.5 percent. Even today with our historically low interest rates, workers in Galveston still receive returns of 3.75 percent on their investment, which is far better than the Social Security rate of 1.8 to 2 percent.

Giving workers this expanded choice is an important option for reforming Social Security because it provides workers with the same or better benefits as our Social Security system does.

The other important aspect of this plan is that as workers get closer to retirement age and more vulnerable to potential swings in investments rates of return, the banking option allows them to move their assets into a conservative investment vehicle that protects their principal from a potential market downturn.

There is nothing new about giving Americans the ability to put their money into an account with guaranteed returns. There is no more risk than what is already inherent in the current Social Security system, and that is why I have introduced, along with my dear friend Congressman Tom Feeney and Congressman Paul Gillmor, H.Con.Res. 209, which the Chairman spoke about. This legislation simply expresses the sense of Congress that any Social Security reform legislation should include this banking option. And I believe that, listening to our witnesses here today, we can begin to further explore how this option can be implemented and successful for so many Americans.

Mr. Chairman, thank you for the opportunity to be with you today, and I yield back my time.

Chairman BACHUS. Thank you, Mr. Sessions.

I now recognize the Ranking Member, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman. I look forward to hearing from our panelists.

Let me just be very brief. There is a saying in Vermont, and, I suspect, all over the country, that if it ain't broke, don't fix it. The truth of the matter is that despite all that we hear from the White House, Social Security is not broke in either a literal or a figurative sense.

Depending on the study that you look at, Social Security could pay out every benefit owed to every eligible American from between 36 and 47 years. That ain't broke. And that is under conservative projections of economic growth. And with modest reforms, modest reforms, not overhauling the whole system, not destroying the whole system, Social Security will be there for our kids and our great-grandchildren.

I think it would be very foolish to dismantle what might likely be the most successful antipoverty program in the history of the world, one that has helped not only retirees, but has also helped millions of disabled people, millions of women and orphans who have lost breadwinners live with dignity.

So I think we have a good system which needs modest changes, and what I object most to in this debate, it is not people who have different ideas than me. I think it is good to debate the ideas. I object to the fear-mongering that is coming from the White House, telling young people that Social Security is not going to be there when, in fact, that is simply not the case.

Mr. Chairman let us take a look at the Galveston plan. First, Mr. Chairman, let us ask the question does the Galveston plan earn a higher rate of return than Social Security? The answer is no, it does not. According to the Wharton School of Business, in 14 out of 16 years since the creation of the Galveston plan, Social Security actually earned the same or higher rates of return than Galveston's.

Second, will privatizing Social Security lead to higher taxes? Yes, if the Galveston plan is our model. Payroll taxes for the Galveston

plan total 13.9 percent compared to 12.4 percent under Social Security.

Third, what would happen to the 45 million current recipients of Social Security if we adopted the Galveston plan? That is a question we must answer, Mr. Chairman, because you see the 5,000 municipal employees covered by the Galveston plan, unlike the Social Security System, do not make any contributions to support current retirees. That means that if we adopted a Galveston-like plan, no one would be paying the $500 billion annual cost of benefits for the Nation's 45 million current Social Security beneficiaries. That would be a disaster.

Fourth, do people receive higher benefits under the Galveston plan than under Social Security? No. According to a study done by the Social Security Administration, the Galveston's plan "offers a lower initial ongoing benefit than Social Security for single workers with low earnings and for married workers at the low, middle and high earning level. After 20 years, all of Galveston's benefits are lower relative to Social Security's."

And according to the GAO, "Low wage earners retiring today generally would have qualified for higher retirement incomes had they been under Social Security. Many median wage earners, while initially receiving higher benefits under the Galveston plan, would have eventually received larger benefits under Social Security because Social Security's benefits are indexed for inflation."

Mr. Chairman, if you are still not convinced that replacing Social Security with the Galveston plan would be a disaster, listen to Galveston's own municipal employees. Here is what Evelyn Robinson, who was the Galveston district court clerk for 13 years before retirement in 2004, had to say about this plan: "I didn't come out ahead. My chief deputy did not come out ahead. My bookkeeper did not come out ahead. I personally don't know anyone who has retired who came out ahead."

So, Mr. Chairman, I look forward to hearing the testimony, and thank you for calling this hearing.

Chairman BACHUS. Thank you, Mr. Sanders.

Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman, and thank you for holding this hearing. And I especially want to thank and congratulate my colleagues, Mr. Sessions and Mr. Feeney, for their leadership on this issue and helping us explore yet another option of what we can do to save Social Security for future generations.

I would respectfully disagree with my colleague from Vermont. I recently became a father 3 years ago, so I have a 3-year-old daughter and a 21-month-old son, and if we don't do something about Social Security now, they are going to receive a negative rate of return. I do not believe that is fair. That is inherently unfair to future generations, and I think something needs to be done.

As my colleague from Florida pointed out, you can't escape demographics. We have increased number of retirees who are living longer. We have fewer workers supporting them. And something is going to have to happen in our system. And if we decide to do absolutely nothing, I can tell you what is going to happen. We all know what is written in the current law, and that is in 2042—and maybe I am not going to be here, but I expect my children will be. And

in 2042 there is going to be a massive benefit cut of almost one-third. And I don't know how people feel in other parts of the Nation, but when I talk to people in my congressional district back in Texas, I have yet to find anybody who wants to embrace a benefit cut in Social Security of almost one-third, nor do they think that is fair for future generations.

Additionally, if we don't do that, we have the option of raising taxes. We can raise payroll taxes 42 percent. I have yet to find anybody again in my congressional district who wants to see payroll taxes raised 42 percent.

Well, indeed there is another option, and that is trying to help Social Security become an asset-based system with real assets that workers own, can manage, that the government can still guarantee, not unlike what our Federal deposit insurance is all about. And that is the option that we need to explore as a Nation, and so that is why I have embraced personal accounts.

Now, we are going to hear a lot of talk today about how risky it is to allow individual Americans the freedom to manage their own personal accounts. Well, I would like to point out how risky the current system is. Congress, over the history of Social Security, has raided that system to surplus 57 different times. And as the Ranking Minority Member has pointed out, they have spent it on all kinds of things that are not related to retirement security. To me that sounds pretty risky.

There have been at least 20 tax increases, and every time taxes increase, your rate of return goes down. And that is why my grandparents, who were born in roughly 1900, when they were alive received about a 12 percent rate of return on their Social Security, and my children will receive a negative rate of return. Part of it has to do with the tax increases.

There have been benefit cuts. I believe, Mr. Chairman, that there is plenty of risk of leaving our money in the hands of Washington, and so that is why we need to explore personal accounts and particularly the guaranteed rate of return that is federally insured that could be offered by our community banks and our credit unions.

Mr. SANDERS. Will the gentleman yield briefly for just 1 second, just for a minute. Just for the record. I respect his point of view. I would categorically disagree with many of the assertions made by my friend from Texas, not the least of which the suggestion that the alternative is privatizing or doing nothing. There is lot that we can do without destroying Social Security. It is not doing nothing, it is making modest changes to keep a very successful program going. Thank you.

Mr. HENSARLING. Well, we look forward to the Democrat plan then, Mr. Sanders.

Chairman BACHUS. Thank you, Mr. Hensarling.

Mrs. Maloney.

Mr. FRANK. If the gentlewoman would yield. We do have a plan: Put the money back. Put the money back in Social Security that it was credited with, and then we have until 2041 to work on it. So if Social Security gets the money it is legally entitled to, that surplus that is being discussed, that is our plan is to put the money back.

Chairman BACHUS. Okay. I think all time has expired on that. And when this—yes, we will recognize Mrs. Maloney. Now, are there members on either side—Mr. Green, do you wish to make an opening statement?

Mr. GREEN. If the Chair will deem it appropriate, I will waive it.

Chairman BACHUS. If you want to, we will have somebody on this side. Otherwise when Ms. Maloney is through—well, actually we do. Mr. McHenry and Mr. Green after that.

Mrs. MALONEY. Thank you very much, Chairman Bachus. And I welcome my friends from the community bankers and the credit unions, and Dr. Furman from New York University, which is in the district that I represent, and is an economist who has written extensively and published on this topic.

But I must say I am puzzled today by the timing of this hearing. By all accounts I truly believe this privatization movement is not going to go anywhere because the more the American people learn about it, the less they like it. And once the American people understand four simple points about the President's proposal, then they understand that it makes no difference whether the private accounts are in a bank or with a broker. It is absolutely a losing proposition for them. And these four points I would like to briefly explain.

Number one, the plan is not voluntary and will result in large benefit cuts because the President's plan will change the calculation of benefits from wage indexing to price indexing, and that will have a result of cutting guaranteed benefits possibly by more than 25 percent, even for the middle-class workers, even for those who choose not to invest in private accounts. And nothing about the bank option that we are considering today changes that fact. And the President has endorsed a substantial benefit cut for the middle class called progressive indexing because the benefit cuts are less for lower-income workers than for middle-class and higher-income workers.

Under this sliding-scale benefit formula, benefits would fall behind the standard of living for almost all workers. For example, once fully phased in, a worker who has earned $37,000 per year would have a 28 percent benefit cut. A worker who has earned $58,000 a year would have a 42 percent benefit cut. A worker who has earned $90,000 a year would have a 49 percent benefit cut. Benefits would be cut for all workers whose annual earnings are more than $20,000 a year.

Number two, in addition to being a substantial benefit cut for almost all workers, including the middle class, the Administration's proposal would, over time, lead to a flat benefit amount, the so-called "clawback" provision. Some call it a tax; some call it a clawback. Whatever you want to call it. If you take money away from someone, I call it a tax. And at retirement, retirees who choose a private account would have to pay back the amount that they would have had, both principal and interest, had the money stayed in a trust fund. And under the bank option, by all predictions, the amount they have to pay back will be possibly up to 100 percent or more of the amount in their private account. They could possibly lose money.

Number three, the vast majority of retirees would not be able to pass funds from their private accounts on to their children. An essential feature of the President's plan which is not affected by the bank option is that, at retirement you will be required to turn over the amount in your private account that is left after the privatization account in an insurance company to purchase an annuity which will give you a monthly income. Reliable, nonpartisan estimates indicate that this would leave little or nothing to be passed on to someone's children. So only those who died before they retired and had money left after the clawback would have assets to pass on.

And number four, the money is not yours to invest as you see fit. In response to criticisms that the main beneficiaries of the private accounts would be money managers, the Administration made clear that the investment would be limited to a few large funds. Most recently the Administration has indicated that to prevent very risky investing that could dump unlucky retirees in the taxpayers' lap, it would require retirees to invest in life cycle accounts, an option in which the accountholder has no control at all over the funds in their account. And these problems of benefiting the money managers and moral hazard are equally pressing with the bank option and compel the same result. And these four points have persuaded many Americans that privatization is a bad idea, whether the private accounts are in the hands of a broker or a bank.

Thank you, and I look forward to your testimony.

Chairman BACHUS. Thank you.

Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman. I will make this brief.

We are the Financial Services Committee. We have oversight over the markets. We have oversight over banks and insurance. We have oversight over Wall Street. This is a wonderful opportunity to discuss the investment opportunities that Americans can have when we have personal retirement accounts, and we are trying to get the full range of options on the table. Those on the other side of the aisle, I think, are arguing that we shouldn't do anything, that the marketplace is bad and dangerous and a horrible place for Americans to even look to. So their arguments, I think, are that we shouldn't even have this hearing today because markets are innately dangerous and bad.

And I think our perspective on this side of the aisle, and what Congressman Feeney—his proposal is that we should actually have a full range of financial opportunities and options for all Americans for their personal retirement accounts, if and when we do proceed to personal retirement accounts; that markets could actually produce benefits for every American of all walks of life—rich, poor, black, white—all walks of life. And so I think it is a healthy thing that we discuss some options in that regard.

And I think we need to look at experiences of those that have had personal retirement accounts, much like Galveston, Texas, and under all press reports that I have read about Galveston, Texas, that all beneficiaries receive twice as much as they would, with their personal retirement accounts, twice as much as they would have under the current Social Security plan.

So I think we need to look at all options. I think a wonderful federally insured manner of investing is with actually FDIC-insured banks. I think it is a wonderful opportunity for us to discuss this, and I think it is very appropriate that this is the week we are doing it, after the Ways and Means Committee leaders put forward their proposal to actually have personal retirement accounts that use the Social Security surplus that we have for the next 12 years, the Social Security surplus to actually start funding these personal retirement accounts and actually inject this capital into the marketplace, rather than having Washington, D.C., politicians spend it on pork barrel projects. So I think it is a very positive thing.

I am looking forward to the testimony that the gentlemen here have to present to us, and thank you, Mr. Chairman, for hosting this meeting.

Chairman BACHUS. I thank you.

Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman, and thank you, Mr. Ranking Member. I, too, look forward to hearing from the outstanding panelists that we have assembled today.

Mr. Chairman and friends, when I left my district to come to Congress, one of the promises that I made was that I would do all that I could as a Member of Congress to protect Social Security. And my constituents made it conspicuously clear to me that for many of them, Social Security is not supplemental income; for many of them it is the only income they have, they have absolutely nothing but Social Security. And for too many of them, that is not enough. They don't want me to use my one precious vote to gamble with Social Security.

Why are we discussing at great length Social Security as opposed to Medicare? Medicare as projected will face its depletion around 2020, whereas Social Security is looking at 2041, and with some tweaking we can go a lot longer. My suspicion is this, friends: There is a surplus in Social Security. We are talking about trillions of dollars in Social Security that, when invested, will benefit somebody, bankers, credit unions, stock market, stock brokers. We are talking about Social Security because we have got a surplus. The house is on fire; that is Medicaid. We need to adjust the flame on the stove; that is Social Security.

Rather than fight the house fire, we are finding ourselves trying adjust the flame on the stove. I contend that is because there is money to be invested. And I am just going to appeal to you to understand that I can't go back and tell my people that I voted to gamble with their future.

I thank you. I yield back the remainder of my time, Mr. Chairman.

Chairman BACHUS. I thank the gentleman from Texas.

That concludes our opening statements. All members are welcome to submit their written opening statements, and I will do so, submit mine for the record, and also associate myself with the remarks of Mr. Hensarling, Mr. Feeney, Mr. Sessions and Mr. McHenry.

At this time we will recognize our panel of witnesses. Mr. Mike Brown is the president and CEO of Harbor Federal Savings Bank and is representing the America's Community Bankers. Mr. Brown

is a native of Missouri, moved to Florida in 1972; is that right? He has held several positions with thrifts and community banks, and now is president and CEO of Harbor Federal. He is active in his community with the regional hospital—I am just summarizing—the theater, the Sunrise Theater, and he has just completed a 2-year appointment on the Thrift Institutions Advisory Council to the Federal Reserve Board of Governors, and was a co-chair of Governor Bush's campaign in your home county. We welcome you.

