

4057

SJUD

SB

56

(FILE 1)

933

AMENDMENT #8 - ADOPTED

Page 8, line 23, after first sentence:

insert "The annuity investment fund consists of amounts transferred from the dividend fund, amounts appropriated by law to the annuity investment fund, and income earned by the annuity investment fund."

Page 9, lines 21-23, after "credit":

delete all material and insert "the net income of the annuity investment fund to the individual annuity accounts."

Page 10, line 8, after "contracts":

insert "purchased from insurance companies that have a Best's Policyholders' rating of A or better and belong to Best's financial size Group XV at the time of purchase"

Department of Revenue
Administrative Services Division
Suggested Amendments
CSSB 56 (SA)
February 28, 1985

Amendment #1

Page 2, line 23 after "receive":

Delete "not less than 25 percent" and insert "25 percent, 50 percent or 75 percent."

Department of Revenue
Administrative Services Division
Suggested Amendments
CSSB 56 (SA)
February 28, 1985

Amendment #2

Page 2, line 26

Insert:

"(e) An election made under (d) of this section for a dividend year is binding and irrevocable for that year."

Department of Revenue
Administrative Services Division
Suggested Amendments
CSSB 56 (SA)
February 28, 1985

Amendment #3

Page 3, line 29, after "(e)":

Insert:

"If a public agency claims a dividend on behalf of an individual, the agency shall elect 100% cash under AS 43.23.005."

Department of Revenue
Administrative Services Division
Suggested Amendments
CSSB 56 (SA)
February 28, 1985

Amendment #4

Page 3, line 21

After "me," delete "including" and insert:

"general fund appropriations allocated to my annuity account in accordance with AS 43.23.110(b), and"

Department of Revenue
Administrative Services Division
Suggested Amendments
CSSB 56 (SA)
February 28, 1985

Amendment #5

Page 7, lines 5-7

Delete all material and insert:

"(b) The Department shall require an individual to take 100% of his or her permanent fund dividend in cash if the Department receives a levy, execution, garnishment, attachment or other legal remedy for the collection of a past due debt described in subsections (a)(1) or (a)(2)."

Amendment #6 - Vogt

Page 10, lines 19, 20:

delete "during the life of the annuitant"

Page 10, lines 22,23, after "account":

delete remainder of sentence, and insert ". An annuity shall be paid in the form of a straight life annuity, or such other payment plan as is authorized by the Commissioner of Administration."

Page 11, line 24, after "possible":

insert "straight life"

Amendment
8

Suggested Amendment

CSSB 56 (SA)

Department of Revenue

Treasury Division

Amendment #1.

Page 8, line 23, after first sentence:

Insert "The annuity investment fund consists of amounts transferred from the dividend fund, amounts appropriated by law to the annuity investment fund, and income earned by the annuity investment fund."

Suggested Amendment

CSSB 56 (SA)

Department of Revenue

Treasury Division

Amendment #2.

Page 9, lines 21-23, after "credit":

Delete all material and insert "the net income of the annuity investment fund to the individual annuity accounts."

Suggested Amendment

CSSB 56 (SA)

Department of Revenue

Treasury Division

Amendment #3.

Page 10, line 8, after "contracts":

Insert "purchased from insurance companies that have a Best's Policyholders' rating of A or better and belong to Best's financial size Group XV at the time of purchase"

CSSB56 (State Affairs)
AMENDMENTS OFFERED/ADOPTED
SENATE JUDICIARY COMMITTEE

AMENDMENT #1 - ADOPTED

Page 2, line 23 after "receive":

Delete "not less than 25 percent" and insert "25 percent, 50 percent or 75 percent"

* Offered by the Department of Revenue, this amendment restricts the amount of the Permanent Fund Dividend that can be taken in an annuity to increments that can be managed most effectively and economically.

AMENDMENT #2 - FAILED

Page 2, line 26

Insert:

"(e) An election made under (d) of this section for a dividend year is binding and irrevocable for that year."

* It is anticipated by the Committee that any change to the Permanent Fund Dividend application procedures will initially cause a certain amount of confusion. This amendment was rejected by the Committee because of its rigid and potentially harsh result in foreclosing a person's remedy for a mistaken election to receive cash or an annuity share.

AMENDMENT #3 - ADOPTED

Page 3, line 29, after "(e)":

Insert:

"If a public agency claims a dividend on behalf of an individual under this section, the public agency shall elect 100% cash under AS 43.23.005."

* The state must take cash for persons when it is acting as a guardian and cannot elect to take an annuity. This amendment seeks to preserve the cash value of the Permanent Fund Dividend to the family of a person temporarily in state custody.

AMENDMENT #4 - ADOPTED

Page 3, line 21

After "me," delete "including" and insert:

"appropriations allocated to my annuity account in accordance with AS.43.23.110(b), and"

* Technical amendment offered to clarify the language and to make it clear that an annuity is forfeited for a false claim the same as cash.

AMENDMENT #5 - ADOPTED

Page 7, lines 5-7

Delete all material and insert:

"(b) The Department shall require an individual to take 100 percent of the permanent fund dividend in cash if the department receives a levy, execution, garnishment, attachment or other legal remedy for the collection of a past due debt described in a) (1) or (a) (2) of this section."

* This amendment is clear on it's face.

AMENDMENT #6 - ADOPTED

Page 10, lines 19, 20:

delete "during the life of the annuitant"

Page 10, line 20:

delete ". The amount of the monthly payment shall be"

Page 10, lines 22, 23, after "account":

delete remainder of sentence, and insert ". An annuity shall be paid in the form of a straight life annuity or other payment plan authorized by the Department of Administration."

Page 11, line 24, after "possible":

insert "straight life"

* The ability to leave the principal and interest earned on an annuity to a person's heirs is considered by private insurance companies to be crucial for marketability. This amendment improves the possibility that the annuity will be better received by Alaskan investors.

AMENDMENT #7 - ADOPTED

Page 1, line 21 after "program":

delete ", and to encourage Alaskans to participate in that program by authorizing general fund supplements that would result in annuity payments that are larger than an individual could earn through private investment of the permanent fund dividend"

* This amendment deletes unsubstantiated guarantees of profitability and the implied requirement of front-loading that is not consistent with the substantive provisions of this bill.

AMENDMENT #8 - ADOPTED

Page 8, line 23, after first sentence:

insert "The annuity investment fund consists of amounts transferred from the dividend fund, amounts appropriated by law to the annuity investment fund, and income earned by the annuity investment fund."

Page 9, lines 21-23, after "credit":

delete all material and insert "the net income of the annuity investment fund to the individual annuity accounts."

Page 10, line 8, after "contracts":

insert "purchased from insurance companies that have a Best's Policyholders' rating of A or better and belong to Best's financial size Group XV at the time of purchase"

* Technical changes that clarify the extent and nature of investment procedures associated with the annuity investment fund.

AMENDMENT #9 - ADOPTED

Page 2, line 17

add: "and may elect to take the dividend as an annuity share for the future benefit of the minor."

Page 2, line 25

after "cash" add: "and may not elect to receive an annuity share."

Page 10, line 26

after "in" add: "(b) and"

Page 10, line 28

after "another." delete "The right to receive an annuity under this section terminates upon the death of the person who is eligible for the annuity and does not pass to that person's estate."

* This amendment makes it clear that, unlike a public agency, (see amendment #3) an individual acting as a guardian may elect to invest a minor's Permanent Fund Dividend in an annuity. It also clarifies that a person 65 or older may not invest their Permanent Fund Dividend in the annuity program. The amendment also makes additional changes that accomplish the purpose of amendment #6 and allow the principal and interest to pass to the annuitant's heirs.

*
* DELIVER TO: JFOM *
*
* ORIGINAL *
* SENT: 03/06/85 TIME: 11:35 *
* FROM: MICHELE MORSETH *
* SUBJECT: POM-FAIRBANKS 3-6 *
* PRINT DATE: 03/06/85 TIME: 11:35 *
* 2 *

TO: SENATOR RODEY

FROM: OLGA T. STEGER
645 9TH AVE.
FAX 99701

PHONE: 452-2993

RE: SB 56 - LONGEVITY BONUS, PERM. FUND DIV.

MSG: PLEASE SHORTEN UP YOUR HEARINGS SO THAT SB 56 CAN BE
MOVED OUT OF THE JUDICIARY AND BACK ON THE FLOOR. I STRONGLY
SUPPORT THE PASSAGE OF SB 56.

DEPOSIT	RATE OF R	TOTAL CV	TAX-B	NET-COST	Prepared for:
350.00	1.10	385.00	0.70	245.00	STEVE WOODRUFF
350.00	1.10	808.50	0.70	490.00	
350.00	1.10	1274.35	0.70	735.00	Date:
350.00	1.10	1786.79	0.70	980.00	1/26/85
350.00	1.10	2350.46	0.70	1225.00	
350.00	1.10	2970.51	0.70	1470.00	Tax Bracket:
350.00	1.10	3652.56	0.70	1715.00	0.70
350.00	1.10	4402.82	0.70	1960.00	
350.00	1.10	5228.10	0.70	2205.00	Rate of Return
350.00	1.10	6135.91	0.70	2450.00	1.10
350.00	1.10	7134.50	0.70	2695.00	
350.00	1.10	8232.95	0.70	2940.00	
350.00	1.10	9441.24	0.70	3185.00	
350.00	1.10	10770.37	0.70	3430.00	
350.00	1.10	12232.41	0.70	3675.00	
350.00	1.10	13840.65	0.70	3920.00	
350.00	1.10	15609.71	0.70	4165.00	
350.00	1.10	17555.68	0.70	4410.00	
350.00	1.10	19696.25	0.70	4655.00	
350.00	1.10	22050.87	0.70	4900.00	
350.00	1.10	24640.96	0.70	5145.00	
350.00	1.10	27490.06	0.70	5390.00	
350.00	1.10	30624.06	0.70	5635.00	
350.00	1.10	34071.47	0.70	5880.00	
350.00	1.10	37863.62	0.70	6125.00	
350.00	1.10	42034.98	0.70	6370.00	
350.00	1.10	46623.48	0.70	6615.00	
350.00	1.10	51670.83	0.70	6860.00	
350.00	1.10	57222.91	0.70	7105.00	
350.00	1.10	63330.20	0.70	7350.00	
350.00	1.10	70048.22	0.70	7595.00	
350.00	1.10	77438.04	0.70	7840.00	
350.00	1.10	85566.84	0.70	8085.00	
350.00	1.10	94508.53	0.70	8330.00	
350.00	1.10	104344.38	0.70	8575.00	
350.00	1.10	115163.82	0.70	8820.00	
350.00	1.10	127065.20	0.70	9065.00	
350.00	1.10	140156.72	0.70	9310.00	
350.00	1.10	154557.39	0.70	9555.00	
350.00	1.10	170398.13	0.70	9800.00	
350.00	1.10	187822.95	0.70	10045.00	
350.00	1.10	206990.24	0.70	10290.00	
350.00	1.10	228074.27	0.70	10535.00	
350.00	1.10	251266.69	0.70	10780.00	
350.00	1.10	276778.36	0.70	11025.00	
350.00	1.10	304841.20	0.70	11270.00	
350.00	1.10	335710.32	0.70	11515.00	
350.00	1.10	369666.35	0.70	11760.00	
350.00	1.10	407017.99	0.70	12005.00	
350.00	1.10	448104.78	0.70	12250.00	
350.00	1.10	493300.26	0.70	12495.00	
350.00	1.10	543015.29	0.70	12740.00	
350.00	1.10	597701.82	0.70	12985.00	
350.00	1.10	657857.00	0.70	13230.00	
350.00	1.10	724027.70	0.70	13475.00	
350.00	1.10	796815.47	0.70	13720.00	
350.00	1.10	876882.02	0.70	13965.00	
350.00	1.10	964955.22	0.70	14210.00	
350.00	1.10	1061835.74	0.70	14455.00	
350.00	1.10	1168404.31	0.70	14700.00	
350.00	1.10	1285629.74	0.70	14945.00	
350.00	1.10	1414577.72	0.70	15190.00	
350.00	1.10	1556420.49	0.70	15435.00	
350.00	1.10	1712447.54	0.70	15680.00	
350.00	1.10	1884077.29	0.70	15925.00	

Amount after 20 years

would you wish losing that amount at age 66?

by Denise M. Topolnicki

HOW TO PICK THE RIGHT ANNUITY

Finding one with high yields and low fees now will pay off in more retirement income later on.

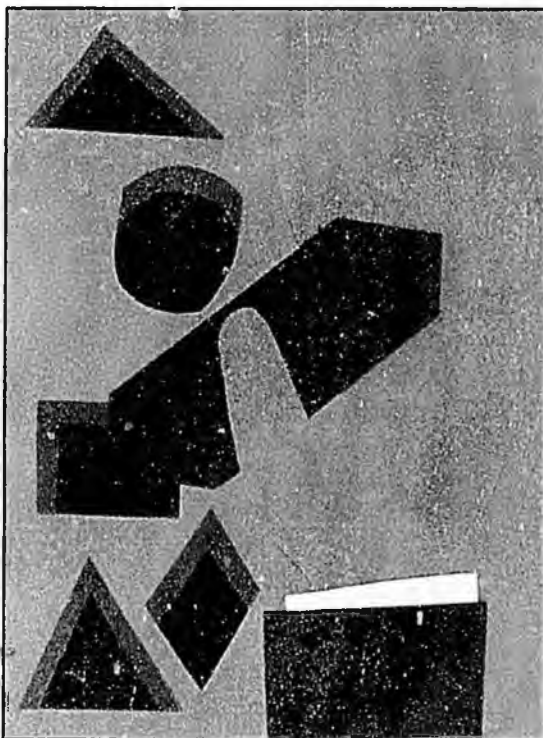
Annuities—those retirement investments sponsored by insurance companies—can play one or two roles in your retirement planning. While you're working, you can stash cash in a so-called deferred annuity and watch it grow unchecked by taxes. After you retire, you can use that money—or other funds—to buy an immediate annuity that pays you monthly income for the rest of your life. Every check you receive comprises principal, which isn't taxable, and earnings, which are. By then, however, you're presumably in a lower tax bracket.

