

Multiple Choices: Property Rights and Individual Accounts

There's a belief that if we move to individual accounts, equity issues will magically go away. But individual accounts will raise their own equity issues - not so much as between different types of families as between different members of the same family.

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Social Security and the Family

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Individual accounts are simple.

One person + One account^o Retirement Income

But are they?

- P Social Security has always provided family as well as individual benefits.
- P Family members as well as individuals will have an interest in the assets in accounts.
- P When changes in the family -marriage, death and divorce -occur, the rights of family members and individuals to accounts will conflict.

Individual accounts are a zero sum game.

P Their assets are fixed.

P What one person wins, another person loses.

Social Security has no system to define and allocate competing interests to benefits.

P It doesn't need one.

P There are no competing interests.

P No one loses - and sometimes everyone gains -when another family member gets a benefit.

Family Benefits Under Social Security Today

	<u>Individual</u>	<u>Spouse</u>	<u>Divorced Spouse</u>	<u>Dependent Child</u>
At distribution	100%	at least 50% of spouse's benefit	at least 50% of former spouse's benefit	up to 50% of deceased parent's benefit
At death		at least 100% of deceased spouse's benefit	at least 100% of deceased former spouse's benefit	up to 75% of deceased parent's benefit

Social Security today has no property rights.

P The Supreme Court said so in *Flemming v. Nestor*.

- < Benefits are not funded.
- < Benefits are not vested.

P It really doesn't need one.

Individual accounts are funded and virtually certain to be vested.

P We will need to create a property rights system for them.

P Risks of a poorly-designed system:

- < premature dissipation of account assets and
- < prolonged disputes, expensive litigation consuming account assets.

Central questions for a property rights system under Social Security

P What property rights should individual accounts have?

P Who should hold those rights?

P When and how should those rights attach to benefits?

P How should those rights be enforced?

Individual accounts will probably have at least these rights.

- P The right to choose and change investments
- P The right to choose when benefits will be paid after retirement
- P The right to choose how benefits will be paid
- P The right to choose a beneficiary

Spouses could have:

- P The right to co-exercise individual rights
- P The right to veto a spouse's choices
- P The right to a portion of the account at divorce
- P The right to attach the account for unpaid child support or alimony
- P The right to inherit all or a portion of the account on the spouse's death

Children might have:

P The right to inherit a portion of a parent's account

P The right to attach the account for support while a dependent

Property Rights Models

There are two different state law traditions.

P In common law states, spouses

- < Own and control their separate property during marriage and at death
- < But judges decide how it is divided at divorce

P In community property states, all property acquired during the marriage

- < Is equally owned and controlled by both spouses,
- < Divided equally at divorce, and
- < Spouses choose a beneficiary for their half interest at death.

There are two federal models.

P In the private pension system, a spouse has rights in some plans

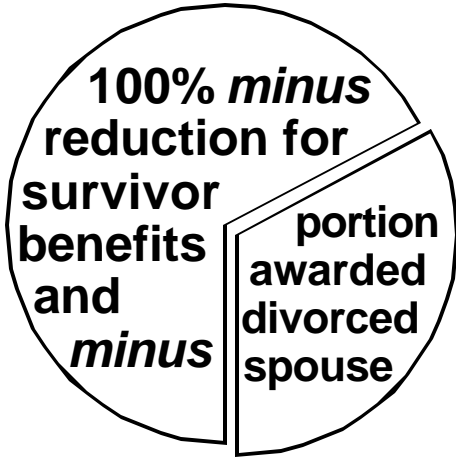
- < To annuity benefits on the death of a spouse
- < To veto a spouse's choice of another beneficiary or form of payment and
- < To consent to any in-service distribution.

P But in most plans, a spouse only has the right

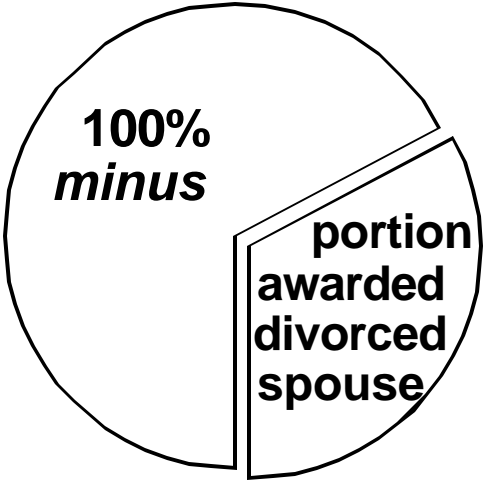
- < To be the beneficiary of any plan benefits left on the death of their spouse.

P In IRAs, state law controls.

Family Rights to Annuity Benefits in the Private Pension System

	<u>Individual</u>	<u>Spouse</u>	<u>Dependent</u>
At distribution		none	none
At death		at least 50% of deceased spouse's benefit	none

Marital Property Rights to IRAs

	<u>Individual</u>	<u>Spouse</u>	<u>Dependent</u>
At distribution	 <p>100% <i>minus</i> portion awarded divorced spouse</p>	depends on state law	none
At death	remainder goes to designated beneficiary	depends on state law and whether designated as beneficiary	none

Multiple Choices

Should a spouse have

- P No rights over the account
< *the IRA and common law approaches*
- P Some rights over the account
< *the private pension system approach*
- P Equal rights over the account
< *the community property approach*

Should a divorced spouse have

P Rights to half the benefits earned during the marriage

< *the community property and earnings sharing approaches*

P Benefits decided by a judge

< *the private pension system and common law approaches*

Who should be able to inherit the account?

P Only the surviving spouse

< *sometimes the private pension system approach*

P Children of a deceased spouse

< *sometimes the community property approach*

P Anyone

< *the IRA and common law approaches*

When should income from the account be available?

P Only at retirement

< *the Social Security approach*

P Before retirement but only for child support and alimony

< *the private pension system approach in some cases*

P Before retirement for any reason at all

< *the IRA approach*

How should the account pay retirement income?

- P With mandatory survivor benefits for a spouse
 - < *sometimes the private pension system approach*
- P In any form the couple chooses together
 - < *also the private pension system approach*
- P In any form
 - < *the IRA approach*

Some suggestions

Conclusions

P Borrow the best features of existing models.

< There's no need for an entirely original approach.

P Recognize the needs of family members from the start.

< But remember that retirement income is the primary objective of individual accounts.

Conclusions

P Define rights and remedies clearly and comprehensively.

< This will minimize disputes.

P Resolve disputes through an administrative claims process.

< Litigation should be the last resort.

P Use federal law.

< Rights should be the same no matter where people live.

< Avoiding state law conflicts is critical.