At this time I am going to recognize Mr. Feeney to introduce Mr. Roberts.

Mr. FEENEY. Thank you, Mr. Chairman.

I think it is appropriate that Florida has three witnesses today, Mr. Brock, Mr. Brown, and Mr. Roberts. Among other things, Florida, while I was a State legislator, took a defined benefit plan that was running deficits, some years as much as $14 billion, for our State workers and State retirees. We have moved it into an optional defined contribution plan. Nobody is forced to move, but we will never again, for those people that have their own defined contribution accounts, have an unfunded liability. These people will be guaranteed that they have a healthy retirement.

So it is great to have three Floridians here today. Mr. Roberts is an at-large director of the Independent Community Bankers of America, which is the Nation's largest banking trade association and the only national association that exclusively serves community banks. The president of First National Bank of Pasco County, Mr. Roberts is a respected leader throughout the banking industry. In addition to serving on ICBA's executive committee, he represents Florida on ICBA's board of directors and serves as a member of the association's Federal legislation committee. He has previously served as president of the Florida Bankers Association. Mr. Roberts has been a director and instructor for the Florida School of Banking, chairman of the Independent Bankers Bank of Florida, and chairman of the Florida Banker Insurance Trust.

Active in civic affairs, Mr. Roberts has served in volunteer leadership positions for the housing authority, two chambers of commerce, a Habitat for Humanity affiliate, and a Rotary Club. He has been named citizen of the year for Zephyr Hills, Florida, and business leader of the year for Dade City, Florida.

My office has had the pleasure of working closely with Mr. Roberts on many matters important to the banking community and to Florida itself. Considering his vast knowledge of community banking, I believe that he will be able to offer us much today in his testimony, and I am grateful for the opportunity to introduce him.

Chairman BACHUS. I thank you, Mr. Feeney, and that was a very good introduction.

So at this time I am going to introduce Mr. David Brock, president and CEO of Community Educators Credit Union in Florida. Representing CUNA, the Credit Union National Association. The fascinating thing about your institution is that it was started in 1953 by a group of 10 teachers, and now has 6 traditional branches and 9 branches in elementary and secondary schools. And from that modest start to the end of 2004 it has $220 million in deposits, $186 million in loans. That is quite impressive.

Mr. Brock is very active in his community. He serves on the Brevard County Foundation, which is the public schools in Brevard County; the Rolling Readers Space Coast, which is a program for disadvantaged children; and the United Way, as well as other organizations. He and Mr. Brown are both active in several other community organizations. So we welcome you to our committee.

And at this time I would like to introduce Mr. Sessions to introduce Mr. Gornto.

Mr. SESSIONS. Yes, Mr. Chairman. Thank you so very much. Mr. Chairman, it is a great pleasure for me to introduce a person who will be providing testimony today, Richard Gornto, who is president of the First Financial Benefits, Incorporated of Houston, Texas. It is important to note that Mr. Gornto is the plan designer of the so-called Galveston Plan, and has continued to successfully manage this plan and several other county plans for the past 25 years. It would be my hope and expectation that Mr. Gornto would be able to debunk any myths that may have been presented today in the opening phase of this hearing as Mr. Gornto would be considered an expert on all aspects of return, rate of return, as well as feedback about that plan.

It is important to note that during this period of time he is past president, board chairman of Houston Society of Certified Financial Planners, trustee of Alvin Community College, board member of Child Advocates of Houston, board member of Alvin National Bank, past president and current board member of the Nolan Ryan Foundation and past board chairman of HCA Clear Lake Regional Hospital.

Mr. Gornto came to Washington as a result of this important hearing, and I appreciate him taking time out of his schedule.

Thank you, Chairman.

Chairman BACHUS. I appreciate that.

And at this time it is my pleasure to recognize the gentlelady from New York.

Mrs. MALONEY. I thank the Chairman for allowing me this opportunity to introduce Dr. Jason Furman, and he is a nonresident senior fellow, Center on Budget and Policy Priorities, and visiting scholar from the New York University Wagner Graduate School of Public Service, which happens to be in the district that I am honored to represent this outstanding university. Previously Dr. Furman served as Special Assistant to the President for Economic Policy in the Clinton Administration.

Dr. Furman has been a visiting lecturer at both Colombia and Yale Universities. In addition, Dr. Furman served as a staff economist at the Council of Economic Advisers and senior economic advisor to the chief economist of the World Bank.

Dr. Furman received his Ph.D. In economics from Harvard University, and he is widely quoted in newspapers and other written documents on the subject that is before us today. We thank you for joining us today, Dr. Furman.

Thank you.

Chairman BACHUS. Thank you, Mrs. Maloney, and we welcome you, Dr. Furman.

At this time we will recognize our panel of witnesses, and we will start with Mr. Brown and go to his left and conclude with Dr. Furman. So at this time, Mr. Brown, you are recognized.

STATEMENT OF MICHAEL J. BROWN, SR., PRESIDENT AND CEO, HARBOR FEDERAL SAVINGS BANK (FL), REPRESENTING AMERICA'S COMMUNITY BANKERS

Mr. BROWN. Thank you.

Chairman Bachus, Ranking Member Sanders and members of the subcommittee, I am Michael Brown, Sr., president and CEO of Harbor Federal Savings Bank. Harbor Federal is a $2.9 billion publicly traded community financial institution serving the eastern coast of Florida in Fort Pierce. I am testifying on behalf of the American Community Bankers, where I have served as a member of the board of directors and continue to serve on several committees.

Thank you for this opportunity to testify on the role of community banks in retirement security and the importance of bank deposits and other investment options in creating a solvent retirement system for America's working men and women.

Let me commend the hard work that Congressman Tom Feeney and Congressman Pete Sessions have done on this issue. They and their staffs have been working tirelessly to ensure that working families have a full range of options as part of any Social Security reform.

ACB believes that allowing workers the choice of investing at least part of their Social Security taxes in personal accounts would create a more solvent system. We have been working for some time on this with Members of Congress and the Administration to make certain that workers have a full range of options for investing in Social Security personal accounts.

Any Social Security reform should give workers the choice of relying on the products their community banks offer for their personal retirement accounts in addition to those investment options available on Wall Street. We call it the community bank option. Workers should have the option of seeking advice on their personal accounts from knowledgeable people they already know and trust, their hometown community banker. Community banks already offer a variety of federally insured retirement investments, including FDIC-insured individual retirement accounts and certificates of deposits.

Workers of all ages would benefit from the community bank option. For example, some who seek greater return than the Social Security program currently provides may be wary of investing all of the retirement funds in equities and other retirement products that carry a higher risk. For these workers, a long-term federally insured deposit account from a community bank would be the most appropriate investment for all or part of the funds made available by Social Security reform.

In addition, workers nearing retirement are traditionally advised to reduce their allocation in equity investments to reduce the risk. ACB believes that FDIC-insured accounts would benefit those older workers not only as a place to invest new funds, but also as a safe

place in which to roll over funds from riskier personal account products.

For more than 70 years, FDIC insurance has given millions of American families the confidence that the money they save in federally insured banks will be where they need it when they need it. Allowing FDIC-insured accounts for community banks as an option under Social Security reform would encourage workers to choose the personal account option, and it would increase support for reform.

Today the shift from defined benefit plans into IRA and 401(k)-type savings has made individuals responsible for managing their own assets. Retirement accounts often exceed the current $100,000 coverage limit provided by Federal deposit insurance. A substantial increase in FDIC coverage for retirement accounts would strengthen the viability of the insured deposit account option. Past assessments on federally insured banks cover the cost of today's deposit insurance. Deposits in FDIC insurance accounts return money to the local communities where workers live. Community banks invest these funds in their communities through loans to local businesses, mortgage loans to families, education loans to students and in many other ways. If the community bank option is adopted, it could result in reduced rates to borrowers and greater economic growth.

ACB strongly believes that the community bank option should be available for workers choosing personal Social Security accounts. It will increase their choices, reduce their risk and help grow their communities. Thank you for giving us this opportunity to present our views.

Chairman BACHUS. Thank you.

[The prepared statement of Mr. Brown can be found on page 56 of the appendix.]

Chairman BACHUS. Mr. Roberts.

STATEMENT OF J. LAMAR ROBERTS, PRESIDENT AND CEO, FIRST NATIONAL BANK OF PASCO (FL), REPRESENTING INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. ROBERTS. Mr. Chairman, Ranking Minority Member Frank and members of the committee, my name is Lamar Roberts, and I am president and CEO of the First National Bank of Pasco, a $105 million community bank in Dade City, Florida. I am also a member of the ICBA's executive committee and board of directors. I am pleased to appear today on behalf of the ICBA and its nearly 5,000 members to testify on ways the community banking industry can contribute to the retirement savings and Social Security reform debate.

Today too many Americans are simply not saving enough for retirement. There is a genuine recognition that the low U.S. savings rate combined with the swell of baby-boomer retirees and the associated stress on the current Social Security system simply cannot be ignored. The ICBA supports bipartisan efforts to strengthen Social Security and retirement savings and the opportunity for new individual savings account contributions for community bank customers. Community banks have always served an essential role in the U.S. economy as a steady and trusted place for consumers to save for life's events, such as retirement.

Notably, ICBA would like to thank Representatives Feeney and Sessions for introducing House Resolution 209. This resolution conveys an important message by the House of Representatives that any plan to reform Social Security should also include what we call a community bank option. Bank CD's are an attractive and safe product for the retirement savings needs of Americans, especially as savers look to reduce risk as they get closer to retirement. Bank CD's can provide both a reasonable rate of return and preserve the saver's principal.

Involving the Nation's community banks in the retirement savings debate is critical. That is because the savings in local community banks support community investment and job creation throughout main street America. We are greatly encouraged that lawmakers are generally considering the full range of personal investment options in the Social Security reform debate rather than just a limited selection of stock and bond investments.

The bottom line is that savings reform must make sense, both on Wall Street and main street. Should enhanced personal savings accounts emerge as a bipartisan remedy to improve retirement savings, the structure of such accounts does demand close attention so that all segments of our Nation can participate in both the savings and associated investment opportunities.

Allowing a community bank savings option is also very important to support local economic vitality. Ample personal savings is vital not only to meet the retirement needs, but also to provide the economic lifeblood for our communities as banks leverage private savings to meet the borrowing needs of individuals, small businesses and farms.

Individuals always need to diversify their savings to help mitigate unwanted risk. As the timeless saying goes, don't put all your eggs in one basket. When it comes to nest eggs, this lesson is paramount. It only stands to reason that a broad array of savings options and financial service providers should be considered in the Social Security reform debate so assets are not unevenly concentrated. The dispersion of our Nation's assets and wealth helps preserve the safety, soundness and stability of our entire financial and economic system. Without solid savings flowing into our local communities, economic prospects are diminished.

Other important retirement savings issues also deserve attention, and I would like to highlight just a couple. First, ICBA supports the initiative for new retirement savings accounts proposed by the Administration and in Congress.

Second, the ICBA-backed Communities First Act introduced by Representative Jim Ryun contains a provision that would allow consumers to defer recognition of interest income on long-term CDs and reduce the top tax rate.

In conclusion, ICBA appreciates the opportunity to testify on this important issue. Community banks are a safe and effective place for Americans to save for retirement. Should new or expanded personal accounts be part of any bipartisan retirement security reform, ICBA urges that community banks have the ability to serve their customers' saving needs with a CD, RSA or similar safe bank product option. We believe having diversity of savings products and

risk options can only better serve America's retirement needs. Thank you.

Chairman BACHUS. Thank you.

[The prepared statement of Mr. Roberts can be found on page 66 of the appendix.]

Chairman BACHUS. Mr. Brock.

STATEMENT OF DAVID O. BROCK, PRESIDENT/CEO, COMMUNITY EDUCATORS CREDIT UNION (FL), REPRESENTING CREDIT UNION NATIONAL ASSOCIATION

Mr. BROCK. Chairman Bachus, Congressman Feeney and members of the subcommittee, I am David Brock. I am the president and chief executive officer of Community Educators Credit Union in Rockledge, Florida. I am here today on behalf of the Credit Union National Association, and I appreciate this opportunity to provide CUNA's views this morning on the topic of Banking on Retirement Security: A Guaranteed Rate of Return.

CUNA is the largest credit union trade association, representing approximately 90 percent of our Nation's nearly 9,300 credit unions and their 86 million members. You have asked us to comment on Representatives Feeney and Sessions' proposal to give workers the option to invest part of their Social Security into a federally insured certificate of deposit offered by a credit union, community bank or savings association.

First, I should clarify that CUNA has taken no formal position on whether any plan to fix Social Security should include private accounts.

However, if legislative changes allow workers to direct part of their payroll taxes into individual accounts, we believe it makes sense to include all financial institutions as one option for participants.

Sound personal financial planning dictates that retirement funds for those nearing retirement be distributed in part in lower-risk safe liquid investments. Financial institutions offer such accounts. In fact, at year end 2004, financial institutions controlled a total of $270 billion in individual retirement account deposits. It is difficult to project the potential effect of allowing consumers to invest Social Security funds in financial institutions savings accounts such as certificate accounts, and because such accounts would provide a relatively low, albeit safe return on the investment, it is likely that it would be used more by those approaching retirement than by younger workers.

This certainly would be consistent with the savings trends and IRA's at my credit union, where IRA savings are significantly concentrated in those in higher age categories. In either case, however, an increase on the order of 10 percent of current IRA balances might serve as a conservative estimate of the increase in savings through a CD option.

In this case, financial institutions would experience a $27 billion increase in savings, and credit unions would garner an estimated total of roughly $5 billion based on their current 18 percent share of the depository institution IRA market. An increase of this magnitude could have an obvious impact on the economy and the communities in which workers live. They would become more finan-

cially independent and be more likely to have sufficient funds to spend on goods in their retirement, thus stimulating the economy and providing or maintaining employment.

Social Security plays a critical role in the lives of 48 million beneficiaries and 159 million covered workers and their families. The widely-acknowledged challenges facing the Social Security system are compounded by the fact that U.S. consumers generally save very little and specifically put very little aside in private retirement accounts.

The U.S. personal savings rate has been on a declining path for roughly 2 decades. In the 1975 to 1984 period, personal savings as a percent of personal disposable income averaged nearly 10 percent, but fell to an average of 7 percent over the 1985 to 1994 period and to an average of less than 3 percent in the 1995 to 2004 period. The personal savings rate at the end of April 2005 was just over .4 of 1 percent, near its historic low.