You shouldn't buy either type of annuity solely on the recommendation of any insurance agent or stockbroker. Shopping is essential because returns on deferred and immediate annuities vary enormously from insurer to insurer.

Also, your money is safer with some companies than with others. The financial woes of two major annuity sponsors, Baldwin-United and Charter Co., underscore the importance of doing business with sound insurers. People who bought annuities from bankrupt Baldwin-United will get their principal back, but they won't collect all the earnings they initially expected, and their cash may be tied up until at least 1987. The Charter Co. insurance subsidiaries that sold annuities haven't gone bust along with their parent company, but thousands of investors have cashed in their annuities early—despite withdrawal penalties of up to 7% on account balances—because they feared a Baldwin-United-style fiasco.

One clue to an annuity sponsor's financial stability is its rating published in the life and health edition of *Best's Insurance Reports*, available at large public libraries. Most financial planners recommend dealing only with major insurers rated A+.

Because contributions to an annuity aren't tax-deductible, a deferred annuity shouldn't be the first, or even second, way you shield savings from the tax collector. Instead, you should first make as many tax-deductible contributions to IRAs or



Keogh plans as you can. Also, put pretax dollars in a 401(k) salary-reduction plan if your employer offers one.

Deferred annuities are advertised as IRA investments, but many financial planners advise against using them that way. Says Gail Pendell, a San Diego planner: "You waste one tax-advantaged investment opportunity by doubling up your IRA and an annuity."

You can buy a deferred annuity with a single premium, typically \$5,000 or more, or you can pay in periodic installments. Your money compounds tax-free, typically until you retire. You can then take it in a lump sum and invest it as you wish, or you can buy an immediate annuity and receive periodic payments for the remainder of your life. You may contract for such payments with the insurer who managed your deferred annuity or with a dif-

ferent insurance company that offers a better return on your investment.

Deferred annuities come in two types, fixed or variable. Fixed annuities, which are invested in bonds and mortgages, pay interest, like a bank account. Your principal is guaranteed. Variable annuities produce fluctuating returns based on the performance of stock, bond or money-market funds managed by the insurer. More unusual funds are also available, including some that invest in real estate. Many insurers let you reallocate your cash among several funds. If a fund flops, of course, you can lose principal.

Despite their monicker, fixed annuities guarantee a stable rate of return for only a few months or a year. After that, the rate changes at the insurer's discretion, though it can't fall below a stated minimum, typically 3.5%. Fees can also affect your return. Insurers usually let you withdraw up to 10% of the money in your annuity each year without charge. If you take out more than 10%, the insurer imposes so-called surrender fees that usually start at 7% of your excess withdrawal during the contract's first year and decline until they disappear in

seven to 12 years. Some insurers offer a bailout clause under which you can get all your money at no charge if interest rates dip a point or two below what you were originally promised. If you buy an annuity after Jan. 18, 1985, and make withdrawals before you reach age 59½, you'll pay a 5% federal tax penalty, as well as income tax, on earnings withdrawn.

Ideally, you ought to be able to compare the historical investment performance of annuities. That's what the National Educational Association did in its 1982 study of fixed annuities sold to teachers by 45 companies. The findings were startling. After fees were deducted, \$14,100 invested over nearly 12 years grew to \$23,560 at the best performing company—an average annual return of 8%. The worst company produced only \$14,484—a dismal average annual return of less than one-half of 1%.

Insurers don't compile such data for individuals, however. Comparative Annuity Reports, an Albuquerque-based firm, compiles data on annuities sponsored by 200 insurers and sells it to insurance companies and school districts. (For lists of recommended fixed annuities based on the firm's computations, see the box at right.) Since annuity contract provisions and interest rates change frequently, you should ask agents where companies they represent rank in the most current report by Comparative Annuity Reports; be sure that the agents quote from the lists that take fees into account.

It's easier to identify the top variable annuities because Lipper Analytical Services, an investment advisory firm, monitors many of them, as it does with mutual funds. As a group, variable annuities invested in stock have gained 77% in the past five years vs. 51% for Standard & Poor's 500-stock index, with dividends reinvested. Two annuities available outside of IRAs and sold by insurers rated A+ by Best's outperformed the pack. National Life's Variable Annuity Account I gained 107% while Aetna Life's Variable Fund increased 98.92%.

Because most insurers have just recently started to offer variable annuities invested in bond and money-market funds, Lipper has followed only a few such funds for more than a year. The variable annuity bond fund sold by Sun Life

of Canada topped Lipper's charts over the past year, as did the money-market annuity from Security Benefit.

Lipper's figures take investment management charges into account, but not sales commissions, which range from zero to 8½%. Insurers typically trim 1.5% off of a variable-annuity account's balance annually for administrative expenses. Ask insurance agents where companies they represent currently rank on Lipper's lists.

When you're considering buying an immediate annuity, bear in mind that the guaranteed lifetime income is most appropriate for people who fret about outliving their savings—or squandering them all in Las Vegas. Be warned too that immediate annuities aren't for fickle folk: once you sign a contract for lifetime income, you're locked in.

You can use cash you've accumulated in a deferred annuity to fund an immediate annuity. It's also possible to buy an immediate annuity with a lump sum from, say, a pension or profit-sharing plan. Immediate annuities are available in fixed and variable varieties.

There are four basic ways to receive an immediate annuity. Monthly payments

get increasingly smaller with each succeeding option:

A *straight-life annuity* pays you until you die. If you're unlucky enough to expire after cashing just one check, the insurance company keeps the remainder of your capital.

An *installment-refund annuity* pays you and a beneficiary at least as much money as you invested.

A *period-certain life annuity* guarantees that you or a beneficiary will collect for at least a set number of years.

A *joint-and-survivor annuity* continues until both you and a beneficiary are dead.

Under any option, the size of your monthly check depends on how much you invested, how old you are, and whether you're male or female. It also varies from insurer to insurer. For example, a 65-year-old man could recently buy a straight-life annuity for \$25,000 from Alexander Hamilton Life and receive monthly payments of \$297.19. Yet Federal Kemper Life would pay him only \$265 a month. Once again, you'll have to shop around. Wait until you're close to retirement, however, because rates change constantly. **S**

SHOPPING FOR ANNUITIES

All the top-performing annuities listed here are of the deferred type: your investment in them grows tax-free until you make withdrawals. Immediate annuities, which begin paying income at once, are not listed because ever-changing payout rates fluctuate widely. Comparative Annuity Reports, a company that sells information on annuities to insurance companies and school systems, provided the two lists of fixed annuities. In both cases, *Money* has omitted annuities designed only for IRAs as well as annuities of insurers rated less than A+ by Best's, a

firm that grades companies based on their financial stability.

The list of fixed-rate annuities with flexible premiums is based on projected returns over the next 15 years as well as the annuities' actual performance over the past five years. Insurers' fees are included.

Comparative Annuity Reports expects the fixed-rate, single-premium annuities on the second list to post the highest returns in their category over the next 15 years, based on interest rates and fee schedules in effect last August.

Top-performing fixed annuities (flexible premiums)

Company	Current interest rate
Fidelity Union Life	10%
Northern Life	12.50
Security Benefit Life	12.25
Travelers	11.75
Western National Life	12

Top-performing fixed annuities (single premium)

Company	Current interest rate
Alexander Hamilton Life	12%
Bank Life	12.1
Minnesota Mutual Life	12.25
New York Life & Annuity	12
Travelers	11.75
Western National Life	12

Reporter associate: Eric Schurenberg

50 Plus' Money Plan For Your Retirement

*An up-to-date look at
the sources of retirement
income and how you
can best use them.*

Reprinted and updated from a special series in 50 Plus Magazine

50 plus
GUIDES

The Need for a Money Plan

RETIREMENT means different things to different people. For some, it opens the door to years of well-earned leisure — for travel, golf, fishing, crafts and hobbies, or just plain loafing. For others, it means finally having a chance to engage in new activities or hobbies, even money-making activities one could not consider during full-employment years — coin, stamp and rare book collecting, antique seeking, dealing, etc. — activities one couldn't afford and didn't have time for while raising a family and working full time (and a half!).

But whatever retirement means to you, it requires MONEY — stable, dependable

income from pension, Social Security, or dividend and interest income from securities accumulated during one's employment years. How much money, how much regular income? — As much as you can get! — Never put an upper limit on your retirement income from accumulated capital, managed during your retirement years so as to provide the kind of life you've looked forward to. Essential to both accumulation and management is *planning*. Money is one thing that doesn't take care of itself (for most of us, anyway). Seat-of-the-pants budgeting (or lack of budgeting) is one sure way to end up singing the "Retirement Blues" instead of "We're in the Money."

Maintaining Your Independence

DURING THE FIRST three quarters of this century, the spread of pension systems—corporate, private, and governmental—has helped make retirement financially feasible for millions of Americans whose parents and grandparents had no plans other than to work until the day they died.

When considered against the background of centuries of lifetime toil, retirement is a revolutionary, new concept for the average man and woman. For the first time in history, the great majority of working men and women can look ahead to a retirement "cushion"—in the form of Social Security and other pension benefits—supplementing their employer's pension payments or income from their own savings over the years. The age-old tradition that "our chil-

dren will have to pitch in and help" is no longer the prime consideration as we get older. With the spread of pensions on all levels, the new philosophy is that a person has the right to retire with full independence, beholden to no one for support.

As a result, planning for retirement has now taken priority over most other financial "programming" once the children's education, liquidation of a home mortgage, and other needs have been taken care of. In some cases, retirement planning is the lengthiest financial plan in one's lifetime—starting with the very first day of employment and the chance to sign up for the employer's retirement plan. You can never begin planning too early!

Storing Up Retirement Income

PUTTING ASIDE funds to finance one's retirement—whether you start 5 years or 40 years before Retirement Day—is no snap. It can mean denying yourself certain luxuries you'd like and perhaps even a few necessities today for the sake of future benefits. It requires giving hostages to the future—something that's not only disagreeable at times but risky as well.

But, unless you happen to be endowed with a long list of rich uncles, there is no substitute for the discipline involved in giving up something you fancy today for the sake of a more comfortable retirement later.

The mechanism for this is the dollar—its saving, its investment, or its accumulation through various "media" (stocks, bonds, real estate, rare works of art, old coins and books, antique furniture), anything you can buy with dollars today and which (you hope) will have increased in dollar-value when you retire.

It's a mistake to think of retirement planning as just an accumulation of dollars. It is, rather, the building of a pool of *buying power* that is the ultimate goal—the more buying power the better.

There are, of course, significant differences in the various "media" one may select for building up assets which can then be translated into buying power during retirement.

Some of them are sound, and some just the opposite. Consider, for example:

You've always regretted not having bought gold during the period of high inflation of the late 1970's, when its price skyrocketed. Today you still wonder if it might not be a bad investment. Like most people, you're not quite sure that inflation won't come back to haunt us and you'd like to have something to hold against that possibility. But is it the right investment to make? You've heard a few predictions that have given you cause to wonder. What should you do?

The high price of gold in recent years made it an enviable commodity to hold during that period. But gold—like other commodities—has a weakness as a hedge against inflation. Gold is always a speculative commodity whose recent price movements had absolutely nothing to do with the factors that caused the cost of living to double during the 1970's. And what's more, gold requires considerable capital for its safekeeping, so that you may actually find yourself losing money in the long run.

Nowadays most experts believe that we have licked the problem of double-digit inflation that plagued our economy during the 1970's. As you enter your retirement years, your main concern should be having something to count on. There are many

safe investments that can yield you a return of 10 to 12 percent a year. Take advantage of these and build your assets—

don't dwell on the possibility of what might happen and lose money in the process.

Real Estate

INVESTMENTS IN real estate, on the other hand, can not only be extremely profitable but, if well managed, can provide rental income at the same time the property is steadily increasing in market value. But there are "catches" with real estate too—such as the taxes you must pay on it, upkeep costs, plus the considerable expertise that's required in selecting and buying the right property, and in subsequently managing it. In fact, such expertise can mark the difference between realty profit and loss.

In most cases, you don't need a great deal of ready cash to invest in real estate. You can pay in installments—through a mortgage from a bank or a savings and loan association. As with buying property, it's wise to shop around for a mortgage banker or broker to get the best possible terms.

The astronomic interest rate climb of the late 1970's and early 1980's has changed the picture for today's real estate investor. As interest rates have dropped from their

14 to 18% peaks, making real estate a more attractive investment, most banks have changed their policy of offering fixed interest rates on mortgages—in other words, rates that don't change over the twenty or thirty years of the loan. Rather than lend money at 12 to 13% for thirty years, they now offer mortgages with flexible interest rates that change on a year-by-year basis. Almost all banks are now doing this, so the average home buyer is forced to accept these rates.

But don't rule out real estate because of flexible mortgage interest rates. They can actually work to your advantage. True, you will have to pay a higher interest rate in years that rates go up. But the reverse is also true. If interest rates drop—as they well may continue to do in the years ahead—you will pay interest on your mortgage at a lower rate. So real estate can be a very solid investment—but one that demands flexibility.

Savings Accounts and Certificates of Deposit

STASHING AWAY money in a savings and loan or bank account is the oldest and probably the most commonly used method to build up a source of retirement income. Too many people, however, are unaware of what is now available to them and have missed some terrific new opportunities in savings accounts.