Moreover, a recent Brookings Institution policy brief found that only about half of workers participate in an employer-based pension plan in any given year, and participation rates in individual retirement accounts are substantially lower.

Further, many households approach retirement with meager defined contribution balances. Financial institutions can help close this gap, and credit unions in particular are uniquely positioned to assist consumers in doing so. Credit unions, which pay very favorable interest rates on savings accounts provide a wide variety of savings product alternatives to their members.

At year end 2004, credit unions had $575 billion in savings accounts. Of this total, 22 percent was held in share certificate accounts; 18 percent was held in money market deposit accounts; and 8 percent was an individual retirement accounts and the remainder in other short-term liquid accounts.

As not-for-profit, member-owned financial cooperatives, credit unions have a long history of serving as trusted financial advisors and in providing their 86 million members with financial education materials, including those that stress the need for savings and retirement planning. These characteristics are reflected in the fact that, while credit unions have a 12 percent share of household savings held in depository institutions, they account for an approximate 18 percent share of IRA balances held in depository institutions.

In summary, we believe that any legislative change allowing workers to direct part of their payroll taxes into individual accounts should include financial institution savings accounts as one option for participants. Financial institutions have extensive experience in providing retirement-related accounts, and financial institution accounts provide a level of liquidity and safety that is not available through other sources.

Thank you.

[The prepared statement of Mr. Brock can be found on page 51 of the appendix.]

STATEMENT OF RICK GORNTO, PRESIDENT, FIRST FINANCIAL BENEFITS, INC. (TX)

Mr. GORNTO. Good morning, Mr. Chairman and members of the committee, in particular Mr. Sessions' office, I would like to thank you for inviting me to this hearing and allowing me to speak to you today about this very important topic of Social Security reform.

My name is Rick Gornto, and I am president of First Financial Benefits, Inc., a retirement planning design and administrative firm in Houston, Texas. The reason I am here today is to talk to you about the Galveston plan, which, by the way, is alive and well after 25 years, which could be used as a model, and to review with you how this plan was designed and how it has performed during the last 25 years in several counties and cities in south Texas.

In 1980, I was asked by Don Kebodeaux, my business partner, County Judge Ray Holbrook, and County Attorney Bill Decker of Galveston County to see if I could design a privatized substitute for Social Security.

During the ensuing 9 months, the plan was developed and presented to the Galveston employees and county commissioners who voted overwhelmingly to adopt the plan, which by the way was after a 2-month debate with the Social Security Administration in 11 various meetings where we debated in front of hundreds, in effect thousands, of employees.

At the end of the day, 72 percent voted to opt out of Social Security. The primary design features of the plan are as follows: Design a plan that mirrors Social Security benefits, retirement, survivorship and disability benefit, design the plan to have equal or greater benefits with equal or less cost than Social Security. Design the plan to have fixed costs over a long period of time. Design the plan with more flexibility than both Social Security and their current State retirement plan, which is the Texas county and district retirement system. Design the plan to have guaranteed returns on investments. That is, take no risks; don't want to lose the money. Allow for hardship withdrawals in the event of medical emergencies during the term of the lifetime. They wanted this because they wanted that flexibility. Allow for lump sum withdrawals at retirement. Do not include a cost-of-living adjustment and design the plan that has private accounts and private ownership of these plan assets. Design the plan that the employees can leave to their estate and design the plan that has built in tax efficiencies.

These plan features were drafted, and all but the hardship withdrawal option exist today, primarily because of Evelyn Robinson, who borrowed out most of her funds to pay for a medical illness for her husband prior to her retirement. That is why she got lower benefits. She forgot to talk about that up there.

This plan has been very successful in meeting its intended goals, and there have been hundreds of people who have used these benefits for their personal retirement income replacement and their estates. The plan has discovered a diverse range of people at different levels as well as both union and nonunion employees. The plan investment performance has been excellent as well.

During the past 25 years, the plan has provided returns from 15 percent to 3.75 percent during the term of the 25 years. The guaranteed rates that have been paid have always been higher than the

general prevailing interest rates in the economy, so the plan has always been very competitive when compared with other fixed return investments including Social Security.

It is my intention that this plan, with a few modifications, could be used as a national plan. It is a plan that is based on asset-building rather than pay-as-you-go; personal ownership rather than no ownership; and guaranteed returns on your investment rather than no assurance that you will get the return that was promised.

Today, there are 7 million government workers in America. There are 30 countries throughout the world that adopted Social Security pay-as-you-go-type plans and opted for asset-building plans. My view of several of these types of plans that I have reviewed show me that they will all outperform their various Social Security systems on an investment-return basis.

They have all recognized the same thing that we are seeing today: It is better out there than it is in here. They understand that a pay-as-you-go system cannot survive when the next 25 years in America—and listen to this statistic—there is a 200 percent increase in plan beneficiaries and a 10 percent increase in workers.

That is a 20-to-1 ratio of people taking out than people putting in. Unless the government can change the current demographic trend than no short-term salvos can fix—like increasing payroll taxes, extending target traffic retirement age or cutting the benefits to any reasonable level—it can't be fixed. That vote won't float.

If we try to throw millions at a system over the next 25 to 35 to 40 years, our children will eventually look up and realize that their fathers and mothers have left them holding the proverbial bag. If we are going to throw money anywhere, then let us throw it at a system that will survive and thrive like Galveston, Brazoria, and Matagorda Counties and so many others have done throughout the country and throughout the world.

Thank you for having me here today, and let us please get together to make something happen for all of us.

[The prepared statement of Mr. Gornto can be found on page 64 of the appendix.]

Chairman BACHUS. Thank you, Mr. Gornto.

Now, Mr. Furman.

STATEMENT OF JASON FURMAN, NONRESIDENT SENIOR FELLOW, CENTER OF BUDGET AND POLICY PRIORITIES, WAGNER GRADUATE SCHOOL OF PUBLIC SERVICE, NEW YORK UNIVERSITY

Mr. FURMAN. Thank you, Mr. Chairman, Mrs. Maloney, for the kind introduction to the committee and the opportunity to address you today.

The question of whether to establish individual accounts in Social Security is a contentious one.

I want to begin my testimony by making a few points that virtually all policy analysts and economists, whether they support accounts or oppose them, would agree with. I then want to go on why I believe that replacing a portion of Social Security with private accounts would be a bad idea, and that, instead, we should be focused on strengthening Social Security while at the same time helping moderate-income families save, invest, and accumulate wealth

through IRA's, 401(k)'s and other vehicles outside of Social Security.

My first point is that if accounts are established, they should not include a bank option. No individual account proposal scored by the Social Security Act raised in the last several years includes a bank option. Account proposals all include a Treasury bond option. This is the safest security there is, although guaranteed to lose money under individual accounts proposals like the President's, as I will explain later.

There is no financial reason to supplement this with an additional bank option. Bank accounts, including CD's, provide a higher agree of liquidity in exchange for a lower rate of return. This liquidity is largely valueless in the context of a retirement account.

More importantly, the additional monitoring and enforcement costs associated with a bank option would be prohibitively expensive compared to the current design of Social Security proposals. Every plan I am aware of, including the President's, is organized through a central administrative authority that collects contributions, manages investments, and maintains records.

This administrative structure limits choices and services and provides lower costs, although even these costs are 10 times higher than the costs of administering the current Social Security system.

Establishing a bank option would entail setting up decentralized accounts like existing IRA's. The losses in terms of economies of scale and higher administrative costs could easily eat up 30 or 40 percent of the final account balances.

Second, Galveston does not provide a model that is relevant for nationwide Social Security reform. The Galveston plan bears little resemblance to individual accounts. The county invests pension funds in the market. Workers do not have accounts. They do not have any control over investment decisions. Participation in the Galveston plan is mandatory, and the contributions are set at 13.9 percent of payroll.

So if your idea is to raise payroll taxes, require people to be part of the system, and then have the government invest the money, Galveston is your model.

According to the Social Security Administration and GAO, Galveston generally provides lower benefits for its beneficiaries. It doesn't provide protections for spouses, inflation and many of the important features of Social Security. But regardless of whether Galveston provides higher benefits or lower benefits, it is still irrelevant for thinking about the problem that we have as a Nation.

The several thousand municipal employees in the Galveston plan do not make any contributions to support current Social Security beneficiaries. If the United States as a whole adopted a Galveston-like plan, there would be no one left to pay the $500 billion annual cost of benefits for the Nation's 45 million current Social Security beneficiaries. The United States as a whole cannot free ride in the same way that government employees in one relatively small county can.

Third, there is no such thing as a higher guaranteed rate of return. The basic principle of financial markets is that you only get higher returns as compensation for taking greater risks. As Nobel Prize winner Gary Becker explained, "There are no freebies from

such investments"—he is talking about individual accounts—"since the higher return on stocks is related to the greater risks and other trade-offs between stocks and different assets."

Social Security benefits are not subject to any market risk. In fact, Social Security provides critical insurance against becoming disabled, dying, or outliving one's savings. No financial instruments provide this range of benefits, and if they did, they would be extremely expensive.

Even more fundamentally, as Greg Mankiw, former chairman of President Bush's Council of Economic Advisors, explained—this is a quote from President Bush's former top economic advisor—"Admittedly, some of Bush's arguments are off the mark. When he compares the 2 percent real return a worker now gets from Social Security with a 6 percent real return offered by portfolio of stocks and bonds, he neglects to mention that the Social Security fund still owes a huge amount to those now or soon to be retired. This liability—the overhang from giving earlier generations more than they put into the system—doesn't disappear with privatization."

Virtually every policy analyst and economist, whether they support or oppose accounts, would agree with my statements about the bank option, Galveston, and rate of return. I would, however, like to make one additional point. In my judgment, the risks associated with a proposal like the President's or the House Republican proposal yesterday are unjustifiable. The President's proposal would not increase the return to Social Security. For many beneficiaries, it would lower it. Under the President's accounts, you need to get a real rate of return of 3 percent above inflation—that is 5.8 percent of the total annual return—just to break even from one of the two benefit cuts he is proposing. By way of comparison, CD's currently have a 3.5 percent rate of return. That is a sure-fire way to lose money under the President's proposal.

As Robert Shiller noted, financial economists found, even with a sounder investment strategy, you lose money the majority of the time. In conclusion, investing in risk plays an important role in wealth creation and retirement security, but they should play that role in a separate part of the retirement system, not replace the retirement security provided by Social Security.

Thank you and I look forward to the committee's questions.

[The prepared statement of Mr. Furman can be found on page 60 of the appendix.]

Chairman BACHUS. Thank you.

I am going to ask for the committee's indulgence. We are going to have a vote in about 30 minutes, if not sooner. What we will try to do is we will recognize each member for 5 minutes. If they are in the process of asking a question or answering a question, we will conclude that with the answer. But there won't be any additional questions past the 5 minutes. If I can ask unanimous consent for that.

At this time, the lady from Illinois is recognized.

Mrs. BIGGERT. Thank you, Mr. Chairman.

And thank you to the panel for all of your expertise that you bring today and talking about this issue.

It is nice to have, I think, a debate that is not, let us say, spirited one way—that we are able to discuss this issue calmly. And I think

that we need a lot more of this, because certainly the Social Security plan that we are going to have really needs to be a bipartisan plan. And we are going to have to reach some accommodation at some point, and it is a critical time that we really need to be looking at this.

So I have just a couple of questions, first, for Mr. Brown. Many of the community banks are offering some type of limited retirement savings products such as the IRA's. What type of outreach in financial education do you provide to help encourage your customers to invest in these products and save?

Mr. BROWN. Well, it is something we have been doing for years. Quite frankly, it is a product that often sells itself because we do find that people clearly want to invest in their retirement. The IRA has been a wonderful vehicle.

We do a lot of mailings, particularly at tax time or the time people are thinking about that year end. We do, in many cases, community outreach where we go to communities where we would also try to promote housing for people who are not necessarily sophisticated investors and try to talk about those things also.

But it is an ongoing year-after-year type of thing to get people thinking about their retirement benefits. One of the things that I think would be—there is a similarity between what we are proposing today or discussing today and the IRA. That is, the beauties of compounding are amazing.

When you continue to put money in on a regular basis, it compounds and builds. It is amazing how much some people have put aside in their IRA account, and we would encourage that the public has a choice of both of those.

Mrs. BIGGERT. I think you mentioned that savings, and almost all of the panel did, that savings is down, that we are finding that people are not putting aside the money, but they are also, particularly the young people, are not putting moneys into accounts. Is there any way to reach the younger people?

Mr. BROWN. Well, my own judgment is, and I am sure this is controversial, but I don't think, quite frankly, the general public understands Social Security, and, quite frankly, I don't think there is a broad confidence in it, particularly the younger people, and they are not counting on it.

My sense of it is that younger workers would be glad to reach out to something of this nature, because they really don't think that there is going to be anything there for them, and that is sad.

Mrs. BIGGERT. I think it has been said many times that they think they will see a UFO before they see their Social Security.

Mr. BROWN. Well, it is—I think there are issues with it, there are problems with it, and we need to deal with it.

People, and actually having something with community banks, I think, would be very valuable, because it is interesting, as getting close to Social Security age myself, I get a mailing once a year now to tell me what I will have. But quite frankly, it is—it just doesn't seem very real. It is very remote.

But I think if someone can go into their bank, and they could check what they have in that account, it would really give them a sense of finishing something. Quite frankly, it probably would increase savings in general.

Mrs. BIGGERT. Thank you.

Mr. Gornto, I think the proponents of personal accounts are really concerned about the risk. Certainly, the plan that has been talked most about is, it starts for those under age 55 and below, and the other people would be still in the traditional plan. Has anyone, besides the one woman that you mentioned who used her money for the hospitalization or whatever, lost money in this?

Mr. GORNTO. No, ma'am. Nobody has ever lost a penny in the account. In fact, we have had, it seems, a great deal of press in the last couple of years, and the reporters have tried to ferret out unhappy people, people who have had problems. They, as you know, they have a way of being able to do this very well. Evelyn was the only one that they could find.

Evelyn, from—I mean, she just simply took out 35 percent of her money 5 years prior to retirement under the hardship option to provide for a heart bypass surgery for her husband, and when she retired, she wanted to know where her money was. She had used it for current dollars rather than future dollars.

Hardship withdrawal was something that was supposed to be a benefit of this plan. Because we got so much bad press on it, and she made such a problem with it, we finally terminated that option. They no longer can have hardship options.

Mrs. BIGGERT. Thank you, I see my time has expired. I yield back.

Chairman BACHUS. Thank you.

Mrs. Maloney.

Mrs. MALONEY. Thank you. I thank all the gentlemen for their testimony.

Dr. Furman, is there anything in the bank option that solves or lessons the clawback problem? Mr. Greenspan testified before this committee that the private accounts do absolutely nothing for solvency. Could you comment more on that?

I have read the Shiller study that you referenced, and it seems to prove private accounts are a bad idea. And can you comment further and elaborate further?

Mr. FURMAN. Sure, I would be happy to comment on all three of those issues. I think it is generally acknowledged now—and the President himself has acknowledged—that individual accounts do nothing to help restore solvency to Social Security. That is especially the case if you did something like the bank option. You are taking moneys that right now are invested, in effect, in Treasury and just investing them with higher administrative costs through another system that would require thousands or tens of thousands of government employees to oversee the circulation of money that isn't doing anything for the system. In terms of the risks you face, the President's plan is what I call offset. Others have called it a privatization tax or a clawback.

What it says is, if your benefit, if your account does not grow more than 3 percent above inflation, that is about 5.8 percent per year, you will lose money. A CD right now, you get a 3.5 percent return. If you put your money in the CD under the President's plan, it is like borrowing at 5.8 percent and investing at 3.5 percent. That is just one of the dumbest things you could imagine someone doing with their money. Giving someone the option to do

something that stupid with their money to me does not seem to be good public policy.

Finally, there are smarter things you can do with your money. Professor Shiller looked at them. If you do invest your money wisely, you don't lose money. One hundred percent of the time, you only lose it somewhere between 32 and 71 percent of the time, depending on the particular assumptions that you use.

Mrs. MALONEY. Could you comment on the fact that the plan is not voluntary and will result—some economists have written—- in large benefit costs because it will change the calculation of benefits from wage indexes to price indexing? Could you elaborate and explain more?

Mr. FURMAN. Sure, the President's proposal has two benefit reductions. One is a sliding scale benefit reduction. Some have called it progressive price indexing. That would apply to everyone, mandatory, across the board, and would result in benefit reductions for middle-class families of between 28 and 40 percent reduction in their replacement rates by 75 years.

In addition, there are private accounts, and people who do those, get a second benefit reduction on top of the first one that applies to everyone.

Mrs. MALONEY. Could you explain how that benefit works in the private—how they cut it back?

Mr. FURMAN. The first benefit reduction or the second one?

Mrs. MALONEY. Both of them.

Mr. FURMAN. For the first one, right now, Social Security benefits are done according to a formula that grows with wages. That ensures that your benefit replaces a constant fraction of your income. You need about 70 percent of your pre-retirement income in retirement to have a dignified retirement.

Social Security provides about half of that, 35 percent of your preretirement income, provided that 20 years ago. It is going to provide that about 20 years from now. That formula would change, and that benefit would be eroded over time, just grow with prices. You would have basically a 1950 standard of living going forward if we had had it in place before.

The second benefit reduction says that, for every dollar you put in your account, your Social Security benefits are reduced by $1 plus inflation plus 3 percent interest. That accumulates to be about $150,000 worth of benefit reductions at retirement.

Mrs. MALONEY. The vast majority of retirees would not be able to pass funds from their private accounts on to their children, according to many economists, yet the President continues to say this is a benefit of that plan.

Could you elaborate further on that aspect of it?

Mr. FURMAN. Right. For example, if your husband dies and has an account, you inherit his account, but you also inherit the entire benefit reduction that he agreed to of the account. So when he set up his account, he agreed to something like a $150,000 benefit reduction. You get his account, you better hope that it has more than $150,000, because you are going to get his benefit reduction regardless of how much is in your account.

Mrs. MALONEY. Could you comment on the inability of individuals to invest their money as they see fit in these private accounts

and estimates about how much these private accounts will cost to set up? I have seen everything from $5 trillion to $10 trillion. Could you elaborate on the cost to the Federal deficit and the growth of the deficit in that respect?

Chairman BACHUS. Dr. Furman, if you could be sort of short on that?

Mr. FURMAN. Okay. The most optimistic estimate of that is 30 basis points as a cost which is about 10 times higher than Social Security's administrative costs now. There are a range of other estimates that are much higher than that, and the range is on government employees required are at the low end of the Social Security Administration, 7,700 to 50,000 or more new government employees required.

Chairman BACHUS. Thank you.

Mr. Feeney.

Mrs. MALONEY. Thank you very much.

Mr. FEENEY. Thank you, Mr. Chairman.

Mr. Gornto, I want to turn first to your plan. We have consensus among actuaries that, give or take a couple hundred billion, over the next 75 years, there is a $2 trillion unfunded liability in what we have promised out in Social Security. Any American who thinks that there is money sitting in Ft. Knox for his or her retirement has been fooled. Whether it was Congress or the trustees, they have been fooled and misled.

I want to know, under the Galveston plan, what your unfunded liability is? To what extent have you lied to people about what assets they will have when they retire up until now?

Mr. GORNTO. Well, there is no lying, and there is no unfunded liability.

Mr. FEENEY. Mr. Roberts, one of the concerns that I think is a legitimate one about personal ownership accounts is that, to the extent any proposal would start with very small ownership accounts, say $500 or $1,000 or even $1,500, a lot of large Wall Street investors have suggested that there is not a lot of incentive for big investors to take those sort of smaller startup accounts and that there is not enough money to make it worth their while to manage those accounts. That is one of the problems, if you don't get a significant size account to start with.

But with respect to community bankers, is it a huge problem for you? Is there a huge transactional cost? Is there a large fee associated with coming in and buying a $500 or $1,000 CD-type instrument?

Mr. ROBERTS. There is a cost, but it is not unreasonable. With computers, with technology the way it is now, it can easily be handled. It can be made profitable. We accumulate funds from a lot of different people, all the way up from children with smaller accounts where we are trying to teach to save to those who can only put a small amount away. When you accumulate all this, you get the millions that we have to invest back in our community in the loans. It is an ongoing expense that we can easily handle and pay them a reasonable market rate and make a reasonable return for the bank.

Mr. FEENEY. One of the suggestions that Dr. Furman had is that T-bills provide a traditionally better return than CD-type instru-

ments because they tend to be more liquid and more flexible. But to the extent that I know to a moral certainty that my—I am not eligible to withdraw money from a personal savings account till I am ready to retire, it seems to me that the banks may be able to offer enhanced rates of return because there would be no liquidity or flexibility that you have in the traditional CD offerings; is that right?

Mr. ROBERTS. Yes, to some extent. I think I take exception, if I understand your question correctly, I think if you look at the CD rates and you look at the Treasury bill, the Treasury bill rates, you will find, they are very similar. So I don't think you will find one more so than the other, and I don't think that you will find one safer than the other. The U.S. Treasury, of course, has the full faith and credit of the government behind it. So does the FDIC insurance.

Mr. FEENEY. As we talk about that insurance and the safety and solvency of the banking community since Glass-Steigel, many, many decades ago, as I stated earlier, all actuaries tell us we have about a $2 trillion unfunded liability in Social Security.

By the way, it gets worse after 75 years, the situation goes on to an infinite obligation that we cannot pay for. When was the last time there was a significant failure within a 401(k) or an IRA in CD-type instruments that are held by investors to pay those investors money that they were owed in a 401(k), CD or an IRA-CD, or have there have been significant bank failures to meet their obligation, like we are going to be unable to meet our obligations?

Mr. ROBERTS. Not to my knowledge.

Mr. FEENEY. Mr. Brown, you did a wonderful job talking about, not just the benefits to the investors, but—and banks, but to communities themselves, there are a lot of things that community banks do.

Do you want to elaborate just briefly—because we do have votes coming up—on the kinds of services you provide in the community with the money that you will hold in a CD?

Mr. BROWN. Well, with—we are a bank that serves 7 counties in Florida, and we have 37 offices. One of the things that we think sets ourselves apart and, quite frankly, seems to be in common between the four presenters, is that we do reach out and deal with individuals. We certainly make loans to businesses. But the prime business that we do is we make home loans. We make home improvement loans, things of that nature.

We find that we deal with all ranges of financial ranges of people's wealth. But, primarily, we are focusing on home loans. Candidly, I think it is readily accepted, as the more money we have to lend, quite frankly, the better rates we are able to give for home loans and home improvement loans.

Even if it doesn't change the rate, it would change the availability. I mean, it is a function of where we are doing our best to lend as much as we can in the community, and we do reach out. And we do try to touch everyone in the markets. Just the other day, we had a function where we were helping with a number of our Latin immigrants as far as helping them, as far as opening accounts.

In many cases, community banks are actually teaching people how to bank who are coming to this country, who are new to this country. That is something, certainly, that money—if we did have personal accounts—some could go to Wall Street. But community banks do something a little different than is done in Wall Street, and the customers that come in our door cover every spectrum of the wage scale.

But, quite frankly, a lot of our growth is coming from the low- to moderate-income people who are learning how to save and who have goals to save for a home. Quite frankly, most of them haven't yet started saving for retirement, so I think that is something that should be done.

Mr. HENSARLING. [presiding] The time of the gentleman has expired.

The gentleman from Texas, Mr. Green, is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and thank you, members of the panel. I appreciate greatly your comments. I support banks, community banks, credit unions. I am a member of a credit union, have several bank accounts, probably more than I need.

Mr. BROWN. No.

Mr. GREEN. But I do have them. I do have a concern that I would like to sort of back into, if I may. Some incident occurred that caused Social Security to come into being. Something happened. Some folks tend to believe that it may have had something to do with 1929 and something that occurred then.

Is it a fair statement, Mr. Brown, that something that happened in 1929 had something to do with the establishment of Social Security?

Mr. BROWN. Well, obviously, we all know what happened in 1929. I do think that we—you know, I am not a historian, but I gather it was determined that we needed to set a safety net for peoples of all ages.

Mr. GREEN. Exactly, a safety net.

Mr. BROWN. If I may—

Mr. GREEN. If I may, you have given me the magic words, safety net. Let me ask you this, do you think that the people who established Social Security were persons who understood that they had the bank option, the credit union option, the option of the stock market? My suspicion is that they were reasonably intelligent, and they knew that they had these options. But for some reason, they did not buy into these options at that time.

Mr. Brown, if you could make it brief, because I would like—I want to respect you.

Mr. BROWN. I suspect that they didn't choose that at the time, but those were different times. We had different demographics at the time. We weren't living as long. The whole world has changed since then. I think we need to change with it. But Social Security is right—

Mr. GREEN. If I may now, because I was yielding to you, but the concept of a safety net, which is what you used, is still one that we are grappling with today. That is the one we are still grappling with.

Now, prior to 1929, good times were here. Folk were having a big time in the country. We didn't plan for the stock market to crash. We don't plan for these types of events. But, unfortunately, with the best of intentions, they sometimes occur. When they happen, we want Social Security.

The question comes, for Mr. Furman, if we should have another event, maybe—let us hope that it is not comparable to what happened in 1929—we are all invested in banks and credit unions, as I am, I have money in banks and credit unions, how is that going to impact us, as opposed to what we have right now with the Treasury?

Mr. FURMAN. The Social Security benefit at least doesn't change with the stock market. It is based on your income and replaces a constant fraction of your income. It is the only investment that most people, in effect, have that has that feature. Everything else is subject to market risk in one form or another.

Mr. GREEN. If the market performs poorly, and we have what is the equivalent of a crash, what do we have?

Mr. FURMAN. Well, bank deposits are insured, so you are not going to lose your bank deposit. But they are not guaranteed to keep up with inflation. They are not guaranteed to replace a certain fraction of your income. They don't provide insurance against living a longer life than you expect to. They don't have any of the features that make Social Security so attractive as one part of a person's retirement planning.

Mr. GREEN. I will just conclude with this, because I would like others to have their time. It does cause me great consternation. I am willing to listen to what everybody has to say and hope to visit with some of you individually.

But it does cause me great consternation to know that we are about to make what I consider a very significant change, if we do this, and that that change is going to put a lot of what we consider our safety net at risk.

I yield back the remainder of my time, Mr. Chairman.

Mr. HENSARLING. The gentleman yields back.

The gentleman from Texas, Mr. Sessions, is recognized for 5 minutes.

Mr. SESSIONS. Thank you, Mr. Chairman.

Mr. Gornto, I would like to go directly to you. We are on votes, and I will leave here in just a moment. There was some discussion about costs associated with running these funds that you—and I would like for you to confine your comments to the Galveston model. Can you talk to us about the cost, the management cost, the cost to run these models?

Mr. GORNTO. Yes. Our costs have been less than 1 percent for the past 25 years. Simply that.

Mr. SESSIONS. 1 percent.

Mr. GORNTO. Less than 1 percent, 90 basis points.

Mr. SESSIONS. There was just a discussion about length of time that Mr. Green talked about, you know, when you retire and how long you can keep these in. Is there any requirement or rules related to when a person can take their money out, must take their money out? Or could a person leave them in as long as they wanted?

Mr. GORNTO. In the Galveston plan, you have several options. You have separation of service options, if you will. In other words, when somebody separates from service, they can take the funds with them at that time. They can roll them to another plan that they would go to. They can leave them in the plan until retirement.

Our retirement—our normal retirement age is in correspondence or coincides with the county and district retirement plan so that they get full benefits, so that certain of the plans, like the paid-up insurance after their retirement, you know, after their retirement age occurs if they go to full retirement. But with respect to the retirement dollars themselves, they have separation of service availability at any time.

That was designed that way, on a local level with that flexibility, because they did have a Texas county and district retirement plan. Had that not been there, we would have limited those options to receipt at retirement age only. They can retire under a variety of different mechanisms, if they are age 60, with 8 years, or if they are 30 years of service or if they have a, you know, years of service and age, work together, they can retire under any one of those three options.

Mr. SESSIONS. Generally speaking, from a person who was on or went into the system, when it was formed, and they get out. In other words, they retire, generally, how much money, assuming they had not taken money out, just as an average, how much money does a person, quote, cash out with?

Mr. FURMAN. We have had a variety of people who, right now, are currently being—been in the system for 25 years. Now, granted, a career, a working career is 35 to 40 years. If a person goes to work at age 20 or 22 and works till age 65 under Social Security, that is a 40-plus year life span. So we don't have 40 years in our plan yet.

We have 25 years. But in the 25 years that we have been in place, we have people with $300,000 and $400,000 in their account who will receive $300,000 and $400,000 in their accounts either in weigh payouts or in lump sum distributions at this time.

Those using that same trending that we are going, even at the lower rate of interest rate, they will end up with substantially more than that in another 15 years when we have a full 4-year, you know, look see at the timeframes.