Between August 1, 1981, and August 1, 1985, all ceilings on interest rates paid on savings account deposits will be eliminated. As a result of this deregulation, the interest on ordinary savings accounts has already begun to rise, and by 1985 many people believe that the 5-1/4 to 5-1/2% interest we've been used to seeing will double.

Since the deregulation began, banks have begun to offer special savings accounts called money market accounts that pay very high interest rates. To qualify for the high interest, you must meet one requirement: a minimum of \$2,500 on deposit. But it's well worth whatever it takes to keep that much on deposit—most money market accounts now pay about 9.8% a year in interest, a far cry of the interest rates of yore.

The best interest available to the savings depositor is still through certificates of deposit (known as CD's). But many people, especially people approaching retirement, shy away from CD's for fear of being locked in and having their money inaccessible to them for long periods. Of course, it sometimes is wisest not to invest in a long-term account. But what keeps most people from investing is lack of knowledge of what's out there—and there are many types of CD's, so it gets pretty confusing. But with some knowledge and a little common sense you can feel safe to

take advantage of these excellent investment opportunities.

Certificates of deposit vary from short-term, such as the 91-day CD's that are now popular, to long-term accounts, such as one, three, four, and five-year varieties. During the term of the account you cannot withdraw on the principal without incurring a penalty. But what many people fail to understand is that the penalty is not all that serious. What happens if you draw on your balance early is that the interest on the amount withdrawn is cut back to the daily rate—which is what you would have been earning on a regular savings account anyway. So you're not losing anything there. In addition, you lose 90 days' interest. You should not be discouraged from the long-term CD for fear of having to withdraw early in case of an emergency. The penalty in many cases is less than what you'd be losing if you kept the money in a regular savings account.

Like the ceilings on savings account interest rates, the interest rates on CD's have been deregulated, so banks are now "competing" for the highest-yielding accounts. Long-term CD's are now paying about 13-1/2% interest, with the short-term accounts around 12 to 13%. The main advantage to the long-term accounts, of course, is the interest rate; you must start with at least \$2,500 minimum deposit. But no investment in CD's, especially for the retiree, should be decided on the basis of interest rates alone. The interest rates on short-term accounts is not much less than the long-term CD's, so it makes sense to use both in combination when you invest. It's wise to divide your money into two

segments—one to be invested at a higher rate, and held untouched for a longer period, and the other to be kept in a short-term account to which you'd have easier access in case of an emergency, such as

hospital or doctor bills. You'll be earning a point or two less in interest, but you'll be able to get to the money fast—and without paying the penalty.

OUR NATION'S securities markets may be compared to giant department stores—offering pretty much whatever customers want. To the pre-retired man attempting to build an estate to support himself and his wife in retirement (and hopefully also to benefit his heirs), they offer growth-type securities and tax shelters. To the retired, they offer various types of securities aimed at providing income plus safety.

Safety is of paramount importance. Normal retirement investing has very, very little room for risk. High retirement income with high risk and attendant worries yields no retirement income that's worth it. Of what profit is a high return on your money if you are too worried to enjoy it? An old Wall Street adage puts it best: "Do you want to eat better or sleep better?" Those who have experienced years of retirement will tell you that, as between steak (or lobster) at every dinner and a good night's sleep, there's little room for argument: worry-free sleep wins almost every time.

This certainly does *not* mean that one can achieve 100% safety or capital from securities (even U.S. Treasury bonds or insured savings accounts). *Every* investment involves risk—whether it is a capital-growth type, an income type, or something in-between. Every negotiable security is subject to market fluctuations. And even if your money is in dollar-fixed savings accounts or U.S. bonds, you must still face the dangers of erosion via inflation.

The "safest" securities are U.S. Treasury bonds, followed by bonds issued by federal agencies backed by the full faith and credit of the U.S., those approved by the Treasury, or issued under an act of Congress, or supported by authority to borrow from the Treasury (a broker can explain the various levels of endorsement to you). These, in turn, are followed by corporation bonds rated (for quality) all the way from AAA (tops), to AA, A, BBB, BB, B, CCC, CC, C, DDD, DD, D.

Then there are the many issues of preferred stocks, followed by common stocks.

This does *not* mean that every bond is better than every preferred stock; or that every preferred is better, safer, or more desirable than every share of common. These are merely the different types of corporate securities available. Each one must be judged on the basis of what it can do for *you* in retirement, and also on just what it is *you* need in retirement.

Good quality bonds and insured savings accounts enjoy high safety of principal. If

you put \$5,000 or \$10,000 into an insured savings account, into a Treasury or federal agency bond, or into a corporation bond rated AAA or AA, you can feel pretty secure that you will get your interest when it is due, and that you will get all your dollars back when you withdraw your deposit or when the bond matures. If you are investing for income, then you can be comfortably certain that \$10,000 invested in a high quality bond will provide the promised interest every 6 months and repay the face amount of the bond at maturity.

And so far as drawing on insured savings accounts is concerned: the figures in the second of the following tables can be checked for accuracy at any bank's saving department. But, unfortunately, its accuracy does not make it a logical program for a retirement planner because there are too many pitfalls in the program. 1) No one can tell you how much interest money will earn over the next 15 to 20 years. 2) No one can assure you that any given annual withdrawal amount will provide more than a starvation diet in the decades ahead. 3) No one can predict that your lifeline will follow actuarial tables. 4) Finally, how are you going to enjoy retirement as you watch your assets dwindling?

A rule of thumb for securities is never adopt any program which could leave you penniless at a time when you could possibly still be breathing, no matter what the actuarial tables predict.

Plan for retirement without the poorhouse as the ultimate goal. Retirement needn't include a yacht tied up at your private pier, but it shouldn't be lived with the spectre of the welfare line-up forever at one's side.

A comfortably financed retirement program should not be approached as merely a childhood game of "put and take"—put so much into a bank while you are working and then taking out so much a year until you are flat broke. It requires setting up a realistic pension plan while you are working plus accumulated capital which you manage to the best of your ability in order to get the most income out of the current investment market. This DOES NOT mean that you should become a stock market ticker tape addict but that you keep yourself informed about job opportunities for your money and that you put your money to work bringing in the best "pay" you can find, with the amount of risk you can afford.

Securities: Safety vs. Risk

How Savings Accounts Can Build Over a 20-Year Span

YOUR WORKING YEARS			YOUR RETIREMENT YEARS		
Starting at age 45 you save each month:	Total amount you deposit by age 65:	Total in your account including dividends at age 65:	Then, if you elect monthly payments of:	You will receive payments for:	You will receive a total of:
\$ 20	\$ 4,800	\$ 8,828	\$ 92	10 years	\$ 11,112
40	9,600	17,656	184	10 years	22,225
50	12,000	22,071	173	15 years	31,270
75	18,000	33,107	260	15 years	46,858
100	24,000	44,143	291	20 years	69,949
125	30,000	55,179	364	20 years	87,390
200	48,000	88,286	582	20 years	139,899
416	99,840	183,634	1,211	20 years	290,909

The figures are based on a 5.50% effective annual yield where interest is compounded daily and paid from day of deposit if money is left until the end of the quarter.

How Long Will Your Savings Last in Retirement?

WITHDRAWAL RATE	ANNUAL INTEREST OR GROWTH RATE OF INTEREST									
	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%
5%										
6%	36									
7%	25	33								
8%	20	23	30							
9%	16	18	22	28						
10%	14	15	17	20	26					
11%	12	13	14	16	19	25				
12%	11	11	12	14	15	18	23			
13%	9	10	11	12	13	15	17	21		
14%	9	9	10	11	11	13	14	17	21	
15%	8	8	9	9	10	11	12	14	16	20

Example: A savings account earning 6% would last 15 years if 10% of the account were withdrawn every year. Money invested at 8% would last 14 years if 12% of the capital is withdrawn every year.

Fortunately for today's retirees there are several sources of steady, high income. Insured banks' and savings and loans' certificate of deposits yield as much as 11, 12, 13% and even a fraction more. And long term U.S. Treasury bonds—the world's safest investment—now yield better than

13% compared with a meager 3.2 or even 1-7/8% they paid earlier in this century. You need more dollars to retire today than ever before in U.S. history, but fortunately, invested money also is bringing in more dollars than ever before.

EE Bonds and HH Bonds

EVEN MORE helpful than a savings account is the use of new EE bonds to help build a retirement nest egg, a source of retirement income. The basic advantage of the EE bond "building blocks" is the fact that all the money you invest is at work building that nest egg—there is no subtraction of money from the account to pay annual income taxes on the interest being stored up. Every dollar you invest in EE bonds, say on a payroll deduction plan, keeps working for you undisturbed by current federal or state and local income taxes. You are free to postpone the day of tax reckoning until retirement when your tax bracket declines.

In other words, you invest when you are most likely enjoying the peak earnings of your career, but delay all tax until you are most likely in the lowest tax bracket of your lifetime.

Like a savings account, buying U.S. Government EE bonds provides a program for accumulating dollars on a systematic basis.

Since November 1982, Series EE bonds have been paying interest at a variable rate that moves according to the rates paid on U.S. Treasury bills, which are auctioned off every two weeks. A minimum rate of 7.5% is paid on EE bonds, compounded semi-annually, if held for at least five years, and the current rate is above that. Series EE bonds can be purchased in denominations of \$50 up to \$1,000 at your bank or through a payroll deduction plan.

Unlike the interest you get on a savings account (which is taxable each year), the interest on EE bonds is exempt from state and local taxes—but *not* from federal tax. However, you don't receive the interest

until you cash the bonds (which is when you pay the federal tax).

EE bonds accumulated during your working years can provide a safe, secure means of building retirement capital. Or you can produce current income from your EE bonds by exchanging them for Series HH bonds which will bring you a semi-annual interest check at the annual rate of 7.5%. You do not pay income taxes on the accumulated interest of the EE bonds which were exchanged for the HH bonds until

you redeem the HH bonds. You thus keep all your principal intact and guarantee yourself a steady income from the total accumulations, which income is subject only to federal income tax, not state or local.

In such bond programs, the investor, building toward retirement, gives up any hope of "doubling his money overnight" in return for a slow, steady accumulation of dollars immune from the risks of the securities or real estate markets.

CORPORATE BONDS are a form of mortgage issue to raise money in the same way a home buyer issues a mortgage to raise part of the purchase price of a home. The bond runs for a set number of years—5, 10, 15, 25, 30—during which time the corporation promises to pay the stated rate of interest in semi-annual installments. The corporation may, in most cases, pay off the bondholder before maturity, but in all cases, must pay at least face value (usually \$1,000) and often a premium if retired before maturity. Interest received from a corporate bond is taxable, although interest paid by U.S. Treasury bonds is exempt from state and local income taxes.

Interest rates in recent years have been at historically high levels, which means bonds are yielding generous returns for investors seeking current income.

Bonds can be bought through brokerage firms and securities dealers and, in some cases, through a commercial bank. New issues are being announced constantly. Your best sources of information and guidance are a reputable broker or banker and newspaper financial pages.

Keep in mind that the investment rating of bonds is more important to you than the name of the issuing corporation and that you cannot expect as high income from a top-quality AAA or AA grade as from a lower quality issue.

Bonds are negotiable, and you may sell them at any time regardless of maturity date at prices affected mainly by changes in interest rates.

Corporate Bonds

IF YOU PAY as high as 30 to 35% federal income tax on part of your income, you should consider tax-exempt bonds issued by states, cities, towns or their political subdivisions, or by public authorities which thus raise money for schools, water supplies, highways, tunnels, bridges, etc. These are called "municipal bonds." If you pay only a modest income tax, it may not be advisable to accept the lower income from these tax-exempt bonds.

In most cases, it is best to buy bonds issued in the state where you live, thus availing yourself, in most cases, of exemption from state and city income taxes if any, in addition to the federal income tax savings. Municipal bonds are issued mainly in bearer form.

As in the case of all bonds, tax-exempt bonds vary in quality, depending upon the financial strength of the issuer. When in doubt, one should restrict investment to bonds backed by the full faith and

credit and taxing power of a strong state or local government, rather than buy bonds depending on revenues raised through fees charged for use of a specific bridge or tunnel. The former are called "general obligation" bonds while the latter are called "revenue" bonds.

Recent years have seen the emergence of two new methods of investing in municipal bonds: the unit trust and, most recently, the mutual fund for municipal bonds. The unit trust represents a fixed portfolio of bonds which is not changed. As bonds mature, you, the investor, receive your pro-rata share of the funds received by the trust. The municipal bond mutual fund represents a managed fund in exactly the same way that common stock mutual funds are managed, with different issues being bought and sold. There is no basis for saying one is better than the other. You should restrict your investing to reputable firms—and spend some time learning the difference in types.

Bonds with Tax Shelters

ANOTHER WAY to build up income for your retirement years: buying stocks—if you are willing to take the risks involved. As no one needs to be told, you can make a handsome profit on the right stocks, and lose your shirt on the wrong ones. Most investors, in practice, fall somewhere in between. Entire books have been written about stock-market investing, but let's just review brief-

ly some of the key facts to keep in mind about stocks for retirement planning.

First of all, folks who have worked hard all their lives to amass a retirement stake are entitled on a regular basis to a dependable, generous dividend check from their stock investments—and should not be reduced to nail-biting decisions based on stock

Common and Preferred Stocks

market fluctuations. So I think it's important that, if you buy stocks, you evaluate them carefully in terms of whether they are *growth* or *income* issues—and how far you are from retirement.

You'll find a long-established school of investment theory which argues that even retired folks should hold growth stocks (regardless of low yields) and depend upon other sources of income for their super-market money. This doesn't make for comfortable sleeping during prolonged periods of stock market decline—unless you're still a long way from retirement and have enormous confidence in the stock's growth potential by the time you'll be retired. But with most growth stocks, yields run from below 1% to about 3%—and you can't buy much these days with such income.