Mr. SESSIONS. Mr. Gornto, thank you so much for taking your time to be with us today. I will tell you that you have had an opportunity to hear from the members on this side some agreement, some disagreement about what we are attempting to do.

I think what you have done by presenting this Galveston model plan, the banking option, will allow members of this committee, the subcommittee and this committee, as well as our general body, to make wiser decisions about the inclusion of this with whatever we do.

I want to thank you so much for taking your time to be with us today.

Mr. Chairman, I am going to go vote. I yield back my time.

Mr. HENSARLING. The gentleman yields back.

The gentlelady from Wisconsin, Ms. Moore, is recognized for 5 minutes. Ms. Moore.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman.

And I want to thank this panel for coming. I can see that there is broad agreement among all the speakers, that, indeed, one of the sort of hidden problems with these proposals, wherever you stand on private accounts, is that we don't have enough savings, and those savings aren't available, quite frankly, to invest, and I think that is a breakthrough, at least for me, in terms of trying to understand where the major disagreements lie.

I can—I guess the question that I would have, first of all, is for Mr. Brock. In your written testimony, you talked about, if the bank option were available, this would immediately bring $27 million into financial institutions, and ultimately into the economy for lending.

I want you to talk about that, and then also I would like you to mention the fees and the servicing fees and so forth that banks would garner as well.

Mr. BROCK. Well, the assumption is, you know, that if this option were available, that we would increase our rate balances by 10 percent. That would create the $27 billion. The credit unions, you know, our structure—you know, the costs are distributed across all the products, and it is really hard to determine exactly what kind of fees would have to be charged on that kind of an account, because it would be built into the rate. I would assume that these kinds of accounts would be no more expensive to operate than any other kind of deposit or certificate account that we have.

Ms. MOORE OF WISCONSIN. Okay. Well, I guess the next question would be for Dr. Furman. I was very interested in your testimony, because you have really talked about the security of Social Security, and the only way—very informative testimony—about the only way to get a higher rate of return is to take that risk. You have made a great argument for having accounts outside of Social Security and maintaining Social Security.

So I guess I wanted to give you an opportunity to elaborate on that, because we are constantly bombarded with information about the ownership society and how people ought to take charge and so on. I guess I just want you to close the loop that some of us may have in our minds about the difference in ownership society or the example of Galveston, Texas, where the claim is that no one has been harmed and that everyone has been doing great.

Mr. FURMAN. I am all in favor of an ownership society, I think it is a great concept but what we really need to do is follow through on it. So let me give you one example. The saver's credit. It is the only tax incentive we have right now for low- and moderate-income families to help encourage them to save. It is not perfect. It needs to be improved in a number of ways, for lowest-income families, but it expires in 2006.

It is the only part of the tax cuts that are expiring in the next decade that the President has not proposed to renew. The only tax incentive we have for moderate-income families, he would like to end after the year 2006. That is a good way to encourage wealth, along with helping families opt into—you know, automatically enroll in 401(k)'s. Low-income families get very low rate of return from their savings, because if they save a lot, they lose their Med-

icaid. They lose a lot of other benefits. We should raise those asset limits so those families aren't penalized for saving.

Finally, if you carve out a portion of Social Security, you have to give up your Social Security to get an account, you are not any wealthier because of that. What is genuine wealth creation is real savings and new savings.

Ms. MOORE OF WISCONSIN. In addition to the progressive indexing proposal, which was not part of the proposal yesterday—but it is still on the table, according to the President—where low-income people would not have to, would not lose any benefits, but your testimony seems to be that everybody is going to lose with some kind of carve-out. So could you explain to us how that would not be the case with low income?

Mr. FURMAN. Under progressive price indexing, people who make under $20,000 a year, retirees, get their benefits reduced. People who make less than $20,000 a year, according to a White House study, a substantial number of them get their benefits reduced if they are getting survivors benefits, disability benefits, or benefits through a spouse. Low-income families can also see their benefits reduced. It doesn't protect anyone.

Ms. MOORE OF WISCONSIN. My time has expired—because I wanted to ask Mr. Gornto something about Galveston, Texas.

Chairman BACHUS. I will indulge you, because it doesn't look like a long line behind you.

Ms. MOORE OF WISCONSIN. Indulge me.

Chairman BACHUS. Ms. Moore, you may miss your vote on the floor, I am not sure.

Ms. MOORE OF WISCONSIN. Oh, I can't do that. All right. Just very quickly. I am very impressed with what is being done in Galveston, Texas, but I see that the contributors have to make more than the 12.4 percent payroll tax to participate in this program, and then there is no portability. Do you have any examples of people who decided that they don't want to work for these three counties? They wanted to walk—you know, they have to move to Milwaukee, Wisconsin? What happens to their benefits?

Mr. FURMAN. On the contrary, it is fully portable to 401(k) rollovers or IRA rollovers. In addition to that, the extra amount that Galveston is putting in is not arequirement. The 12.26 percent of 6.13 percent, which is the 1981 Social Security level, is still in place. The additional amount they are putting in was a voluntary amount they would put in because they had extra budget. It wasn't a requirement for cost.

That has been a real misunderstanding. They keep, you know, talking about the comparison. But the only requirement has been—and the employees are still paying in 6.13 percent, which was the 1981 level. The employer is just putting in a little extra, and it is fully portable.

Ms. MOORE OF WISCONSIN. Well, thank you very much. I don't want to miss my vote. I absolutely am going to read all of your testimony. Thank you for coming.

Chairman BACHUS. Thank you, Ms. Moore.

Dr. Furman, do you believe that we do have a crisis in Social Security?

Mr. FURMAN. I don't think the terminology matters a lot. We certainly have a problem or a challenge. You can call it a crisis if you want.

Chairman BACHUS. We should move as quickly as possible to address the problems with Social Security?

Mr. FURMAN. The most important thing is to not do any harm. But if we are doing a proposal that is constructive in moving forward, doing that sooner rather than later would certainly be better.

Chairman BACHUS. What would be your proposal for a constructive plan to reform and strengthen Social Security? I mean, specifically?

Mr. FURMAN. We have—the benefits we have promised are $4 trillion larger than the taxes we are scheduled to collect over the next 75 years. Whether you have accounts or don't have accounts, you need to reduce benefits by $4 trillion or raise revenues in some form by $4 trillion. I would like to do some balance combination of both of those. I think that progressive revenue sources have a very important role to play like raising the cap on taxable earnings from the level of today.

Chairman BACHUS. So you would lower benefits and raise taxes?

Mr. FURMAN. Or some combination of the two of those. There is no other way to solve the problem. I don't know of any.

Chairman BACHUS. Now, you were Senator Kerry's advisor during the campaign?

Mr. FURMAN. Correct.

Chairman BACHUS. Was that your advice to him?

Mr. FURMAN. I don't think that political campaigns are the right place to undertake Social Security reform.

Chairman BACHUS. Okay. What did you advise him, I mean, publicly?

Mr. FURMAN. I advised him on a number of issues, but one thing that was very important, I think Social Security is a very small part of our long-term fiscal challenges.

If you look at the tax cuts that were passed over the past couple of years, they cost about 3 times more than the Social Security deficit. The Social Security deficit is $4 trillion. That is pretty large. Tax cuts are about $12 trillion. The prescription drug benefit is about $9 trillion. So if you think about our overall fiscal problems and how we could address them, I recommended to him and I would recommend to you, is the most important thing that any of us can do.

Chairman BACHUS. You know, the Wharton School of Business and others have said that those tax cuts created 3 million jobs. Would you concur with that conclusion?

Mr. FURMAN. Job growth since the recovery began in, I believe, November 2001 has been among the slowest of any job growth recoveries. In fact, we have only just now had more private-sector jobs than we had in January 2001 when President Bush became President. So in my view, the tax cut is successful. Tax cuts should have been done, but there should have been more up-front stimulus and less long-term cost.

Chairman BACHUS. So you don't disagree with the tax cuts. You think it should have been more sooner?

Mr. FURMAN. I think it should have been more bang for your buck, not tax cuts with long-term costs that didn't encourage consumption economic stimulus.

Chairman BACHUS. Well, more sooner would have actually made the tax cuts more expensive than they are, would they not?

Mr. FURMAN. I actually think we could have done about the same magnitude. We did about $200 billion sooner. So I shouldn't have said more sooner.

Chairman BACHUS. If we create personal accounts, would the proposal that we are discussing today be a viable vehicle?

Mr. FURMAN. As you may have noticed from the hearing, I don't think that personal accounts are the greatest idea. That being said, as I look at the proposals by a range of people, the President, Senator Hagel, Congressman Shaw, Bob Posen, every single one of those proposals doesn't have anything like a bank option. The problems of the bank option are not the costs of the bank managing the money. I think, sure, it can do that reasonably well.

It is that needed to take 100 million different accounts and keep track of each one of them separately. In something like the President's proposal, all the money goes into the Government, and then the Government looks, how many people wanted to invest in the stock market, adds up to 50 billion. They hand Barclays $50 billion, and they invest it in the stock market. Here you hand this group $5,000, that group $15,000, and then you need a monitoring and enforcement structure to make sure people didn't withdraw it earlier and break the other rules.

That is why every one of those have rejected it. In fact, I testified to Senator Hagel's committee last week, and he was very strenuous that, no, no, this is government centralized management of the money to keep down costs. Every time I said, you know, it might have a higher cost, he said it is not going to have a higher cost because we are not going to do it that way.

Chairman BACHUS. Well, you are talking about 20,000, 30,000 different accounts, some investing 20, some investing 30 in different funds. Isn't that what the Federal workers do today through the Thrift Savings Account?

Mr. FURMAN. No, it is not. First of all, there is one employer, the TSP. And the country as a whole, there are millions of employers. There are a lot of administrative complications that you have that you don't have with the TSP. But the TSP, assuming that you have a TSP, the TSP administrator doesn't have your own personal account with your name on it keeping track of the moneys.

They just take all the money. They figure out how many people wanted to invest in the stock market, including potentially you. They take all of that together, and they hand it to Barclays, and they invest it collectively.

Chairman BACHUS. Actually, they don't hand it—there are different funds, T-bills.

Mr. FURMAN. No, no, most of them are invested by Barclays, one by the Treasury, the G Fund. But the administrative complications of a decentralized system is something we see in Chile and the U.K. Studies have found it eats up about 40 percent of your retirement balance. I have been on a lot of panels.

Chairman BACHUS. I am not—generally, it doesn't really. Understand, I am more interested, you know, in the Federal employees. As a Federal employee, whether you are a Congressman or a postman or an air traffic controller, the yield has been, the return on investment has been—the worst you could have done if you had made all the worst decisions on which funds would have been 3.9 percent. The best would have been 11 percent. In my case, it is about 8 percent. I thought I was doing fairly conservatively. But how does that compare with the rate of return on Social Security?

Mr. FURMAN. There are, you know, as I tried to explain in my testimony, there are three problems with comparing the rate of return in Social Security and the rate of return in the private market. One, Social Security—the private market has risks associated with it, market risks. Number two, the private market doesn't provide insurance services. Then, the most important thing is, if we could—

Chairman BACHUS. I think what we have done there is we have broken out the disability insurance. I think every proposal has taken the pension or the retirement component, and they have broken out the disability insurance and preserved that.

Mr. FURMAN. Almost all of them, you are correct, take out the disability. Some of them don't take out the survivors'.

Chairman BACHUS. Let us just say, and I think we would agree, that one that did not break out the disability and the President proposes breaking out the disability—

Mr. FURMAN. He did. But, unfortunately, not the survivors', but we don't need to get hung up on that. The most important economic issue is one that I tried to explain through the words of Greg Mankiw when quoting him.

If we could all take our money out, we are getting about a 1.5 percent rate of return above inflation and Social Security right now. If we could all take our payroll tax out, our 12.4 percent out, and put it in bonds, we could do a little bit better than that. The problem is, we are still spending $500 billion a year on the current senior citizens. Where is their money going to come from?

Chairman BACHUS. What about a phase in?

Mr. FURMAN. Well, what would happen, during the course of that phase in, you would have to—I would have my money getting a higher return on the account, but then I would be paying higher income taxes to support the current retirees.

Chairman BACHUS. I think the people who get a greater return wouldn't mind paying income tax on that return. It would actually be when they paid it—

Mr. FURMAN. There is a mathematical theorem, and it is associated with a number of economists. Olivia Mitchell, who is a member of the President's Social Security Commission, supports reform and supports private accounts.

They have proven that how you did that transition, no matter how you phased it in, the cost of that transition was exactly equal to the difference in the rate of return between Social Security on the market right now, so that once you factored that transition cost in, no matter how you phased it in or out—if—and this is a member of the President's Commission that explained it—you can't get a higher rate of return.

Chairman BACHUS. Thank you, Dr. Furman, I do appreciate your candor.

Mr. Gornto, they teach you in law school, never ask a question you don't know the answer to. But this Evelyn that we talked about earlier—

Mr. GORNTO. This what?

Chairman BACHUS. Evelyn, the lady.

Mr. GORNTO. Oh, yes, Evelyn.

Chairman BACHUS. Did she express regret that the money was spent on her husband's open heart surgery?

Mr. GORNTO. I don't think so.

Chairman BACHUS. Okay. So she actually doesn't—she agrees that was pretty good?

Mr. GORNTO. She agrees that that was—

Chairman BACHUS. I would agree with her. Particularly, if they are still married.

Mr. Pearce.

Mr. PEARCE. I can't follow that. I may have to go to the House.

Mr. Gornto, you are described in, I think, Mr. Furman's testimony as free riders in your Galveston system. Free rider indicates, it hints at someone who gets on the train and goes to their destination and then gets off without paying.

Do you all draw—in terms of Social Security, that would indicate you all are drawing Social Security benefits without paying into the system. Do you all do that?

Mr. GORNTO. I am sorry. I am not quite sure I understand your question.

Mr. PEARCE. Do you all, are you free riders on the Social Security system? The accusation has been made by the gentleman sitting to your left.

Mr. GORNTO. Are we free riders?

Mr. PEARCE. In Social Security. Do you draw benefits without paying into the system?

Mr. GORNTO. The—

Mr. PEARCE. Do you draw Social Security benefits?

Mr. GORNTO. Yeah, the Galveston County employees when they terminated the contract in 1980 accrued a benefit up to that point. Whatever they paid in they accrued, and that benefit has stayed with the benefit they have gotten from us.

Mr. PEARCE. So you get Social Security benefits.

Mr. GORNTO. Whatever had accrued to 1980 or any other type of job they would have, yes, sir.

Mr. PEARCE. Okay. It is also stated that Social Security is paying greater benefits than in your plan. You are saying that you had hoped to draw equal or greater benefits to Social Security. Are you succeeding in that?

MR. GORNTO. Yes. I have a chart that shows—

Mr. PEARCE. Mr. Chairman, with a unanimous consent I would like to get that chart as a part of the record.

MR. GORNTO. I think I gave it to you.

Mr. PEARCE. Okay. Fine. Mr. Furman, you alleged exactly the opposite. Did you bring your chart showing where the benefits are not as great?

Mr. FURMAN. I have my chart and it is from the Social Security Administration.

Mr. PEARCE. Okay. But it shows that actually the benefits are less than in the Galveston plan.

Mr. FURMAN. Correct.

Mr. PEARCE. Mr. Chairman, if we could get that put into the record.

Mr. Furman, you indicate that the cost on the administration can be 30 to 40 percent of the final account balance. When I look at my costs for the TSP, and that is what the President has said he visualizes, a TSP type program. I look at my costs and they are .001. Now that is 1/300th of your estimate. You range—actually I round off, it is .0006 of my actual cost, and that makes your estimate 500 percent overinflated.

Can you submit the documentation by which you say that our costs are going to be 500 percent greater under TSP under Social Security of the President's plan?

Mr. FURMAN. Sir, would you let me explain briefly?

Mr. PEARCE. No, I just want you to submit your documentation. I think it bears the scrutiny. You have made a pretty strong claim and I would like to see that documentation.

Mr. FURMAN. Okay. It is not the TSP that would. It is the bank option. But I will submit it to you.

Mr. PEARCE. I understand. Mr. Gornto, you said that you provide survivor benefits. Can you provide documentation that you actually do that?

Mr. GORNTO. Yes.

Mr. PEARCE. You said the Galveston plan has survivor benefits. And again Mr. Furman claims that it doesn't.

Mr. GORNTO. We can prove that.

Mr. PEARCE. Mr. Furman is shaking his head.

Mr. FURMAN. I said it doesn't have spousal benefits for dependent spouses while you are alive. That is different from survivor's benefits.

Mr. GORNTO. I disagree. It has them.

Mr. PEARCE. All right. I see that. Okay. Would any of you tell me what we do with our Social Security surpluses right now? We have surpluses at the current point. What do we do with those surpluses? How do we invest them? Anyone?

Mr. FURMAN. Special issue treasury bond.

Mr. PEARCE. Special issue treasury bonds. And what are the rates of return on those special interest treasury bonds?

Mr. FURMAN. Long term projection is for 3 percent rate of return, above inflation about 5.8 percent.

Mr. PEARCE. If I go down and buy a long-term bond today I can get—

Mr. FURMAN. I think it is less than that today.

Mr. PEARCE. It is somewhere down on the floor at 4 percent. Are we buying long-term bonds for Social Security or are we buying short-term bonds? I have the information that we are actually buying short-term bonds because we are not allowed to buy the longer term bonds.

Mr. FURMAN. We buy bonds that are a special issue. They have the same rate of return as a maturity of 4 years and up average—from 4 to 30-year bonds to average return.

Mr. PEARCE. So on the—let me switch over and I will ask the question. Mr. Furman, I walked in on the discussion about the tax cuts and what should have been on tax cuts. Does the size of our government spending as a percent of our overall economy rise to the level of concern for you?

Mr. FURMAN. I am concerned that we have seen one of the largest expansions in government.

Mr. PEARCE. Not size, that is relative. In other words, when we cut taxes the idea is we depress down the size of government?

Mr. FURMAN. I see that that theory works. We have actually seen a huge expansion in government spending.

Mr. PEARCE. I mean we went from 25 percent to 23 percent. Now, the relationship is that as you move beyond 25 percent your economy stagnates and becomes very immobile. As you lower the percent it has greater vitality and growth. And if you want, the way that that has played out, you could look at the Irish miracle, where they have a tax rate of 10 percent, the government spending lowered and their economy jumped significantly. You could also scoot over to New Zealand where they cut the size of government significantly, and they graduated it up, the scale of industrialized economies and then if you come to current day Germany, at 52 percent, we are again at 23 percent. They haven't created a new job in 10 years.

Now, your basic assumption that we should have left the tax rates up would encourage us to be higher—in the higher percentage of government projects. And if we look at the other side of the aisle's recommendation on spending, we could easily find ourselves way up in the 30 to 40 percent range if we delay the solution of Social Security right now, solution, use the high estimates, $3 trillion averaged out over 10 years, $300 billion. The low end is a trillion dollars. Average that out over 10 years you get 100 billion.

If we do like you are recommending and do nothing, the estimates are $11 trillion to solve the problem 75 years from now. And divide that by 10 and you get one trillion per year solution cost with a $2.5 trillion budget.

I don't see how we can keep our economy vital; that is, the percent of government spending as a total percent of the economy. I don't see how we can get where we need to be as far as a vital economy. If you have any comments on that.

Mr. Chairman, I see my time has elapsed and I will let him close.

Chairman BACHUS. I would appreciate that, Mr. Pearce. We are going to conclude our testimony at this time. Before I do, I want to thank the panelists for their testimony and I also want to thank Mr. Sessions and Mr. Feeney's staff who were very effective in putting this hearing together as well as Marisol Garibay, who is here on Mr. Oxley's staff, who coordinated this entire hearing and did an excellent job. I would like to commend you, Ms. Garibay.

We do appreciate your testimony. I think the thing that we all agree with on both sides of the aisle is that we do have, whether we call it a crisis or a critical juncture in Social Security, there

needs to be reform, overhaul, whatever we want to call it. And every year that goes by we don't do it, it costs almost a trillion dollars a year, which is a staggering amount. And we have our baby boomers facing us 3 years down the road. And so we appreciate your testimony.

Without objection, all written statements will be made a part of the record, and the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses and to place their responses in the record. This hearing is adjourned.

[Whereupon, at 12:14 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 23, 2005

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"BANKING ON RETIREMENT SECURITY: A GUARANTEED RATE OF RETURN"
JUNE 23, 2005

Good morning. The subcommittee will come to order. Today's hearing, which was requested by Congressman Sessions and Congressman Feeney, will focus on giving workers a community bank/Federally insured financial institution option in any Social Security reform plan that includes personal accounts. This will allow workers to invest part of their Social Security into a Federally insured certificate of deposit (CD) offered by a community bank, savings association, or credit union in addition to securities instruments.

Congressman Sessions and Congressman Feeney have introduced H. Res. 209, expressing the sense of the House of Representatives that any plan to reform Social Security should include a bank option. In addition, they sent a letter that was signed by 15 other Members to the Ways & Means Committee urging that Committee to support a bank option as part of Social Security reform. Five members of this Subcommittee including myself signed onto that letter. I commend them for their work on this issue and appreciate their bringing it to my attention.

Changing demographics, including an aging baby boom generation, will inevitably bankrupt Social Security. President Bush deserves high praise for his leadership in opening an honest debate on this issue. While today's retirees and those approaching retirement are guaranteed their benefits, we must take action to ensure Social Security is there for future generations. The longer we delay, the more drastic the remedy that will be required to rescue the system.

While no specific plan has been submitted to Congress to review, the creation of Personal Savings Accounts has been discussed as a measure that will allow younger workers to invest part of their Social Security and earn a higher rate of return than the traditional system. I endorse the general concept of allowing younger workers to invest part of their Social Security accounts and earn the much greater rates of return available in other investments.

Those who oppose Social Security reform have long argued that creating personal accounts would expose Social Security benefits to the uncertainties of the market. Although I disagree with those arguments and believe that the typical returns on stocks and bonds will substantially enhance retirement benefits for today's workers, I believe Americans should

also have a relatively risk-free option, such as the bank option. This option would become more important as workers get closer to retirement age and want to move their assets from stocks and bonds to an investment that protects their principal against market swings.

By including a community bank option in any reform bill, workers would be permitted to rollover funds into more than one product. This would give workers the flexibility to invest part of their assets in almost risk-free products, such as CDs, offered by any FDIC or NCUIF-insured financial institutions, and part of their assets into a higher risk/higher return vehicle if they choose to do so.

Another unintended benefit of this option is that allowing investments in FDIC-insured accounts returns money to the communities where taxpayers live and work. Community banks and credit unions will invest these funds in their local communities by providing loans to local businesses, mortgage loans to families, education loans, auto loans, etc. This community development component will help neighborhoods and communities throughout the country. In short, the community bank option is a win-win for America's savers and its local communities.

Let me close by saying this isn't about politics, it's about basic arithmetic. In the 1940's there were 42 workers paying into the system for every retiree, and the average worker did not live to retirement age. Today there are three workers paying in for every retiree, and the average American is living almost ten years past retirement. This is unsustainable, and we here in Congress owe it to our constituents to roll up our sleeves to solve this problem, rather then engaging in partisan-politics-as-usual.

Again, I want to thank Congressman Sessions and Congressman Feeney for their efforts on this issue and for working with us on this hearing. I look forward to the witnesses' testimony on this important topic.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

STATEMENT OF THE HONORABLE WM. LACY CLAY
Before the
Committee on Financial Services
"Banking on Retirement Security; A Guaranteed Rate of Return"
June 23, 2005

Good morning Chairman Baucus, Ranking Member Sanders, Members of the Committee and Witnesses.

I oppose any form of privatizing Social Security because it is the wrong choice for American workers. I am committed to strengthening and preserving Social Security. Social Security has offered a priceless assurance that those who have spent their lives working hard will receive guaranteed benefits; this safety net must not be destroyed by risky investments in an often volatile and always unpredictable market.

According to the Congressional Budget Office (CBO), Social Security will be able to pay *full guaranteed benefits* for all participants for nearly 50 years and even after that it will still be able to pay 80 percent of all benefits. Congress must work in a bipartisan manner to modernize Social Security and prevent any future cuts in benefits, but we should not destroy a program that has well served the American people for the past 70 years.

Now we have new proposals that would create individual retirement accounts from the surplus left over after program expenses and benefit packages are paid. There is a Senate version and a House version of these proposals. They both look very pretty on paper. However, this is simply another method or excuse to borrow money from social security.

Leave Social Security alone!! The American People want Social Security made solvent, not changed. If you want new programs, that is fine. Just create them somewhere else and not in the Social Security program. If the programs are so great, they don't need Social Security to back them up. Additionally, Social Security is not a cover for ill advised tax cuts. Leave Social Security alone!!

Too many seniors, particularly those with lower incomes, have difficulties saving for their retirements. Stock market returns are never guaranteed as we realized between 2001 and 2003 when the NASDAQ lost 75 percent of its value. Relying on risky financial markets to acquire a secure retirement is not the answer. A comfortable retirement rests on a three-legged stool: pensions, personal savings and Social Security. Social Security is the most reliable leg of that stool and continues to be the foundation for a secure retirement.

It is morally wrong to make today's workers bear the transition costs of switching to privatized Social Security accounts.

Statement of Congressman Pete Sessions (TX-32)
"Banking on Retirement Security: A Guaranteed Rate of Return"
House Committee on Financial Services
Financial Institutions and Consumer Credit Subcommittee
2128 Rayburn House Office Building
Thursday, June 23, 2005

Mr. Chairman, I appreciate the opportunity to address the House Committee on Financial Services on the important issue of retirement security. I would also like to take this opportunity to thank you for the leadership and vision that you have demonstrated on this issue. Few debates in Washington have as great a real-world impact on the quality of life of older Americans as our nation's retirement security policy. In its current state, Social Security – upon which many workers rely to provide a comfortable retirement income – is supremely inefficient for accomplishing this important and necessary goal. In a little more than a decade, Social Security will reach a critical juncture in its history, as it begins to pay out more in benefits than it takes in through payroll taxes – which everyone understands is an untenable financial situation that cannot continue indefinitely.

It is critical for Congress to examine ways to provide a long-term solution for the problems that currently plague the system. Social Security needs to be reformed – and another short-term fix that fails to address the underlying causes of these problems is simply unacceptable. As Congress examines its options for providing long-term solvency of Social Security, I believe that there is one essential element that must be part of any comprehensive reform – what I call "the

banking option." The banking option would allow workers to put part of their Social Security benefits in a product similar to a federally insured (FDIC or NCUSIF) certificate of deposit (CD) and receive a guaranteed rate of return. Perhaps most importantly, the banking option would give risk-averse workers the opportunity to own a safe, personal account that would guarantee a set rate of return greater than what is offered by Social Security and one that is as safe as money in the bank.

While studying measures that can serve as components of comprehensive Social Security reform, I believe that Congress should pay particular attention to measures that have already been created and implemented in "field laboratories" at the local level throughout the nation. Fortunately, one such laboratory for studying the real-world effects of the banking option already exists in Galveston County, Texas – the birthplace of the banking model. Over 20 years ago, county employees in Galveston County – recognizing the future problems facing Social Security – voted overwhelmingly to create an alternative to the Social Security system that gives retirees control of their own money at virtually no risk to the beneficiary. These workers' payroll taxes are deposited in personal retirement accounts that purchase commercial banking and life insurance products already available in the marketplace – like certificates of deposit, annuities, and government bonds – all with fixed and guaranteed rates of interest. The results have been extraordinary, and Galveston County employees have averaged annual returns of 6.5 percent. Even today with our historically low interest rates, workers in Galveston still receive returns of 3.75 percent on their investment, far better than Social Security's current return of 1.8 to 2 percent. For a person working 37 years in Galveston County, making about $25,000 a year, they

would receive $1,250 a month from the alternative plan – as opposed to $669 from the current Social Security system.

Giving workers this expanded choice is an important option for reforming Social Security because it provides workers with the same or better benefits – including retirement, survivorship, and disability benefits – as an unreformed Social Security system. The other important aspect of this plan is that, as workers get closer to retirement age and more vulnerable to potential swings in investment rates of return, the banking option allows them to move their assets into a conservative investment vehicle that protects their principle from a potential market downturn.

There is nothing new about giving Americans the ability to put their money into an account with guaranteed returns. Because it is a savings plan and not an investment plan, employees benefit from the security of a minimum return and professional management of their account. If the stock market declines, financial institutions bear the burden – not account holders. There is no more risk than what is already inherent in the current Social Security system. That is why I have introduced, along with Congressman Tom Feeney and Congressman Paul Gillmor, H. Con Res. 209. This legislation simply expresses the sense of Congress that any Social Security reform legislation should include this Community Bank option, and I believe that listening to our witnesses here today, we can begin to further explore how this option can be implemented.