Some investors are misled by the word *preferred* stock, in contrast to *common* stock. A preferred stock is so named because it enjoys a preferred position in a corporation's stock capitalization—preferred to the common, that is, but subordinated to the company's bonds and debentures. This means the preferred claim to dividends comes ahead of the common's. If the company can't pay a preferred dividend, no common dividend is paid. But the label "preferred" or "preference" has only relative value. One company's preferred is not always a safer investment than the common stock of another company. So don't let the word lull you into a feeling of security. Each preferred must be judged on its own merits.

Much more common (no pun intended) is common stock. Shares may be acquired

in a number of ways—and with even the most modest budgets. Many workers looking ahead to retirement have acquired shares of their own corporate employer—especially if a favorable purchase plan is available under which the company contributes to the investment or offers it to employees on a preferential basis.

Another method: purchasing shares of other leading corporations which over the years have shown an ability to operate profitably through boom and depression. First purchases of such stocks can be made through various brokerage offices. But many companies then facilitate the acquiring of additional shares through program⁷ for the reinvestment of dividends—and additional cash—sometimes without the payment of additional brokerage fees.

Investment in common shares of stock in a corporation offers the unique advantage of acquiring a say in corporate management along with the asset itself. You may know nothing about flying an airplane, or producing automobiles, or chemicals, but the purchase of shares in any of these industries carries with it some of the management of the companies. As a stockholder you become, in essence, a "silent partner" insofar as you have the right to vote for directors at annual meetings and the right to question the operations and policies of the company. It is not a completely democratic set-up, but then it doesn't require that you devote much of your time and effort to the "management" of your share of the total assets of the company.

Mutual Funds

IF YOU BUY stocks or bonds on your own, you're relying, of course, on your own judgment (and/or your broker's). Instead of putting all your eggs in one basket, you may prefer to spread your risk by investing in many different kinds of stocks and bonds for the same amount of money—doing so through a mutual fund. This reinvests your money (and the funds of other investors) in the shares of hundreds of different corporations, all done through a professional money manager whose annual fee usually runs around 1/2 of 1% of your total investment. Some mutual funds invest almost exclusively in growth stocks, and are frankly speculative. Some others invest in preferred stock and high-rated corporate bonds, to provide maximum income with maximum security. Other funds try to balance the types of investments. On the average, mutual funds are now paying dividends of about 10%. Most analysts rate the reliability of income from mutual funds as good to fair.

Mutual funds traditionally are sold by security salesmen who are paid out of a sales fee which runs to 9% or slightly

higher. However, there are an increasing number of mutual funds that do not charge a sales fee. These are referred to as no-load funds. The investor who wants a no-load fund must approach the fund himself. There are no salesmen.

To make an intelligent choice among the many no-loads the investor must study their records in the financial manuals. A listing of no-loads is available from the No-Load Mutual Fund Association at Valley Forge, PA 19481. You can always tell a no-load fund in the newspaper's listing of funds by the fact that a no-load fund "bid" and "ask" quotes are alike.

In a Load Fund the difference between the "bid" and "ask" figure for most funds represents the commission for buying one share.

Never make a decision between the two funds on the basis only of "Load" and "No-Load" which has no bearing on the fund's success.

An investor pays a management fee in all funds, load and no-load.

Making It a Habit

WHATEVER COURSE you choose to store up retirement income, the important factor is

to develop a "habit"—the continuing investment or steady application of a portion of

your current income in an investment program which will ripen in 10, 20, or 30 years, to provide you with years of retirement income. This "habit" is fully as important in acquiring a portfolio of stocks and bonds as it is in making regular additions to your savings account.

Since there is no stock market barometer that has proven 100% accurate in all kinds of economic weather, the only "safe" solution is to set up a regular, periodic investment program. This is called "dollar-cost averaging" and, if continued over a long period of time, can result in the investor being able to acquire more shares when prices are low and fewer shares when prices are high. The result: an average

long-term cost that's usually far more favorable than the straight mathematical average of prices over the same period of time. Furthermore, it takes much of the nail-biting worry out of investing in stocks.

But it must be kept firmly in mind that, in this pursuit of capital gains with which to increase your retirement stake, the laws of risk are always in force! Risk is ever-present in every form of investment. And the amount of risk rises with the expectation of profit. You can't hope to double your money overnight unless you also are prepared to risk a heavy loss. Wall Street may be a one-way street for automobiles—but not for securities prices!

Annuities

AN ANNUITY is primarily a contract, not an "investment." It is a contract by which you buy an income for as long as you live (and, in the case of a "joint" annuity, for as long as both you and your spouse live). For many people it is a comforting contract, because it assures you that you will not outlive your income. But, as is the case with every financial contract, it has its plusses and minuses.

great many years, or they may be bought with a single, lump-sum payment on the eve of retirement.

If you buy them over a long period of years, you may find that you have tied your retirement income 10, 20, or 30 years before retirement—and done so unrealistically in terms of the buying power of the dollar when you actually retire.

An annuity income program purchased with a single lump sum of money on the eve of retirement at least reduces your vulnerability to inflation by many years. If you should buy such a program today, to begin providing income next month, you have a more current view of what the dollar of income will buy. You have not only escaped 10 or 20 years of seeing your premium money melt away, but you are able to buy the entire contract with "now" (cheaper) dollars. Although no fixed annuity income can protect you against further inflation, a lump-sum purchase on the eve of retirement can at least reduce much of the effect of past years of inflation.

The table on page 10, furnished by the American Council of Life Insurance, shows how much it will cost you currently to buy \$100 a month of annuity income. You will notice that the cost is based on present age (the lower one's life expectancy, the more generous the insurance company can afford to be). Also, women—because, statistically they live longer—must pay more than men for the same \$100-a-month income. And a married couple must pay even a bit more (the conjugal life is evidently conducive to living longer, at least statistically).

The "life annuity" column shows one type of annuity and the sums which must be paid to receive \$100 a month "for life"—for the life of a man, a woman, or "joint." (If you die a few years after taking out the annuity, the insurance company "wins.") The "refund annuity" column shows the amount you must pay to receive \$100 a month income for life with the additional proviso that if the annuitants do not live long enough to collect all that they've paid in, their estate will get the balance.

Single Premium Annuity To Get \$100 a Month		
BOUGHT AT AGE	"LIFE ANNUITY"	"REFUND ANNUITY"
Males		
60	\$12,037	\$12,666
65	11,130	11,892
70	10,031	11,008
75	8,816	10,039
80	7,551	9,015
Females		
60	\$12,956	\$13,161
65	12,142	12,514
70	11,071	11,581
75	9,807	10,516
80	8,466	9,376
Joint and Survivor		
60	\$14,548	\$14,314
65	13,764	13,647
70	12,799	12,741
75	11,595	11,673
80	10,155	10,470

The plusses: (1) lifetime income; (2) knowing exactly how much to count on each year; (3) assured income (provided, of course, that you make the contract with a reputable insurance company licensed to do business in your state, or with an educational, charitable, or religious institution licensed and supervised by your state's Superintendent of Life Insurance).

The minuses: (1) the fixed-income type of annuity offers no protection against inflation; (2) any variable-income program must depend upon the manager's skill as an investor in the securities markets; (3) erosion of your capital to the point where there may be no estate left for your heirs.

Annuities may be bought along with insurance through premiums paid over a

How a Level Savings Withdrawal Plan Works

Beginning balance	If you elect monthly payments of:	Your balance would last	Total you would receive:	Or you may choose monthly payments for the rest of your life	AND leave this amount for your beneficiary at the end of each year:
\$ 1,000	\$ 25	3 yrs. 8 mos.	\$ 1,103	—	—
2,000	25 50	8 yrs. 3 mos. 3 yrs. 8 mos.	2,476 2,206	—	—
3,000	25 50	14 yrs. 3 mos. 5 yrs. 9 mos.	4,296 3,496	—	—
5,000	50 100	11 yrs. 0 mos. 4 yrs. 8 mos.	6,626 5,666	\$ 22.22	\$ 5,000
10,000	75 100	16 yrs. 10 mos. 11 yrs. 0 mos.	15,185 13,253	44.44	10,000
15,000	100 200	20 yrs. 7 mos. 7 yrs. 7 mos.	24,773 18,284	66.66	15,000
30,000	200 500	20 yrs. 7 mos. 5 yrs. 9 mos.	49,545 34,964	133.33	30,000
40,000	300 500	16 yrs. 10 mos. 8 yrs. 3 mos.	60,743 49,534	177.78	40,000
50,000	400 500	15 yrs. 2 mos. 11 yrs. 0 mos.	73,141 66,267	222.23	50,000
100,000	800 1,000	15 yrs. 2 mos. 11 yrs. 0 mos.	146,283 132,535	444.46	100,000

Source: The Bowery Savings Bank

After "R-Day"

RETIREMENT DAY is the day you turn to your money and say, "OK, I've worked for you all my life—now let's see what you are going to do for me!"

Everyone is entitled to enjoy his or her retirement years to the fullest—and that requires, in the simplest terms, getting the most current income out of accumulated funds. This income, furthermore, must be measured not only in dollars but also in the peace of mind which comes from the knowledge that both the principal and the income it generates are safe.

There's an old Wall St. adage which asks: "Do you want to eat better or sleep better?" There's a great deal more substance to this than its glibness would indicate.

Stretching income from investments so as to cover the costs of big cars, lavish homes, and eating out in fancy restaurants is a possibility *if* you're prepared to accept the risks which always accompany very high-yielding securities—and the resulting loss of sleep. On the other hand, the vast majority of retirees, already having experienced the decades of worries and sleeplessness that go with their work-years and raising a family, prefer to "eat less steak" and sleep better. It's a decision only you can make for yourself—on your own.

To help you decide, let's look at the usual sources of retirement income and how they are likely to affect you in different but generally basic circumstances.

Financing Your Retirement

CAN YOUR INVESTMENTS handle their New Job? Come Retirement Day, you leave the office luncheon with your colleague's praises ringing in your ears, with a gold watch in your vest pocket or on your wrist and with the general euphoria which follows a good lunch. But with the chilling realization that you've received your last paycheck. After 30, 40 or more years of working for "the company," you are now pretty much on your own, with a fixed pension and Social Security checks every month, but with no boss to appeal to for a raise in salary with which to meet steadily rising prices for food, clothing, shelter. If the cost of living goes up you'll either have to face up to it yourself, or do without!

So your own portfolio of investments becomes pretty important. As you begin to

mentally review your list of stocks and bonds, apply the acid test—Is this item doing the best it can for me . . . either in amount of regular, steady dollar income, or in its ability to increase dividends with which to meet higher expenses? Thus, the problem is really two-fold:

1. Can a rejuvelling of securities bring more income now? or
2. Can I shift types of securities so as to have more of my money at work in higher-yielding securities over the next 10 to 20 years of my life expectancy?

Example: Those 9½% utility bonds are highly rated, but that's all they can pay—\$95 a year for each \$1,000 face value bond. Would it be best for me to shift some of this money to a sound utility or manufacturing

company stock which could possibly increase its dividend to 12 or 15% of the market value? Should I give up a steady, regular source of income for a higher yield? With inflation much lower than in previous years, it's safer now to take more risks. Income is no comfort if costs rise steadily because of unchecked inflation. And if you want to play it safe, don't rely too much on any hope that our government can or will really check inflation.

A comfortable retirement income source must include not only solid interest payers (bonds) but some hope of increased income—that means ownership of common shares—an equity position or convertible

preferreds or debentures convertible into common. In other words, while it is comfortable to provide one's self with a solid, unwavering income from high grade bonds and preferreds, you'll have to take a bit more risk if you want to hope for extra income. No one has yet discovered how to take the risk factor out of economics, either nationally or personally.

So the best thing to do is to sit down with your broker and try to arrive at a cautious division of your funds between high yield, low risk bonds, some commons (or senior issues convertible into common) which could increase your income with as much risk as you can comfortably assume.

IT IS ALWAYS disheartening—and surprising—how many workers reach retirement age without understanding completely the terms of their company's pension plan—and the various options which may be open to them.

Basically, pensions are paid out in either of two types of programs:

(1) A lump-sum payment which you yourself then re-invest in income-producing stocks, bonds, real estate, etc.;

(2) A monthly benefit check for the rest of your life or that of your surviving spouse, with a residual payment to your heirs in some cases.

Certain companies may offer other options. Be sure you ask your company's pension officer about them.

The questions you must answer for yourself before making a choice between a lump-sum withdrawal of your company pension or a monthly check (if you have the option) can be answered only by (1) arithmetic, and (2) whether or not you want to leave money for your heirs.

The arithmetic involves figuring out the difference between the lump-sum (and what

you estimate it can produce from investments) and the monthly check you would receive if you left the principal in the pension program. For example: Let's say you have a choice of taking either \$20,000 in a lump-sum (most likely subject to federal and state income taxes) or \$125 a month for your lifetime (or the lifetimes of yourself and your spouse). Let's assume the \$20,000 after taxes boils down to \$15,000—which you could then invest (as of 1981) at 10%. The annual income would then be \$1,500 a year, or a bit more than \$100 a month. You must now decide whether you would rather have \$125 a month for your spouse and yourself for the remainder of your lives, or whether to take the \$20,000, pay \$5,000 in taxes, have about \$105 to \$125 a month "forever," and still have the principal (\$15,000) basically intact to pass on to your heirs or to draw on as you yourself might require. Keep in mind, of course, that any drawing on the principal would reduce your monthly income. Also keep in mind that my arbitrary figures would vary with different income tax brackets, and—most important of all—with the different ages of the pensioners involved. But the basic arithmetic and the method of comparison apply.

Company Pension Plans

MANY PEOPLE TAKE Social Security for granted—only to discover, when they go to apply for it, that their understanding of Social Security and how it works is considerably off-base.

Social Security checks generally are based on your average earnings under Social Security over a period of years. The amount of benefits to your dependents or survivors also depends on your average earnings during your working years.