I commend the Subcommittee on Financial Institutions and Consumer Credit for dedicating this morning to examining how the banking option could be incorporated into an overall Social Security reform plan. Any long-term solution proposed by Congress must be voluntary and

equal to or greater than the current benefit that workers receive and guarantee the long-term solvency of the system – two tests that the banking option meets. I believe that individual choice and opportunities are crucial for any Social Security reform plan and that allowing workers to diversify their assets will make for a stronger and safer retirement security plan for American workers. Inaction on the issue of Social Security reform is not a solution, and will result in either massive tax increases or massive benefit cuts – both of which are unacceptable options. I look forward to working with the Chairman, and with all relevant parties, on strengthening and improving Social Security for future generations of American workers by giving workers the choice to own personal accounts that include a Community Bank option.

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TESTIMONY

OF

DAVID O. BROCK

PRESIDENT/CEO, COMMUNITY EDUCATORS CREDIT UNION

ON BEHALF OF THE

CREDIT UNION NATIONAL ASSOCIATION (CUNA)

ON

"BANKING ON RETIREMENT SECURITY: A GUARANTEED RATE OF RETURN"

BEFORE THE

HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

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JUNE 23, 2005

Chairman Bachus, Congressman Feeney, and members of the Subcommittee, on behalf of the Credit Union National Association, I appreciate the opportunity to provide CUNA's views this morning on the topic of "Banking on Retirement Security: A Guaranteed Rate of Return." CUNA is the largest credit union trade association, representing approximately 90% of our nation's nearly 9,300 state and federal credit unions and their 86 million members.

You have asked us to comment on Representatives Feeney and Sessions' proposal to give workers the option to invest part of their Social Security into a Federally insured certificate of deposit (CD) offered by a credit union, community bank, or savings association.

First, I should clarify that CUNA has taken no formal position on whether any plan to fix Social Security should include private accounts. However, if legislative changes allow workers to direct part of their payroll taxes into individual accounts, we believe it makes sense to include all financial institutions as one option for participants.

Sound personal financial planning dictates that retirement funds for those nearing retirement be distributed, in part, in lower-risk, safe, liquid investments. Financial institutions offer such accounts. In fact, at year-end 2004, financial institutions controlled a total of $270 billion in Individual Retirement Account (IRAs) deposits.[1]

It is difficult to project the potential effect of allowing consumers to invest Social Security funds in financial institution savings accounts such as certificate accounts. And because such accounts would provide a relatively low, albeit safe, return on the investment, it is likely that it would be used more by those approaching retirement than by younger workers. This certainly would be consistent with the savings trends in IRAs at my credit union, where IRA savings are significantly concentrated in those in higher age categories. In either case, however, an increase on the order of 10% of current IRA balances might serve as a conservative estimate of increase of savings through a CD option. In this case, financial institutions would experience a $27 billion increase in savings and credit unions would garner an estimated total of roughly $5 billion (based on their current 18% share of the depository institution IRA market). An increase of this magnitude could have an obvious impact on the economy and the communities in which workers live. They would become more financially independent and be more likely to have sufficient funds to spend on goods in their retirement, thus stimulating the economy and providing or maintaining employment.

Social Security plays a critical role in the lives of 48 million beneficiaries, and 159 million covered workers and their families.

[1] Federal Reserve and National Credit Union Administration.

The widely-acknowledged challenges facing the Social Security system are compounded by the fact that U.S. consumers generally save very little and specifically put very little aside in private retirement accounts.

The U.S. personal savings rate has been on a declining path for roughly two decades. In the 1975-1984 period personal savings as a percent of personal disposable income averaged nearly 10%, but fell to an average of 7% over the 1985-1994 period, and to an average of less than 3% in the 1995-2004 period. The personal savings rate at the end of April 2005 was just 0.41% -- near its historic low.[2]

Moreover, a recent Brookings Institution Policy Brief found that only about "half of workers participate in an employer-based pension plan in any given year, and participation rates in Individual Retirement Accounts (IRAs) are substantially lower. Further...many households approach retirement with meager defined contribution balances."[3]

Financial institutions can help close this gap. And credit unions in particular are uniquely positioned to assist consumers in doing so.

Credit unions, which pay very favorable interest rates on savings accounts, provide a wide variety of savings product alternatives to their members. At year-end 2004, credit unions had $575 billion in savings accounts. Of this total, 22% was held in share certificate accounts, 18% was held in money market deposit shares, 8% was in individual retirement accounts and the remainder was in other short-term liquid accounts.

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[2] Bureau of Economic Analysis.
[3] Brookings Institution Policy Brief #135. July 2004. Improving the Saver's Credit. William G. Gale, J. Mark Iwry and Peter R. Orszag.

As not-for-profit member-owned financial cooperatives, credit unions have a long history of serving as trusted financial advisors and in providing their 86 million members with financial education materials, including those that stress the need for saving and retirement planning.

These characteristics are reflected in the fact that while credit unions have a 12% share of household savings held in depository institutions, they account for an approximate 18% share of IRA balances held in depository institutions.

In summary, we believe that any legislative change allowing workers to direct part of their payroll taxes into individual accounts should include financial institution savings accounts as one option for participants. Financial institutions have extensive experience in providing retirement-related accounts. And financial institution accounts provide a level of liquidity and safety that is not available through other sources.

Thank you.

Testimony of

America's Community Bankers

on

"Banking on Retirement Security: A Guaranteed Rate of Return"

before the

Subcommittee on Financial Institutions
and Consumer Credit

of the

Financial Services Committee

of the

United States House of Representatives

on

June 23, 2005

Michael J. Brown, Sr.
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Harbor Federal Savings Bank
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and

Member
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Washington, DC

Chairmen Bachus, Ranking Members Sanders and members of the Subcommittees, my name is Michael J. Brown, Sr. I am President and Chief Executive Officer of Harbor Federal Savings Bank, a $2.9 billion publicly traded savings association located in Ft. Pierce, Florida. Harbor Federal Savings Bank is a community financial institution serving the eastern-part of Florida, where we currently operate 37 full-service banking offices. The primary business lines of the bank are consumer, mortgage and commercial lending.

I am testifying today on behalf of America's Community Bankers, where I have served as a member of the Board of Directors and continue to serve on several committees. Thank you for this opportunity to testify on Banking on Retirement Security: A Guaranteed Rate of Return and its importance for a solvent retirement system in the United States.

Before I begin, I must also commend the hard work that Congressman Tom Feeney and Congressman Pete Sessions have done on this issue. They and their staffs have been working tirelessly, along side with America's Community Bankers, to ensure community banks across our nation are part of any Social Security reform with the so-called "Community Bank Option."

Personal Savings Accounts

The debate over creating a more solvent Social Security retirement system has gained momentum over the past few years, especially with the Administration putting the issue front and center. Because Social Security operates almost entirely as a pay-as-you-go system, it is highly sensitive to the dramatic demographic changes that are increasing the average ages of our population. Increased life expectancies mean more retirees collecting benefits for more years. The resulting decline in the ratio of workers to beneficiaries is pushing the system toward insolvency, and personal savings accounts may be one way to create a more secure Social Security system.

For several years now, ACB has supported allowing workers the choice of investing at least a part of their Social Security taxes in personal accounts. This approach will give individuals greater control over how their retirement security funds are invested and can create a more solvent system. Social Security reform should give workers the option of relying on their community banks and the investment products those banks offer, including insured deposits, in addition to those investment options available on Wall Street.

Community Banks Are Experienced Investment Advisers

Community banks already offer a variety of retirement investments, including FDIC-insured Individual Retirement Accounts (IRAs), certificate of deposits (CDs), mutual funds and annuities. Because community bankers understand the creation of wealth and their customers, they are in an excellent position to help consumers choose appropriate investments for these personal accounts.

ACB believes that any Social Security reform should ensure that consumers have the option of

Age Distribution of IRA Accounts at Insured Institutions

Age of head of household	Percent of all households in each age group that have IRA accounts at insured institutions	For each age group, IRA deposits at insured institutions as percent of total IRA funds
< 35	5.3	25.0
35 – 49	11.1	16.4
50 – 64	17.0	18.4
65 – 69	18.5	28.0
>= 70	16.1	27.4
All ages	**12.3**	**21.2**

[1][2][3][4]

Community Bank Option Invests In Local Communities

Allowing investments in FDIC-insured accounts returns money to the local communities where taxpayers live and work. Community banks will invest these funds in their local communities by providing loans to local businesses, mortgage loans to families, education loans to students headed off to college, and in many other ways. If this option is adopted, it could result in reduced rates for these loans.

Increase Deposit Insurance

Providing a substantial increase in deposit insurance coverage for all retirement accounts would further enhance the community bank role. Currently, the FDIC provides up to $100,000 of deposit insurance for the retirement accounts (e.g. IRAs and Keoghs) of a depositor in a bank. The shift in America from defined benefit plans to IRA and 401(k)-type savings has increased the burden on individuals to manage their own assets. Retirement assets often exceed the current $100,000 coverage limit by substantial amounts. A substantial increase in FDIC coverage of retirement accounts would strengthen the viability of the insured deposit account option. And it is important to note, the FDIC is funded through assessments on banks and savings associations.

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[1] Data were provided by Federal Reserve Board staff based on the 2001 Survey of Consumer Finances (the most recent survey available) published in 2003.
[2] IRA accounts refer to all IRA and Keogh accounts, excluding IRA-SEPs and similar accounts maintained as part of an employer-provided retirement benefit.
[3] Insured institutions include banks, thrifts, and credit unions.
[4] IRA deposits refer to the sum of IRA account balances of all household members at all insured institutions used by the household.

Conclusion

ACB strongly believes that FDIC-insured retirement accounts, or the Community Bank Option, should be available for workers choosing personal accounts. Workers of all ages could benefit from an FDIC-insured deposit option. Some workers will be wary of investing their retirement funds in equities and other retirement products that carry risk. For these workers, an FDIC-insured long-term deposit account would be the most appropriate investment for all or part of the funds freed up by Social Security reform.

We thank Chairmen Bachus and the rest of the Subcommittee members in giving us this opportunity to present our views.

Testimony on "Banking on Retirement Security"

Jason Furman[1]
Non-Resident Senior Fellow, Center on Budget and Policy Priorities &
Visiting Scholar, New York University Wagner Graduate School of Public Service

Testimony Before the Financial Services Subcommittee
of the U.S. House Committee on Financial Services
June 23, 2005

Mr. Chairman and other members of the Committee, thank you for the invitation to address you today. The question of whether to establish individual accounts in Social Security is a contentious one. I want to begin my testimony by making a few points that everyone – whether they support or oppose accounts – generally agrees with. I will then go on to explain why I believe replacing a portion of Social Security with individual accounts would be a mistake.

First, if accounts are established, they should not include a bank option.

No individual account proposal scored by the Social Security actuaries in the last several years includes a "bank option." There are two principal reasons for this:

First, accounts proposals all include a Treasury bond option. This is the safest security there is (although guaranteed to lose money, as I explain below). There is no financial reason to supplement this with an additional bank option. Bank accounts – including CDs – provide a higher degree of liquidity in exchange for a lower rate of return. The additional liquidity provides no additional benefit for retirement savings which often are not needed for several decades.

Second, and more fundamentally, the additional monitoring and enforcement costs associated with a bank option would be prohibitively expensive compared to the current design of Social Security proposals. Every plan I am aware of – including those developed by President Bush, Congressman Shaw, and Senator Hagel – has what are called "government-organized" accounts. A so-called "central administrative authority" would, according to the White House fact sheet on the President's proposal, "collect personal retirement account contributions, manage investments, maintain records, and facilitate withdrawals at retirement." This administrative structure limits choices and services, but takes advantage of economies of scale to provide lower costs (although still about ten times higher than the cost of administering the current Social Security system).

Establishing a bank option would entail setting up what are called "privately-organized" accounts, like existing IRAs or the accounts in the U.K. and Chilean individual accounts system.

[1] The views expressed in this testimony are mine alone.

In addition to loss of economies of scale and the higher administrative costs to track each individual account, a system would need to be set up to monitor early withdrawals and other program rules. The costs of such accounts, according to the Congressional Budget Office, the observation of 401(k) plans, and the experience of Chile and the United Kingdom, could eat up more than 30 or 40 percent of the final account balance.

Second, Galveston does not provide a model that is relevant for nationwide Social Security reform.

The Galveston Plan bears little resemblance to individual accounts plans. Instead, county invests pension funds in the market; individual workers do not have accounts or any control over investment decisions. Participation in the Galveston plan is mandatory. The Galveston Plan also features higher payroll tax contributions: 13.9 percent of payroll, as compared to 12.4 percent under the traditional Social Security system.

In addition, retirement benefits are generally lower in the Galveston plan than under Social Security. The plan has no spousal benefits and no adjustments for the cost of living. According to a study by the Social Security Administration, the Galveston Plan "offers a lower initial ongoing benefit than Social Security for single workers with low earnings and for married workers at the low, middle, and high earnings level… after 15 years Galveston's benefits are lower than Social Security's for all family/earner types with the exception of single, very high earners. After 20 years, all of Galveston's benefits are lower relative to Social Security's."

Finally, and most importantly, Galveston could not provide a model for the country as a whole. The several thousand municipal employees in the Galveston plan do not make any contributions to support current Social Security beneficiaries. If the United States as a whole adopted a Galveston-like plan, *there would be no one left to pay the $500 billion annual cost of benefits for the nation's 45 million current Social Security beneficiaries.*

In other words, Galveston's municipal employees are "free riders" who are escaping their share of the national obligation to finance Social Security for current retirees. The United States as a whole cannot "free ride" in the way that government employees one relatively small county can.

Third, and most fundamentally, there is no such thing as a guaranteed higher rate of return.

The basic principal of financial markets is that you only get higher returns as compensation for taking greater risks. As Nobel Prize winner (and supporter of individual accounts) Gary Becker explained, "There are no freebies from such investments since the higher return on stocks is related to their greater risk and other trade-offs between stocks and different assets."

Social Security benefits are not subject to any market risk. In fact, Social Security provides critical insurance against becoming disabled, dying, or outliving ones savings. No

financial instruments provide this range of benefits and, if they did, they would be extremely expensive.

Comparison of the rate of return in Social Security to the rate of return in private markets are misleading because they ignore the insurance provided by Social Security and the greater risks associated with equity investments. More fundamentally, these comparisons ignore the cost of paying for *current* Social Security beneficiaries – a cost that must be paid regardless of whether *future* retirees get benefits from Social Security or from market-based investments.

As Greg Mankiw, former Chairman of President Bush's Council of Economic Advisers explained,

> "Admittedly, some of Bush's arguments are off the mark. When he compares the 2% real return a worker now gets from Social Security with the 6% real return offered by a portfolio of stocks and bonds, he neglects to mention that the Social Security fund still owes a huge amount to those now or soon to be retired. This liability – the overhang from giving earlier generations more than they put into the system – doesn't disappear with privatization. Whatever system Bush comes up with, it won't give young workers a 6% return."

Every policy analyst and economist, whether they support or oppose accounts, would agree with my statements about the bank option, Galveston and rates of return. I would, however, like to make one more point:

Fourth, in my judgment the risks associated with a proposal like the President's are unjustifiable.

The President's proposal would not increase the return to Social Security, in fact for many beneficiaries it would lower it. Under the President's accounts proposal, you need to get a rate of return of 3 percent above inflation just to break even – that is about 5.8 percent total annual return. By way of comparison, CDs currently have a 3.5 percent rate of return. That is a surefire way to lose money under the President's proposal.

Even a sounder investment strategy would still be highly problematic. A study by noted financial economist Robert Shiller, the author of *Irrational Exuberance* and a professor at Yale University, found that people that held accounts modeled on the President's "lifecycle" proposal would lose money between 32 and 71 percent of the time. This is not a risk I would recommend taking with a secure retirement benefit.

In conclusion,

Investing and risk taking have an important place to play in wealth accumulation and retirement security. Policymakers should do more to encourage savings by moderate-income families through IRAs and 401(k)s. But I do not recommend reducing Social Security benefits

and replacing them with an individual account that is subject to market risk. And if Congress does choose to establish individual accounts, I would strongly recommend not including a bank option.

Thank you, I look forward to the Committee's questions.

First Financial Benefits, Inc
Houston, Texas

Statement of Rick Gornto, CFP, President of First Financial Benefits Inc.

To the House Committee on Financial Services

2129 Rayburn House Office Building

Thursday, June 23, 2005

Mr. Chairman and members of the committee, thank you for inviting me to this hearing and allowing me to speak to you today about the very important topic of Social Security reform. My name is Rick Gornto and I am President of First Financial Benefits, Inc. a retirement plan designer and administrator in Houston, Texas. The reason I'm here today is to talk to you about how the Galveston Plan could be a model for America and to review with you how the plan was designed and how it has performed during the last 25 years in several counties and cities in south Texas.

In 1980, I was asked by Don Kebodeaux, my business partner, county Judge Ray Holbrook and county attorney Bill Decker of Galveston County to see if I could design a privatized substitution for Social Security. During the ensuing nine months the plan was developed and presented to Galveston employees and county commissioners who both voted overwhelmingly to adopt the plan.
The county then had decided to opt out of Social Security and install a private plan beginning Jan.1, 1981.

The primary design features of the plan were as follows:

1. Design the plan that mirrored Social Security benefits; Retirement, Survivorship and Disability benefits
2. Design the plan to have equal to or greater benefits with equal to or less costs
3. Design the plan to have fixed costs over an long period of time
4. Design the plan with more flexibility than both Social Security and their current state retirement plan(Texas County and District Retirement plan)
5. Design the plan to have guaranteed returns on the investments i.e. take no risks
6. Allow for hardship withdrawals
7. Allow for lump sum distributions
8. Do not include cost of living adjustments
9. Design the plan that has private accounts and private ownership of the plan assets

10. Design the plan that the employees can leave to their estate
11. Design the plan the has built in tax efficiencies

These plan features were drafted and all but the hardship withdrawal option exists today. The plan has been very successful in meeting its intended goals and there have been hundreds of people who have used these benefits for their personal retirement, income replacement and their estates. The plan has covered a diverse range of people at different wage levels as well as both union and non union workers.

The plan investment performance has been excellent as well. During the past 25 years the plan has provided returns from between 15% and 3.75% return. The guaranteed rates that have been paid have always been higher than the prevailing interest rates in the general economy so that the plan has always been very competitive when compared to other fixed return investments.

It is my contention that this plan, with a few modifications, could be used as a national plan. It is a plan that is based on asset building rather than pay-as-you-go, personal ownership rather than no ownership and guaranteed returns on your investment rather than no assurance that you'll get the return that was promised.

There are seven million government workers in America and 30 countries throughout the world that have dumped Social Security pay as you go type plans and opted for asset building plans. My review of several of these type plans shows me that all of them have and will outperform our current Social System on an investment return basis. They have all recognized the same thing that we're seeing today. It's better out there then it is in here. They understand that a pay as you go system cannot survive when in the next 25 years in America there will be a 200% increase of plan beneficiaries and only a 10% increase in workers. That's a 20: 1 ratio. Unless the government can change the current demographic trend than no short term salvos; like increasing the payroll taxes, extending the retirement age or cutting the benefits to any reasonable level can fix the problem. And if we do try to throw trillions at this system over the next 35-40 years our children will eventually look up and realize that there fathers and mothers have left them holding the proverbial "bag". If we're going to throw money anywhere then let's throw it at a system that will survive and thrive just like Galveston and Brazoria Counties and so many others have already done.

Thank you again for having me here today let's please get together to make something good happen for all Americans.

TESTIMONY

of
J. Lamar Roberts
President & CEO
First National Bank of Pasco
Dade City, Florida

On behalf of the
Independent Community Bankers of America
Washington, DC

"Banking on Retirement Security: A Guaranteed Rate of Return"

United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

June 23, 2005

Mr. Chairman, Ranking Member Sanders and members of the Committee, my name is Lamar Roberts, I am President and CEO of the First National Bank of Pasco, a $105 million community bank in Dade, City, Florida. I am pleased to appear today on behalf of the ICBA[1] and its nearly 5,000 members to testify on ways the community banking industry can contribute to the important retirement security debate and Social Security reform. Today, too many Americans are simply not saving enough for retirement. The ICBA is glad to have the opportunity to assist this committee and Congress in examining policies that can help improve retirement security for all Americans.

ICBA Supports House Resolution 209

We thank Chairman Bachus and Representative Tom Feeney for holding this important hearing and for recognizing the need to include our nation's community banks in the ongoing Social Security reform debate. We appreciate all your efforts on behalf of the community banking industry. Specifically, the ICBA would like to thank Reps. Feeney and Sessions for introducing House Resolution 209. This resolution expresses the sense of the House of Representatives that any plan to reform Social Security should include a "community bank" option.

In particular, ICBA applauds Chairman Bachus, Reps. Feeney and Sessions, and the 16 additional signatories on a recent letter sent to Ways and Means Committee Chairman Bill Thomas urging any Social Security reform plans include an opportunity for investments in federally insured certificates of deposits (CDs) offered by community banks.

Importantly, deposits in local community banks support the community investment and job creation throughout Main Street America. We are greatly encouraged that lawmakers are genuinely considering the full range of personal investment options in the Social Security reform debate, rather than just a limited selection of stock and bond investments.

Community Banks Play Key Role in Savings

The ICBA supports bipartisan efforts to strengthen Social Security and retirement savings and the opportunity for new individual savings account contributions for community bank customers. Community banks have always served an essential role in the U.S. economy as a steady and trusted place for consumers to save for life's events such as retirement. ICBA's community bank members deliver financial advice and services in 17,000 locations nationwide, and provide personal retirement savings advice and products for their customers.

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[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to promoting the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

Therefore, community banks are well-positioned to help implement and offer savings products should Congress choose to enact new, or expand the existing personal retirement accounts as part of Social Security reform. I believe the community banking industry can continue to help encourage more Americans to better save for retirement with the right mix of investment products.

Community bankers will continue to do their part to foster solid individual savings opportunities so all Americans can have a secure retirement. The vast majority of our nation's commercial banks are community banks. The geographic dispersion of community banks and thrifts around the country fosters a financial system where saving and lending resources are made available to individuals not only in urban areas, but in suburban and rural areas as well.

Need to Diversify Savings
Individuals will always need to diversify their retirement savings to help mitigate unwanted risk. As the timeless saying goes, "don't put all your eggs in one basket." When it comes to nest eggs, this lesson is paramount. It only stands to reason that a broad array of savings options and financial service providers should be considered in the Social Security reform debate so assets are not unevenly concentrated. The dispersion of our nation's assets and wealth helps preserve the safety, soundness and stability of our entire financial and economic system. Therefore, ensuring the Social Security reform debate is well balanced and includes a full range of savings options is important.

Bank products such as CDs are an attractive and safe product for the retirement savings needs of Americans. As savers look to reduce risk as they get closer to retirement, bank CDs can provide both a reasonable rate of return and preserve the savers' principal.

Local Economies Benefit from Diverse Savings
Allowing a community bank savings option is also very important to support local economic vitality. Ample personal savings is vital not only to meet retirement needs, but also to provide the economic lifeblood for our communities as banks leverage private savings to meet the borrowing needs of individuals, small businesses, farms, and Main Street America. Money deposited in the local community bank is reinvested locally to provide small business loans, home mortgages, and other forms of credit. This investment fosters economic growth and job creation. It's simply "Economics 101" to realize that savings equals investment, and investment means jobs, innovation, and a growing economy and standard of living for all. Without solid savings flowing into our local communities, economic prospects are diminished.

Today and for generations, community banks have always been there to help people save; offering customers personal assistance and a range of savings accounts, CDs, money market accounts, IRAs, 401(k)s, education savings accounts, health savings accounts and much more. Community banks are delighted that the importance of fostering adequate personal savings is now at the forefront of political debate. There is a genuine recognition that the low U.S. savings rate combined with the swell of baby-boomer

retirees and the associated stress on the current Social Security system simply cannot be ignored if we want to maintain or improve our nation's economic strength and our standard of living. Today, the personal savings rate hovers around 1 percent. This is dangerously low and simply unacceptable.

Assuring ample retirement savings is far too important a national issue to be sidestepped any longer. We must ensure our savings policies are the best they can be. Several bipartisan commissions to strengthen Social Security over the years have already conducted solid analysis on the problems facing Social Security and recommended a number of broad reform ideas that are being given serious attention in the current debate. The challenges in achieving long-term solvency for Social Security are well documented.

Savings Reform Must Make Sense on Wall Street and Main Street
New voluntary personal retirement savings accounts have been proposed as a Social Security reform option. Both "add-on accounts" to the existing Social Security system and "carve-out accounts" from the current Social Security payroll tax have been proposed. Should enhanced personal savings accounts emerge as a bipartisan remedy to improve retirement savings, the structure of such accounts does demand close attention so that all segments of our nation can participate in both the savings and associated investment opportunities.

Simply stated, a solid retirement savings option for individuals must make economic sense on Wall Street and Main Street. It is important that our nation's wealth is not concentrated in only a handful of investments. The decentralized dispersion of our nation's assets and wealth helps preserve the safety, soundness, fairness, and stability of our entire financial system. And community banks are often the linchpin to the survival and well-being of local communities, particularly in small towns and throughout Main Street America. They specialize in doing business in their respective towns and most importantly, reinvest any savings deposits back into their communities through local lending. Therefore, community bankers, as always, will support sound savings options for their customers and communities.

Other Policies to Encourage Retirement Savings
Other important savings policy issues also deserve attention, and I would like to highlight a few. To address the low U.S. savings rate, ICBA supports efforts to end punitive double taxation on savings and investment, and to promote expanded savings options initiatives for new Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs).

The current tax code too often discourages or punishes savings and investment with double or even triple taxation. While the Code offers some tax-advantaged savings accounts, they are often too limited, restrictive, complex, and confusing -- which only works to discourage much-needed savings.

Our tax system should promote savings not punish it. ICBA recently advocated the adopted changes in tax laws to promote greater savings including allowing contribution

amounts for IRAs to increase from $3,000 to $5,000 by 2008, and 401(k) plan contributions to expand from $10,500 to $15,000 by 2006. While this was a positive tax policy step to encourage savings, much more must be done. These recent increased savings incentives are set to expire and should be made permanent and indexed for inflation.

We encourage this Committee and Congress to consider the ICBA-backed savings accounts that have been advanced by the Administration in the FY 2006 federal budget and introduced in Congress. Specifically, the proposed Retirement Savings Account (RSA) and Lifetime Savings Account (LSA) would go a long way in removing the tax complexities and restrictions on current savings accounts. Today's array of complex, restrictive and fragmented savings plans prevents Americans from having a simple and flexible account to meet their various savings needs. It is no secret that millions of Americans cannot qualify for today's tax-advantaged savings plans because of complex restrictions.

RSAs and LSAs would help more people save. These new simplified savings options would allow many more Americans to save up to $5,000 after-tax per year in both accounts and remove counterproductive restrictions now seen on savings accounts. Earnings and qualified distributions would be tax-free and the accounts would be available to all individuals with no income or age limit restrictions. ICBA will work to have such accounts passed into law.

Improved CD Product

Multiple layers of tax on the same income impairs saving and causes tremendous administrative and compliance costs and complexities in the tax system. Double taxation of savings and investment distorts the choice to save income in favor of spending. The current tax system more-heavily taxes savings verses consumption.

An ICBA-recommended policy change that could help individuals save more for retirement is to address the punitive tax-treatment of CDs. The ICBA-backed Communities First Act (HR 2061) contains a provision that would allow consumers to defer recognition of interest income on long-term CDs (one or more years) and to reduce the top tax rate on this interest to the long-term capital gains tax rate.

This would help put CD products more on par with the tax treatment of stock investments, where income tax is paid only when the stock is sold and any gain gets a lower capital gains tax rate (currently 15 percent). Conversely, tax on interest income from a CD is paid every year and at a top tax rate of 35 percent. Therefore, for the typical saver, equity investments get better tax treatment than bank CD products. This tax disparity distorts investment decisions and works to encourage more savings to flow into riskier stock investments verses bank CD products. ICBA would encourage Congress to promote greater tax parity for CD savings products so consumers can have greater choices to protect their retirement savings. This change would dovetail nicely with a community bank CD option as part of a Social Security reform with private account opportunities.

Conclusion

ICBA appreciates the opportunity to testify on this important issue. Community banks are a safe and effective place for Americans to save for retirement. Community banks will continue to work closely with Congress to help strengthen Social Security and improve retirement savings opportunities for all Americans. The ICBA appreciates the interest of this Committee to help ensure community banks have a meaningful role in the retirement security debate. Specifically, should personal "add-on" or "carve out" accounts be part of any bipartisan Social Security reform, ICBA urges that community banks have the ability to serve their customers savings needs with a CD, RSA, or similar safe bank product option. We believe having diversity of savings products and risk options can only better serve America's retirement needs.

We applaud this important debate on strengthening Social Security and retirement savings and look forward to working with Administration and with both sides of the aisle in Congress to achieve positive change.

Thank you.

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