While you are working, Social Security contributions are deducted regularly from your wages. But these contributions are not exactly "yours" the way money you put into a savings account would be. Instead, your contributions are more like the money you pay for an insurance policy; you may get back all or much more than you contributed—or nothing at all. It de-

pends on many different factors when you reach the eligibility age. Chances are you'll get back more in benefits than you paid in. This is partly because your employer(s) also contribute(s) a Social Security tax on each of your paychecks over the years.

The original Social Security Act of 1935 grew out of the Great Depression when extensive unemployment had wiped out the savings and equity built up by many people—leaving nothing to carry them through old age. The Social Security Act set up a compulsory federal program of payroll deductions, with employers contributing an amount equal to that paid by employees—up to a specified wage-base "ceiling." This ceiling has been changed by Congress several times since 1935, most recently (and most drastically) in 1977. Congress has raised Social Security benefits periodically, too.

Social Security Benefits

At the same time, Congress has at various times extended benefits to *non*-retirees, including disabled workers, children, widows, and widowers. Some of these supplementary programs have come under fire in recent years as cutting too heavily into Social Security funds—particularly in the face of inflation and population changes that have sharply increased outgo in relation to income from S. S. taxes.

Contrary to many people's belief, Social Security was never intended to be a dollar-for-dollar replacement of the income lost when a person retired, died, or became disabled. It was intended only as supplemental income—to provide a base or "floor," with personal savings, private pension plans, etc., providing the rest of one's retirement income.

So if you continue to work after you retire, you may still be able to receive benefits. The amount that you can earn and still collect full benefits depends on whether you are age 65 to 70 or under 65. The limits are different for the two age groups.

In 1984 you may earn up to \$6,960 and collect all your benefits for the year. If you earn more than that, \$1 in benefits will be deducted for each \$2 earned above \$6,960. In future years, the amount that is exempt will automatically be adjusted annually to reflect increases in average wage levels.

If you are under 65, you can earn \$5,160 in 1984 without losing benefits. Again, for earnings above that amount, \$1 will de-

ducted for every \$2 earned. This earnings limit will continue to rise annually, automatically adjusted to reflect increases in wage levels. The year you reach age 65, the higher earnings limit will apply.

But the picture changes for people age 70 and above. At age 70 retirement benefits are payable regardless of how much you earn.

The following chart gives you an idea of how the earnings limit works, assuming that you retired in 1984 and are eligible for the maximum annual benefit of \$8,436, based on maximum career earnings under Social Security law:

If you earn in 1984	Your benefit will be:
Up to \$ 6,960	\$8,436
7,000	8,416
8,000	7,916
9,000	7,416
10,000	6,916
11,000	6,416
12,000	5,916
13,000	5,416
14,000	4,916
15,000	4,416
16,000	3,916
17,000	3,416
18,000	2,916
19,000	2,416
20,000	1,916
21,000	1,416
22,000	916
23,832	0

Monthly Benefit Payments for Workers Who Reached 65 Before 1982 (Including 3.5% "cost-of-living" increase effective December 1983)									
FOR WORKERS					FOR DEPENDENTS (1)				
Average Yearly Earnings	Retirement at 65	at 64	at 63	at 62	Spouse 65 or Child	at 64	at 63	at 62	Family (2) Benefits
\$ 3,000	\$391.10	\$365.01	\$338.93	\$312.88	\$195.50	\$182.46	\$169.42	\$156.40	\$ 597.90
4,000	460.00	429.32	398.64	368.00	230.00	214.66	199.32	184.00	786.10
5,000	533.50	497.92	462.33	426.80	266.70	248.91	231.12	213.36	984.20
6,000	603.00	562.78	522.56	482.40	301.50	281.39	261.28	241.20	1,105.70
8,000	749.40	699.41	649.43	599.52	374.70	349.71	324.72	299.76	1,311.50
9,000	792.10	739.27	686.43	633.68	396.00	369.59	343.17	316.80	1,368.00
10,000	830.40	775.01	719.28	664.32	415.20	387.51	359.81	332.16	1,453.00

1. If a person is eligible for both a worker's benefit and a spouse's benefit, the check actually payable is limited to the larger of the two.
2. The maximum amount payable to a family is generally reached when a worker and two family members are eligible.

Since 1974 annual cost-of-living increases have raised Social Security benefits substantially, thanks to an important provision in the Social Security law that makes benefits "inflation proof" by providing automatic yearly increases to keep up with the cost of living. Each year in which the cost of living rises 3% or more, there will be an automatic increase in benefit rates. The latest automatic "cost-of-living" benefit increase was 3.5% across the board, effective January 1984.

Up to now, Social Security benefits were not subject to federal income tax. But for some people, a portion of Social Security benefits will be included in their taxable income for 1984. If your adjusted gross income is more than a certain base amount—\$25,000 for a single person, \$32,000 for a couple filing jointly—the amount of your Social Security benefits that are subject to tax is whichever is less: half of the benefits for the year, or half the amount by which your income exceeds the base amount.

SOME OTHER FACTS about Social Security to help your financial planning:

If you qualify for checks on the record of more than one worker (for example, on your own record and your husband's), you'll get only an amount equal to the larger of the two amounts.

The lump-sum payment made at a worker's death is \$255.

Under present laws, you can retire as early as age 62 and start collecting Social Security, but your benefits check will be reduced permanently. Payment amounts are also reduced if a wife, dependent husband, widow, or dependent widower starts getting payments before age 65.

The amount of the reduction depends on the number of months you get checks before you reach 65. If you start your checks early, you'll get about the same value in total benefits over the years but in smaller installments to take account of the longer period you'll get them.

Although the exact amount of your retirement check can't be figured out until you actually apply for benefits, you can estimate the amount ahead of time. Ask at any Social Security office for a copy of the leaflet, *Estimating Your Social Security Retirement Check*.

In any case, you should apply in person for Social Security at your local Social Security Administration office *three months before your actual retirement date*.

DOES OWNERSHIP of your retirement home make sense? Does ownership of other real estate guarantee you retirement income?

More fortunes have been made in real estate than perhaps in any other single investment medium. At the same time, the same holds true for fortunes lost. Crumbling real estate values have all but wiped out many an entrepreneur.

If you have for years enjoyed the gift of real estate investment and management, you have probably made money from this over your lifetime and can conceivably continue to profit from it in retirement.

But if you have never gone beyond ownership of your own home, consider making your first real estate investments for

When you apply for Social Security benefits, you should have with you:

★ Your own Social Security card or a record of your number (if your claim is on another person's record, you'll need that person's card or a record of the number).

★ Proof of your age; a birth certificate or a baptismal certificate made at or shortly after birth if you have one.

★ Your marriage certificate if you're applying for wife's or widow's benefits.

★ Your children's birth certificates if you're applying for them.

★ Your federal tax W-2 form for the previous year; a copy of your last federal income tax return if you're self-employed.

If you return to work after you start getting retirement checks, your added earnings will often result in higher benefits when you again stop working. Social Security will automatically re-figure your benefit after the additional earnings are credited to your record.

Social Security benefits are, of course, always subject to government changes dictated by the changing economic climate. For this reason you should get answers to your Social Security questions directly from the nearest Social Security Agency office. Do not make the mistake of listening to self-proclaimed experts, or to uninformed neighbors who may already be receiving benefits. Get your advice *only* from an *official* source. That is the only way you can be certain of having the full, correct story!

profit in retirement with all the caution you would practice in launching a retirement career as a lion tamer. It can "bite." The fact that you may have owned your own home does not qualify you as a real estate investor or manager any more than the fact that you have played the piano since age 9 qualifies you to give a recital at Carnegie Hall or the Hollywood Bowl.

Investing in real estate for profit requires just as much expertise as practicing law or medicine, playing an instrument, or cutting fine diamonds. It is a business which requires the ability to evaluate real estate—whether vacant land or buildings—to judge what it may be worth in the future, to manage it profitably for whatever period you intend to hold it, and, finally, to handle

Other Points to Keep in Mind About Social Security

Retirement and Real Estate Ownership

the sale of real estate at the most favorable terms (to you). And, if it is going to be a successful venture, the financial savvy to judge how best to use your own capital for the most gain.

Small realty investments require that you do all the work yourself. Large real estate investments, however, require that you know and trust the managers.

Owning Your Own Home

THE QUESTION OF OWNING your own retirement home, of course, is an entirely different matter. Some persons have long owned their own homes, and it's therefore a familiar and comfortable life-style for them. But many who have lived all their lives in rented quarters decide on the eve of retirement that they finally must hold title to their home. It's not an unreasonable sentiment, but too often is not evaluated in the harsh light of mortgage rates, monthly amortization, real estate taxes, maintenance costs, and involvement of what may be limited capital. *A home is not a home if its ownership is a constant drain on limited capital and income.*

The problems with a sentimental approach to home ownership in retirement are reflected in the following shibboleths and slogans which have grown up around such ownership:

"We will always have a roof over our heads."—*Not necessarily.*

"We'll have something to show for our money— not merely a bunch of rent receipts."—*That doesn't mean you will always show a profit.*

"We'll always have something which goes up in value." *No guarantee in this day and age.*

Ownership of real estate, very much like the little girl with the curl in the middle of her forehead, can be beautiful or horrid.

First, the positive attributes of home ownership:

It provides a sense of deep, long-term comfort which many retirees can not achieve in rented quarters. The satisfaction of putting a shelf or a terrace or a door exactly where you want it, and where it will stay for as long as you want it there, offers enjoyment not available in rented quarters. Long-term friendships with neighbors and with merchants are further bonuses.

Financially, a house with reasonable maintenance costs and reasonable real estate taxes may very well supply living quarters at a cost below what rented apartments or flats can provide. Such a house also provides tax credits for interest paid on mortgages and for real estate taxes—two deductions renters do not get. It may, if all goes well with your city or township show you a substantial capital gain (provided, of course, you sell out at some time and take the profit).

But, there are these negatives:

Long-term associations and geographic roots may not be what you want in retire-

ment. You may want to buy a motorhome and travel, or move to a more comfortable climate, or move closer to your children, or to other retired friends or relatives.

Financially, home ownership often masks real costs so that folks retiring on limited or tight budgets may not be aware that their home—comfortable as it may be—is actually costing them much more than they suspect.

For example: (you'll have to put current interest rates into the formula) let's say you were employed at \$20,000 annual salary. A \$50,000 to \$60,000 home (present value) may not have been too much of a burden. But on a \$12,000 retirement income (company pension, plus Social Security) it may turn out to represent a luxury you'll end up wishing you could trade for other things —if you ever took the time to figure out exactly what it is costing you.

Consider these fallacies: "We own it free and clear—no mortgage, so the rent is cheap." Not so. You may own all \$50,000-\$60,000 of it, but that means all of that money is devoted to paying part of your rent via equity ownership. (The rest of the "rent" expense—real estate taxes, heat, home repairs, insurance, water—are current *out-of-pocket* expenses.) Only such arithmetic will tell you what your "rental" expense *really* is.

Now, to the total of the above-mentioned current expenses (let's call it \$2,000 a year), add the net income (after taxes) that \$50,000 or \$60,000 could bring in if you had it invested in securities and not in your home.

Let's call that income in today's interest rate market \$4,000 to \$4,500 a year before taxes. So, your total annual rental for your "owned-down-to-the-ground" home is not the \$2,000 you pay out for taxes and services, but a total of \$6,000 or \$6,500—or better than \$500 a month. (Keep in mind, too, that if in retirement you are in a low tax-bracket, the net income from that \$50,000 to \$60,000 equity could run as high as \$5,000 making your total "rental" bill \$7,000 a year.

Some retirees, of course, simply prefer to remain in their own home so long as they can comfortably afford it. And that is their right. My only warning is: Make sure you understand, to the dollar, just what your home costs you—in actual money going out for tax, fuel, and all other costs *plus* the income you are passing up by keeping your equity invested. This is the only way you can arrive at a decision as to whether or not your present home is your *best* financially comfortable retirement nest.

SHOULD YOU USE a mortgage loan to buy your retirement home? And should you retain the mortgage on your retirement home if you have funds with which to wipe it out?

There are two approaches to this question: (1) psychological and (2) financial.

Psychologically, there is a tremendous "lift" to be derived from a mortgage-free home, especially in retirement when paycheck earnings have ceased and you are living on money accumulated during your working years. But even a mortgage-free "roof" doesn't come free of charge. There are always taxes, insurance, repairs, water and other utility costs to be met. Furthermore, the money you expended to wipe out that mortgage had earning power for your retirement also.

If the psychological comfort of a mortgage-free home is of paramount importance to your retirement happiness, then there is no debate: wipe out the mortgage. But if you are sufficiently unemotional to do some basic arithmetic, read on.

Let's say you are about to buy, or have bought, a retirement home for \$50,000, and are wondering whether to pay all cash (which, let's assume, you could do) or put down only \$30,000, borrow the remaining \$20,000 at an interest rate now around 10% on a 15-year mortgage, and keep your own \$20,000 invested in savings certificates or high-quality corporate bonds. Here are your options:

Under *Plan A*—you pay \$30,000 cash. *Advantages:* No mortgage, no monthly interest payment, plus amortization, a "free and clear" retirement home. *Disadvantages:* The loss of income from that \$20,000—which could be bringing in anywhere from \$1,500 to \$1,700 a year.

Under *Plan B*—you pay \$30,000 down, borrow \$20,000 on a 10% 15-year mortgage. *Advantages:* You retain \$20,000 for investments which can provide income and some reserves. *Disadvantages:* You saddle yourself with monthly payments for the next 15 years.

Which is financially more advantageous? Part of the monthly mortgage payment can be counted, of course, as income-tax-deductible interest and part of it as amortization. The latter is a form of "forced savings" since it steadily builds up your equity in the house. However, it is all monthly outgo. You've got to have it in order to pay it, and it must mean that you have less to spend for other things—necessities as well as luxuries. The interest portion is, of course, nearly offset by the income you could expect from \$20,000 retained in your investment portfolio, but the amortization payout is above and beyond that. The \$20,000 retained in investments could, presumably, bring in about \$135 a month from an "8% plus" bond investment. But that still leaves a budget deficit in order to meet the monthly mortgage bill.

If you are retired on a tight budget, it may well be that it will pay to buy for all cash and save the amortization outlay. However, there is no way to give a blanket answer to this problem without doing all the arithmetic for your specific situation.

You must take into account the earnings of the \$20,000 you now have invested, the

cost of the mortgage—in interest rates, setting-up expenses, and amortization. Also your individual tax savings in retirement on any interest deduction, and finally, the net result of a mortgage vs. no mortgage on your actual monthly budget—in dollars and cents

A Dividend Check Every Month?

For many retired folks, the regularity and frequency of dividend income is important. It is possible to arrange a common stock portfolio so as to receive a different dividend check every month. A minimum of three different issues, each paying dividends in different quarters, is all that is needed.

Following is a brief sampling of common stocks rated B plus or higher, yielding about 5 per cent or better, which have paid dividends quarterly for at least 30 years. The list is not all-inclusive. Inclusion here is not a recommendation to buy. You should invest only with the help of a reputable broker. (For further background on stocks, see page 8.)

Some companies paying dividends in JANUARY, APRIL, JULY and OCTOBER: American Telephone & Telegraph, Amstar, Atlantic City Electric, Baltimore Gas & Electric, Bangor Hydro Electric, Bell Telephone of Canada, CPC International, Duquesne Light, Middle South Utilities, Mountain States Utilities, New England Tel. & Tel., New Haven Water, Northern

States Power, Pacific Gas & Electric, Portland General Electric, Southern California Edison, United Illuminating.

Some companies paying dividends in FEBRUARY, MAY, AUGUST and NOVEMBER: American Can, American Smelting & Refining, Arkansas Western Gas, Boston Edison, Brooklyn Union Gas, California Water Service, Central Hudson Gas & Electric, Central Vermont Public Service, Columbia Gas, Commonwealth Edison, Consumers Power, Illinois Power, Public Service of Colorado.

Some companies paying dividends in MARCH, JUNE, SEPTEMBER and DECEMBER: Alabama Gas, Allegheny Power, American Brands, Arizona Public Service, Caleneese Corp., Central Illinois Light, Central Illinois Public Service, Central Maine Power, Consolidated Edison, General Foods, General Motors, Gulf Oil, Inland Steel, Potomac Electric Power, Public Service Electric & Gas, Public Service of Indiana.

A PARTIAL LIST OF STOCKS QUALIFYING AS RETIREMENT INCOME SOURCES

Here is a list of investment grade companies which have paid dividends without interruption for many years. It is by no means all-inclusive. Every issue listed is not suited to every investor. Nor does the fact an issue is omitted imply any criticism of its investment standing. This is merely a sampling of the type of securities to consider if safety is import-

ant to you. Only a reputable broker can help you decide. Income varies, but current yields of 5% and more are obtainable from some of the commons, and even higher returns from some of the preferreds and bonds of these corporations—both "straight" and convertible issues. (For further background on stocks, see page 7.)

RAILROADS

Chessie System Norfolk & Western	Pullman Santa Fe Industries	Southern Pacific Southern Ry.
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UTILITIES

Allegheny Power American Electric Power American Natural Resources American Telephone & Telegraph Baltimore Gas & Electric Boston Edison Brooklyn Union Gas Cincinnati Gas & Electric Columbia Gas Cleveland Electric Ill.	Commonwealth Edison Consolidated Natural Gas Duke Power Duquesne Light El Paso Natural Gas Equitable Gas Houston Lighting National Fuel Gas New England Electric New England Tel. & Tel. New York State Elec. & Gas	Niagara Mohawk Northern Indiana P.S. Pacific Gas & Electric Pacific Lighting Peoples Gas Philadelphia Electric Potomac Electric Providence Gas Public Service Elec. & Gas Puget Sound Power & Light Southern Co.	Southern Natural Gas Tenneco Toledo Edison Tucson Gas & Electric Union Electric United Gas Corp. United Gas Improvement Washington Gas Light Washington Water Power Wisconsin Electric Power
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INDUSTRIALS

Allied Stores American Brands American Can American Cyanamid Armco Bethlehem Steel Borg-Warner CIT Financial Cities Service	CPC International Dow Chemical Exxon Ford General Foods General Motors W. R. Grace Goodyear Tire Gulf Oil	Inland Steel Int'l Harvester Kimberly-Clark Kraft Kroger Libby-Owens-Ford Liggett Group Mobil Oil	Nabisco National Distillers National Gypsum Phelps Dodge RCA Corp. Reynolds Industries Safeway Stores Sherwin-Williams	Standard Oil of Cal. Stone & Webster Texaco Union Carbide J. S. Gypsum J. S. Tobacco F. W. Woolworth Wm. Wrigley
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Setting Up Your Personal Budget

A RETIREMENT BUDGET is—and must be—a very personal thing. It should reflect *you*—not your brother or sister or any of the folks you used to work with. But, most important, it should be set down on paper. Too many retirees try to live by the seat-of-the-pants method of budgeting—only to see money going out faster than it comes in. The result: there are days (or weeks) when you're so short of funds that all you can do is sit and complain until the next Social Security or pension check arrives. That's no retirement life.

Some experts advise setting up a month-by-month budget. But few of us spend identical amounts each month. More flexible is an alternate-month budget. This means budgeting your income and outgo over a two-month period, pairing "survival needs" with less essential items that bring you joy in living. The first month, for example, might call for roughly 10 to 20% (or whatever amount you estimate) more spending than in the second month, when you cut your spending to match the cash flow. During the first month, you live a bit more self-indulgently—eating out, shopping, traveling. During the alternate month you can catch up on correspondence, hobbies, reading, home repairs, or just visiting friends.

Whatever method or time-period you decide on, the key to any useful budget is

clearcut, *comprehensive* planning. It should begin with a simple listing-and-matching exercise—using, for example, the worksheet provided on the last page.

The way to start your budget computations is by listing a *full year's* income sources, along with the amount you estimate you'll accrue from each. Then divide the total by 12, to get your average monthly retirement income—or divide by 52 or 26 if you prefer to set up your budget on a weekly or bi-weekly basis.

Next, list your expenses—and again the decision must be your own as to whether it's monthly, weekly, bi-weekly, or even bi-monthly. But make this list as all-inclusive as you can. It may take some juggling to break everything down into one time-period, since some bills obviously will come in weekly, some monthly, some bi-monthly, and some quarterly.

What will come to the surface as you work on your budget is something that sums up a lot about any money plan for retirement: It should be shaped to meet not just survival but expanded retirement interests. So be imaginative in listing items that will enable you to achieve not only a feeling of financial independence but also of participating more fully in life. Be flexible, and a little daring where you can afford it. As John Ruskin once said: "There is no wealth but life."

IRA: All the Way or No Way?

DESPITE THE SPATE of publicity and advertising about the new rules on Individual Retirement Accounts, many people in their 50's and 60's have no idea whether this tax shelter benefits them or whether they are even eligible. This is not surprising. Most banks and other financial institutions have pitched their advertising to 30-year-olds, whose money they can tie up for 25 years or more on the less than solid promise that an IRA will turn them all into millionaires by the time they retire.

The new IRA rules allow you to stash away up to \$2,000 of earned income each year without paying taxes on it until you withdraw it—no sooner than age 59½ and no later than age 70½. This tax shelter is available in addition to any other pension plan you may have and regardless of your total earnings. (Even if you earn only \$2,000 a year, you can put it all into your IRA if you can afford to.) But the age limits may have caused 50-plussers a good deal of confusion. Fifty-year-olds wonder whether the plan is worth their trouble, and 60-year-olds may think that the 59½-year age limit renders them ineligible.

Actually, if you are in your 50's, the new IRA is probably more advantageous to you than it is to your 30-year-old son or daughter. To begin with, you'll be tying up your money for only nine years or less. More important, if you are at peak income, you can more easily afford the full \$2,000 deposit. And, of course, the higher your tax bracket, the more the tax shelter is worth to you.

If you are in your 60's, you can enjoy these same advantages plus a couple of others. First, you can open an IRA without tying up your money at all, since withdrawals are permitted after age 59½. This gives you great flexibility, because you can deposit the maximum to take advantage of the tax shelter but withdraw it (and pay taxes on it) if you happen to need it a few months later. Moreover, if you deposit your money a year or two before beginning your Social Security benefits, you can withdraw it after you begin collecting these benefits, at which time you are almost certain to be in a lower tax bracket.

How much more money will an IRA yield than a regular savings account that doesn't allow for tax-deductible contributions? The answer is a lot more. Consider a couple age fifty who are in a 30% tax bracket. A contribution of \$2,000 by each spouse—for a total of \$4,000—would actually cost them only \$2,800, given the tax that they are saving by investing that money in an IRA. If they had chosen instead to invest that same \$2,800 in a regular savings account at 10% annual interest, in twenty years their investment would yield \$10,835. By investing in an IRA, however, in twenty years their initial investment would bring them \$26,910! Even after paying taxes they are much better off with the IRA.

The following table shows the growth of IRA contributions at 8% and 12% annual rates of return, assuming that a \$2,000 contribution is made each year from the starting age until age 70:

Age When IRA is Estb'd	Total Amount Invested by Age 70	Accumulation at Age 70, Assuming Rates of Return of:	
		8%	12%
50	\$40,000	\$106,754	\$180,765
55	30,000	63,340	93,527
60	20,000	33,794	44,026
65	10,000	13,686	15,938

It's important to remember that while contributions to the IRA are tax-deductible, when the amounts are withdrawn taxes must be paid on them.

There are several different types of IRA's that are available, so it makes sense to shop around and find the plan that is best for you. Commercial banks, savings banks, and savings and loan associations offer IRA's, through regular passbook savings accounts and certificates of deposit (CD's), with a variety of maturity dates. Certain "wild card" CD's can earn interest at whatever rate a given financial institution chooses to pay—either a fixed rate or a variable interest rate. A fixed-rate CD guarantees you an interest rate for a certain period, which guards against falling interest rates but doesn't allow for shifts to a higher rate during the period. When you are comparing the fixed-interest rates offered by different institutions, be sure to consider how often interest is compounded (for example, daily, monthly, or quarterly). The more frequent the compounding of interest, the greater the yield on the account.

Variable rates change weekly or monthly over the term of the CD in step with a selected market index. Most institutions use an index that fluctuates with interest rates. And some institutions will guarantee a minimum rate of return for a limited period—such not as less than 8% during 1984. This guarantee protects the customer, while allowing for increases in the index.

IRA's that are established through banks and savings and loan institutions are insured by government agencies. As a rule, these organizations do not charge set-up fees or annual maintenance fees.

Another kind of IRA is the mutual fund, the investment in a pool of assets such as growth stocks, tax-exempt municipal bonds, income stocks, or a combination of these. There are two main advantages of the mutual fund for the IRA investor. One is that there is sometimes no charge for setting up the IRA and management fees usually run no more than \$10 a year. The second, and more important, advantage is that many mutual fund organizations offer a variety of investment funds and give you the option of moving your money among them. For example, you can usually choose from among money market, bond, and

common stock funds, invest in one or any combination of these, and then transfer your assets among them to maximize your return. Some mutual funds will place some limits on transferring, such as by requiring you to name one fund as the "lead," or primary fund and require you to invest a certain amount before you can transfer to another fund. You can make transfers easily, too, usually by phone or by mail.

Insurance companies also offer IRA's, in the form of annuity contracts. The most common type of annuity is the traditional annuity, which guarantees that you will receive a certain amount of money per month for life for every \$1,000 that you have deposited. Some insurance companies offer annuity contracts with different types of investment approaches, such as a stock account or money market account. If you choose a stock account or a money market account—which is a pool of bond-type assets similar to a mutual fund—your return will depend on how well the investment performs. These accounts involve a certain amount of risk, as you are relying on the results of the company's investments. But the returns have proved to be much greater than with traditional annuity contracts.

If these advantages appeal to you, shop around carefully and don't put all your eggs into one IRA. Although the law limits your annual deposit to \$2,000, it doesn't limit the number of accounts into which this maximum can go. Splitting your deposit

among two or three accounts (perhaps a savings certificate, a money market fund, and a stock broker) offers you not only the advantage of diversification but—more important—flexibility in making withdrawals. Many IRA's must be withdrawn either in a lump-sum or on an annuity basis. Thus, if you put all \$2,000 into one account and then need some cash, you'll have to withdraw the full amount and pay tax that year on \$2,000 plus earned interest. If, however, you deposit \$500 into each of four accounts, you can withdraw only one or two of them and leave the others for withdrawal in later years so as to even out your tax burden. Moreover, if you want to make further deposits during the next few years, you can choose the account that has demonstrated the best performance.

IRA's have other uses as tax-saving vehicles. If you have participated in a company pension plan, you may transfer the payment from the pension plan, or "roll over" the funds, into an IRA when you retire and avoid paying tax on the funds. The amount of money rolled over will be taxable later, when you receive money from the IRA.

Thus you can avoid paying a very high tax on a payment from your employer's pension plan by rolling over the funds into an IRA. You'll pay tax later, of course, but only as you receive the assets from the IRA—usually when you are older and in a lower tax bracket anyway.

Borrowing on Your GI Insurance

IF YOU BOUGHT GI insurance (National Service Life Insurance) when you served in the armed forces 30 or 40 years ago, you are probably unhappy about what inflation has done to its face value. The maximum \$10,000 policy, which at that time was equivalent to about to about three years of earnings, has sunk to less than one-sixth of its original value. But if your policy is still in force, there is one way—not widely known—in which you can beef up its value. Many of these policies have a cash value which you can borrow from the Veterans Administration at the fixed rate of 5% per year. If you borrow the full cash value and invest it at today's high interest rates (the approximately 13% currently available from money market funds and savings certificates), you'll pocket 8% a year on the amount you borrow.

You will, of course, be paying annual interest on the loan but this, like all loan interest, is tax-deductible. The regular dividend you may be receiving on your policy from the Veterans Administration will not be affected. Of course, the face value of your policy will be reduced by the amount you borrow, but the high return your loan will be earning should make up for this. If interest rates ever drop to 5%, you can repay the loan and restore the full value of your policy. By that time, however, the amount of money you borrowed may well have doubled.

To find out the cash value of your policy and to get a loan application, get in touch with the nearest office of the Veterans Administration.

Your Own Retirement Budget Worksheet

MONTHLY INCOME: SOURCES		MONTHLY OUTGO: EXPENSES <small>(Including 1/2 of bi-monthly expenses, 1/3 of quarterly, 1/12 of yearly, etc.)</small>	
ITEM	AMOUNT	ITEM	AMOUNT
Social Security	_____	Food	_____
Pension and Annuity	_____	Housing (rent, mortgage)	_____
Interest (Bonds, savings account, loans, mortgages you own)	_____	Utilities Fuel/Water	_____
Part-time wages or salary	_____	Telephone	_____
Consulting fees	_____	Laundry/Dry Cleaning	_____
Commissions	_____	Auto: Gas, etc.	_____
Widow's benefits	_____	Bus fares	_____
Endowment policy	_____	Church donations	_____
Veteran's compensation	_____	Clothing	_____
Stock dividends	_____	Recreation (movies, concerts, ballgames, etc.)	_____
Annuities	_____	Alcohol and tobacco	_____
Insurance cash value	_____	Entertaining	_____
Capital gains	_____	Eating out	_____
Tax refunds	_____	Magazines, newspapers	_____
Rent from property	_____	Medical/dental	_____
Profit from sale of real estate or stocks	_____	Drugs/medicines	_____
Windfall sales (antiques, stamp or coin collections, old books, etc.)	_____	All insurances	_____
Royalties	_____	Medicare	_____
Other sources	_____	All taxes (income, property, state, city)	_____
TOTAL	_____	Personal services (barber, hairdresser)	_____
		Tools, hobby materials	_____
		Home repairs	_____
		Gifts	_____
		Other	_____
		TOTAL	_____

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REPORT
TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND
TO GOVERNOR BILL SHEFFIELD
FROM
THE STATE SPECIAL COMMITTEE ON THE
ALASKA LONGEVITY BONUS PROGRAM



February 1, 1985

REPORT TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND TO GOVERNOR BILL SHEFFIELD FROM THE STATE SPECIAL
COMMITTEE ON THE ALASKA LONGEVITY BONUS PROGRAM

together with

DISSENTING VIEWS AND ADDITIONAL COMMENTS

February 1, 1985

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Introduction.

In June, 1984, the Alaska Longevity Bonus Program (AS 47.45) was declared unconstitutional because it required recipients to have resided in Alaska both prior to statehood and for 25 consecutive years. The Thirteenth Legislature, 2nd Sess., repealed these lengthy residency requirements, thus opening the program to new participants. Ch. 38, SLA 1984. However, the amended law, by its own terms, is to be repealed effective June 30, 1985. Id., Sec. 11.

The legislation also established the State Special Committee on the Alaska Longevity Bonus Program to "determine the feasibility of replacing the longevity bonus program, as amended by this Act, with an annuity program, a needs-based program, or other longevity program." Id., Sec. 7. This is the committee's report.

Recommendation: Annuity Approach.

The committee has developed a proposal which would phase out the existing longevity bonus program and replace it with individual annuity accounts funded primarily by the permanent fund dividends of participants. 1/ The proposal has been

1/ Three different annuity approaches were initially considered by the committee: (1) SB 465, introduced in the 1984 legislature by several senators; (2) an amended version of HB 700, also introduced in that legislature; and (3) a draft bill prepared by Senator Bill Ray (D., Juneau). The Ray bill became the vehicle for the Committee's proposal. All three proposals involved

introduced in this legislature as SB 56. Under the committee bill, Alaskans who choose to participate in the program will receive monthly benefits, after reaching age 65, of at least the \$250 which is currently provided by the bonus program, inflated by three percent annually.

The program is available to those who reach age 65 after 1985. Under the bill, Alaska's existing elderly will receive their current \$250 bonus, inflated by three percent annually, without having to forego their permanent fund dividends.

The committee bill provides that each year every Alaskan (except those who are 65 or older before 1986) will receive his or her permanent fund dividend in the form of a credit to an annuity account, unless the individual affirmatively elects to receive cash. 2/ Section 2 of the bill envisions that the

foregoing a permanent fund dividend in return for some type of future annuity benefit.

SB 465 would have paid \$16.50 per month to each elderly Alaskan for every permanent fund dividend foregone -- to a limit of \$250 per month.

HB 700 would have given each Alaskan one annuity share for each foregone dividend. Each year, one third of the money available for permanent fund dividends would then be divided by the number of annuity shares held by those over the age of 65. Each elderly Alaskan would receive a portion of that annuity fund commensurate with the number of shares held.

The committee was advised by legal counsel that HB 700 and SB 465 created greater constitutional risks than did the Ray proposal; the committee therefore focused on the concept embodied in Senator Ray's bill.

2/ This aspect of the committee proposal reflects a change from

legislature may, at least in the early years, "front-load" the program by appropriating additional funds into the annuity account, which will be attributed to individual accounts on a prescribed formula. Under that formula, state contributions are greatest for those approaching retirement age, and decline for younger Alaskans. Beginning at age 65, a participant receives an annuity based on his contributions and any front-loading -- plus earnings accumulated on those amounts. 3/

Even with front-loading, it will be years before annuity payments are sufficient to replace the longevity bonus. The ALB program is thus retained at a level which, for those turning 65 after 1985, will be reduced annually. 4/ Under the bill, a "target amount" for the ALB is established (Section 8), which is \$250 per month (in FY 1986) inflated by 3% each year. That target amount is then reduced by the maximum possible annuity which would be available to a 65-year old who has participated in

earlier annuity bills, which required an election to forego cash payment. Because, in the future, the annuity program will be the only state source of non-need-based retirement assistance, the committee believes that each Alaskan should be required to come to grips with the long-term consequences of a decision to take the dividend in cash.

3/ Under the committee bill a participant who dies before age 65 will forfeit his accumulated annuity credits (see the discussion of survivor options at 17, post); the amounts forfeited will be reallocated to surviving participants and thus will increase their annuities.

4/ The longevity bonus itself is, of course, available to all elderly Alaskans whether or not they have also established annuity accounts.

the program in each year since the program's inception. For example, if the inflated ALB "target" for a particular year is \$280, and a person turning 65 who received an annuity credit in each year of the program would be entitled to an annuity of \$100 per month, the ALB payment for all recipients would be \$180. That \$180 will not vary according to the actual participation histories of individual ALB recipients.

Over the years, individual annuity accounts will become greater, and each year the longevity bonus payable to new recipients becomes correspondingly smaller. By the year 2003, the committee projects that the maximum possible annuity will be sufficient to bring an end to the general-funded ALB program, except for those relatively few who were 65 or older before 1986, and are still receiving ALB payments in that year. This is best illustrated by the following chart:

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	<u>Maximum Possible Annuity 5/</u>	<u>ALB (for all new recipients)</u>
1986	4.37	\$245.63
1990	32.50	248.88
1995	106.27	219.92
2000	255.70	122.45
2005	533.39	-0-

Other Options Considered

The committee invited its members, and others, to suggest alternatives other than an annuity program. Only one was advanced -- a "means test" program under which elderly Alaskans earning less than \$25,000 per year would receive a payment of \$250 per month. Those earning more than \$25,000 would receive a payment of \$100 per month. To qualify for the \$250 bonus, the applicant would be required to submit his or her tax return to the Department of Administration.

This program is intended as a permanent replacement for the ALB. However, the program envisions that the size of the payments, and the \$25,000 income limit, remain constant over the years. In terms of real income, the effect is as follows:

5/ Annuity projections are without "front-loading."

	<u>Maximum Income Eligibility for Bonus (year)</u>	<u>Amount of Bonus</u>	<u>Size of Alternate Bonus</u>
1986	\$25,000	\$250	\$100
2000	\$10,569	\$104	\$41.60
2010	\$ 5,902 <u>6/</u>	\$ 59	\$23.60

It is estimated that, initially, 80% of Alaska's elderly will be eligible for the \$250 bonus. Because that maximum income requirement drops each year in terms of real income, so too does the percentage of eligible elderly. Thus, less than half of Alaska's elderly will be eligible for the bonus in the year 2000, and only 30% will be eligible in the year 2010.

The committee rejected this means test proposal for the following reasons:

1. Any welfare program is contrary to the intent of the ALB program and is vigorously opposed by Alaska's elderly. The Longevity Bonus Program now says to Alaska's elderly that they are a precious human resource, and that it is in the state's interest to provide them with the wherewithall to remain in Alaska after retirement. The means test payment, on the other hand, carries with it quite different, and less favorable connotations.

6/ This is below Alaska's \$7032/year poverty level.

2. Of those who are potentially eligible for the \$250 means test payment, many may not apply because of its welfare connotations. This is strongly suggested by available statistics. Currently, nearly 6,700 ALB recipients -- or 40% of all recipients -- have incomes below the current eligibility limit for existing Old Age Assistance and Medicaid benefits. These benefits are substantial -- averaging \$2,640 per year for OAA and an additional \$2,500 per year for Medicaid. Yet, of the income-eligible, only 2,526 -- or roughly 38% -- have in fact applied for OAA and Medicaid. Certainly, some of the remaining income-eligible have not applied because they have more assets than current law allows. Nonetheless, these statistics manifest an aversion to need-based assistance which has deterred many of Alaska's apparently eligible elderly from applying for substantial benefits.

3. Thus, while 20% of Alaska's elderly will be ineligible for the \$250 bonus, an additional percentage of existing ALB recipients will lose their current benefits because of their unwillingness to participate in a welfare program. For these reasons, this means test proposal fails a threshold test which should be a cornerstone of any longevity bonus legislation. Any ALB alternative, the committee believes, should provide those who have received the ALB over the years with the same benefits as under current law.

4. The proposal hurts both existing and new ALB recipients in another way. Because the real value of both the benefits and

the income ceiling will decrease over the years, fewer elderly will find themselves eligible, and those who are eligible will receive smaller benefits. By the year 2000, for example, less than half of Alaska's elderly will be eligible for a benefit with a real value of \$104 per month, while the majority will receive a token payment with a real value of \$41.60.

5. The proposal is substantially more expensive than the committee bill. Even though: (1) the committee bill protects existing elderly, while this means test proposal does not; and (2) the committee bill inflates the ALB annually, while the means test proposal does not, enactment of this means test proposal would cost nearly \$2 billion more than the committee bill over the next 50 years. Moreover, that cost would be born when the state could least afford it -- after the turn of the century, when oil revenues are projected to rapidly decline. It is important to the committee to develop an ALB alternative which phases out general fund obligations after the year 2000. As part 12 of this report discusses, while post-1999 costs under the committee bill are projected to be \$285 million, 21st century costs under the means test proposal would be roughly \$2.28 billion.

6. The committee has several concerns regarding the \$100 payment for which all elderly would be eligible. First, the committee does not know what that payment is intended to accomplish. It is doubtful that \$100 per month is a sufficient sum to allow any elderly to remain in the state who would

otherwise be financially required to leave. The payment may thus at once be too small to accomplish any social goal, and yet large enough to constitute a substantial drain on the state treasury.

Additionally, many elderly may view the \$100 payment as tokenism. If that is not the case now, it will certainly become so in the future when the real value of that payment shrinks to \$41 (2000) and \$23 (2010).

Finally, since the \$100 and \$250 payments are fundamentally different in purpose, the committee believes that they should be administered under separate programs. The \$100 payment is apparently intended as a residual ALB. On the other hand, the \$250 payment is a form of welfare. This payment, the committee believes, should be administered by the Department of Health and Social Services under the state's welfare laws. Otherwise, the state will, in essence, be creating two welfare bureaucracies -- one for Old Age Assistance, and one for the mis-named "longevity bonus."

7. Fewer people will meet the \$25,000 eligibility requirement as the years go by. Thus, by the year 2010, only 30% of Alaska's elderly will be eligible for this means test payment. Why, it might fairly be asked, are 80% of today's elderly in "critical" need of the higher payment, while only 30% will require the payment in years hence? For one who is currently denied the larger payment, or who may be denied it in the future solely because of inflation, this precise question will invariably be asked, and may be asked in the courts.

8. Finally, in requiring one year's residency in order to receive the \$250 means test payment, the proposal raises a substantial constitutional issue. The current ALB's one-year durational residency requirement is constitutional because the bonus is not dependent upon "need." Under both the federal and Alaska constitutions, if a program provides "the basic necessities of life," a 30-day residency requirement is the maximum constitutionally permissible. Memorial Hospital v. Maricopa County, 415 U.S. 250, 259 (1974); Shapiro v. Thompson, 394 U.S. 618 (1969). Generally, benefits which are accorded on the basis of the recipient's income tend to be viewed by the courts as involving "basic necessities." For example, in Jeffrey v. Colorado State Department of Social Services, 599 P.2d 874 (Col. 1979), the Colorado Supreme Court struck down the lengthy durational residency requirement of that state's old age pension program, and held that the program provided basic necessities of life. The state argued, unsuccessfully, that its program was more akin to an income supplement, rather than a form of welfare. The court, however, ruled that because the size of the pension was a function of the applicant's other income, a 30-day residency requirement was required:

[The state] attempt[s] to avoid the strict scrutiny - compelling state interest test mandated by Shapiro by characterizing the old age pension program as an 'annuity.' However, unlike true annuity or pension programs which are unaffected by a recipient's other income, the old age pension benefit is directly and proportionately reduced by the amount of other income. Thus, the characterization of the old age pension program as an "annuity" puts form over substance and

disregards the nature of the program, which is to fulfill basic needs and not to supplement separate income.

599 P.2d at 879. Emphasis added.

The means test proposal has been defended because of its high income limits. This does make the program different from that involved in Jeffrey, and the committee agrees that this defense could be made in good faith. To the committee, however, that is not enough. Early in the committee's deliberations, the committee agreed to develop a proposal which would avoid serious new constitutional issues and the threat of continued litigation. While any legislation which treats some people differently than others may result in litigation, the means test proposal raises a serious and substantial residency discrimination issue, and therefore does not meet the committee's goal. 7/

For these reasons, the committee does not believe that the means test proposal is a viable alternative to the existing ALB program.

The committee was also aware of the "stair-stepping approach," under which the ALB program is slowly phased out through an annual increase in the eligibility age. Under legislation which passed the House of Representatives during the

7/ Additionally, it should be noted that the issue will become more serious in future years. This is because while the income level is high at the outset, it shrinks dramatically, and in real value falls below the state's existing poverty level in the year 2008.

previous legislature, the eligibility age would begin to rise above 65 in 1991. Although no "stairstepping" proposal was ever advanced by anyone for formal committee review or action, the committee is aware of some continued interest in developing this concept outside of this committee's deliberations. The proposal thus warrants some comment.

First, the term "stairstepping" is a misnomer, since it connotes a gradual phasing out of the ALB program. In truth, the stairstepping approach causes the most abrupt program termination of any option considered, and also results in the most severe discrimination between groups of Alaskans. Under the stairstepping approach, if a person was born on or before June 30, 1925, the state would pay him or her \$250 per month for life. For persons born on July 1, 1925 and thereafter, the state would pay nothing. And, it is irrelevant whether that person is now an Alaskan. A current non-resident who is now 62 would receive \$250/month when he or she moved to Alaska, while a current 59-year old Alaskan would receive nothing. There is thus nothing gradual, or "stairstepped," about this process.

The stairstepping approach would be more expensive than the committee bill, 8/ and much of this added expense would be born after the turn of the century when the state can least afford it. See Section 12. Yet, despite its high cost, stairstepping would

8/ Assuming, of course, that the two had similar provisions dealing with the erosion of the real value of the bonus.

benefit fewer Alaskans. For example, some have assumed that participation in the annuity program is necessary in order for future elderly to benefit from the committee bill. This is not true. Under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever, while that same person would receive a 1991 ALB of \$222.61 under the committee bill, even if that person had never participated in the annuity program. Thus, for similar total costs, and substantially lower 21st century costs, the committee bill extends the benefits of the ALB program to many more Alaskans.

Most fundamentally, the committee believes that there is a need for future state participation in the building of retirement security that is not recognized in the stairstepping approach standing alone. Apart from the ALB, the principal form of non-need based assistance is, of course, Social Security. Yet Alaska's elderly receive the same Social Security payments as those who reside where the cost of living is much lower. Moreover, Alaska has a uniquely high percentage of elderly who are ineligible for Social Security because of a lack of wage-earning history. Thus, in one area of the state -- Northwest Alaska -- 66% of the region's elderly reported the ALB as their principal source of income.

As oil revenues decline, and economic activity in the state becomes more uncertain, it is entirely possible that the state's future elderly will find themselves in a more precarious position

than today. And, at that point, the state -- for these same economic reasons -- may be unable to help.

One obvious impact of abolishing the ALB program through "stair-stepping" is an increased Old Age Assistance case load. Certainly, when those near the poverty line are denied \$250 per month, they will simply turn to the welfare system, and the state will realize no net saving. Moreover, and as discussed previously, many ALB recipients who are apparently eligible for OAA and Medicaid have in fact not applied for these benefits. Over the years, the ALB program has been defended on the ground that it has enabled many Alaskan elderly to remain off the welfare roles. Statistics bear this out, indicating that many of those ALB recipients who are eligible for OAA and Medicaid have been able to remain off these programs because of the bonus.

For these reasons, stair-stepping by itself is also not being recommended to the legislature.

On the other hand, the principal advantage of "stair-stepping" is the protection which it affords those who are currently on the ALB program, and who have come to rely on both the Longevity Bonus and the permanent fund dividend to sustain themselves. The committee concluded that forcing Alaska's existing elderly to forego their Permanent Fund Dividend in order to assure continued receipt of the "target" Longevity Bonus might work a hardship on these older Alaskans. As a result, the committee decided to include in the bill a so-called "grandfathering" provision which allows those reaching age 65

before 1986 to take their Permanent Fund Dividend in cash and still receive a full Longevity Bonus for the remainder of their lives. The committee legislation, then, is intended to blend the most salutary aspects of both an annuity approach and "stair-stepping."

The virtue of an annuity approach is that it enables the state and each individual Alaskan to set aside funds now for those perhaps more difficult years ahead. It is a program designed to substitute private thrift for public largesse. The committee also believes that the permanent fund dividend is an appropriate source of funds for the annuity program. The purpose of the annuity program is much like the purpose of the permanent fund itself. Moreover, one purpose of the dividend program -- to give each Alaskan a stake in the management of the permanent fund -- will be enhanced if Alaskans' retirement security is at least in part dependent on wise stewardship of that fund.

Major Features.

1. Front-loading. The committee envisions that the legislature may add additional sums to individual annuity accounts. Under "front-loading," a person will receive an annuity account credit greater -- and perhaps substantially greater -- than the amount of cash he or she could have received. It is the committee's hope that the legislature will consider front-loading for each of the program's first three years.

The committee initially analyzed the annuity concept without front-loading. Even without front-loading, annuity payments eventually replace longevity bonus payments from the general fund. Nonetheless, the committee feared that because annuity payments were low in the early years, those Alaskans who are now near retirement age would not participate in the program. Moreover, general fund contributions did not begin to see significant reductions for about 10 years.

Front-loading provides a substantial incentive to individuals to forego immediate cash in favor of retirement security. While it costs more in the initial years, that cost is incurred in years in which oil revenues are expected to remain high. Moreover, general fund contributions to the ALB program taper off rapidly. In other words, because front-loading causes the maximum possible annuity payment to increase, residual longevity bonus payments decrease more rapidly. Thus, dollars invested in early years through front-loading result in a decrease in general fund obligations in later years.

Under the committee bill, substantial front-loading now would actually result in a net savings over the life of the ALB program -- at least in nominal dollars. Thus, if \$79 million were appropriated for front-loading over the next three years, that investment would result in a return of \$82 million in reduced ALB payments over the next 25 years. In constant 1986 dollars, the ultimate cost of investing \$79 million now is \$30 million.

Additionally, front-loading serves other important purposes which the committee believes warrant the cost in constant dollars:

(1) The committee bill will work only if Alaskans participate. If they do not, Alaska's future elderly may still place demands on the general fund; and

(2) A premium may fairly be placed on the current availability of funds. If \$1.00 of general funds front-loaded now returns 75¢ (in constant dollars) years hence, the fact that the general fund has that \$1.00 now, but may not have the 75¢ later, is of some relevance.

Whether front-loading extends beyond the three-year period envisioned by the committee depends on the availability of funds, actual participation rates, and the projected rate of return on subsequent front-loading investments. If front-loading has succeeded in creating substantial participation, continuation would seem unnecessary, since those Alaskans already in the annuity program would be unlikely to drop out. On the other hand, if participation is low, the legislature may wish to consider inducements other than front-loading.

The committee settled on a front-loading concept weighted in favor of older Alaskans. Several other options were also considered. The first was a per-capita contribution made to each Alaskan who chose an annuity credit. Under this option, the annuity accounts of those near retirement age did not increase enough to substantially increase the "maximum possible annuity."

Thus, it did not significantly reduce long-term general fund obligations. Nor did it satisfy the goal of providing the greatest incentives to those who may need them most.

To better accomplish this goal, the committee next considered a straight \$10 incremental increase in front-loading based on age: that is, participants would receive \$10 for each year that they were older than age 17 -- up to age 65. 9/ This option produced a better result in terms of reduced general fund obligations, but it still did not increase annuity payments fast enough to be a significant incentive -- to older Alaskans in particular -- to participate in the program.

Finally, projections were run on the option embodied in the bill: persons 18-34 years old would receive a base amount of front-loading in addition to the dividend -- for example, \$50. Those over 34 would receive a percentage increase (for example, 10%) for each year of age over 34, up to age 65. Under this option, front-loading increases on a curve rather than a straight line -- increasing dramatically as an individual approaches age 65. Thus, a \$50 base with 10% per year increases results in a 34 year old receiving \$50, a 50 year old \$211, and a 64 year old approximately \$800.

The incentive to join the program, then, increases dramatically as retirement age approaches. It is this aspect

9/ Thus, an 18 year old would receive \$10, a 38 year old \$210, and a 65 year old \$480.

which is most appealing to the committee, for the following reasons:

First, older Alaskans are most in need of incentives to participate. Because initial annuity payments are small, many may be tempted to take a cash payment which is larger than the annual annuity which it will yield. Then, years later, that person will suffer materially reduced benefits because of that short-sighted decision. On the other hand, younger Alaskans need not participate in the program every year in order to build a sizeable annuity. Based upon projections available to the committee, a 47 year old (in 1986) would be required to participate every year in order to achieve the target annuity when he reaches 65 in the year 2004 -- the year the ALB program disappears. Recognizing that financial circumstances may require a cash election in some years, and that some individuals may be ineligible for a dividend in some years, the committee concluded that additional incentives are appropriate beginning at age 35 in order to help ensure that the maximum possible number of Alaskans will achieve the target annuity.

Second, while older Alaskans will receive more at the outset, the front-loading given younger Alaskans will be invested for a longer period of time. To the extent that the percentage differential is commensurate with account earnings, the eventual return to both old and young will be quite similar.

Finally, this option actually costs less in front-loading dollars than the straight line approach -- even though the now-elderly receive larger amounts.

Two additional points regarding front-loading warrant note. First, and as discussed earlier, under the committee bill those who reach age 65 before 1986 do not participate in the annuity program because they are guaranteed a full longevity bonus for life. As a result, in 1985 there will be no front-loading for any individual over the age of 64. In future years, the incremental increase in front-loading will end at age 65, and those over age 65 will receive the same amount of front-loading as a 65-year-old.

Second, the committee bill envisions that the source of front-loading funds may be the earnings of the undistributed income account of the Alaska permanent fund. In past years, permanent fund earnings have exceeded the amount necessary to pay dividends and inflation-proof the fund itself. The resulting surplus comprises the undistributed income account, which has a current balance of \$557 million. That account itself yields annual earnings which are greater than that necessary to provide front-loading, and which are available for appropriation.

The committee concluded that these earnings are an appropriate source of funds for front-loading for one obvious reason: as with the basic structure of the annuity program itself, this aspect of the bill will devote current permanent fund earnings in a manner which will substantially decrease

general fund obligations in later and perhaps leaner years. Once again, however, only earnings are involved. It must be stressed that nothing in the committee bill in any way impairs the integrity of the permanent fund itself.

2. The 3% Escalator.

Since the beginning of the ALB program in 1972, the original \$100 payment has been periodically increased to its current \$250 limit. While that increase seems large, it has, in fact, roughly kept pace with inflation. If the ALB is retained, the committee believes that it is unreasonable to assume that no increase in the ALB will ever be made. The persistent erosion in the real value of the ALB would at some point become so severe that relief would be necessary. For example, assuming a 6% inflation rate, a \$250 ALB now will be worth only \$104 in 15 years.

There are two ways of dealing with the gradual erosion of the value of the ALB. The first is to leave the problem to future legislatures. The second is the approach taken in the committee bill, which provides a modest 3% annual adjustment intended not to precisely keep pace with inflation, but rather to provide certainty in the amount of the payment.

3. Administrative Costs of the Program. The committee bill provides that the legislature may appropriate funds from the annuity account to pay the administrative costs of the annuity

program. 10/ Thus, the costs of the program will be borne by the annuity participants, whether the funds are privately placed or not.

The bill states that administrative costs will be "equitably allocated" among annuity accounts; it is the committee's intent that an equitable allocation will take into account such factors as numbers of participants, age, and relative account balances.

4. Choice of Benefits. Most annuity programs offer participants a choice of options, such as joint and survivor benefits. The primary reason for survivor benefits in employment annuity programs is that among married couples there is often only one wage earner. Survivor benefits are thus available to insure that the dependent spouse is not left without income. Since the annuity program is available to both spouses, just as is the present longevity bonus program, the committee opted for simplicity and did not include a choice of benefits. 11/

5. Setting the Amount of the Longevity Bonus Payment. Section 8 of the bill provides that the longevity bonus payment -- for those who have not reached 65 before 19⁹⁶ -- is determined by deducting from that payment the maximum possible annuity

10/ If the states chooses to place the funds with private carriers, any costs shifted to the carrier under the contract would also be paid from the annuity accounts.

11/ A death benefit for those who die prior to reaching age 65 has been included in the Senate State Affairs Committee substitute for SB 56.

available to a person who turns 65 in the year in question. The bill uses the annuity available to a 65-year-old because that annuity is the smallest available (among those who have received the maximum possible credits). A 75-year-old with the identical contribution of a 65-year-old will receive a larger annuity because his life expectancy is shorter, and his capital will be returned faster. Thus, some Alaskans will receive more than the target amount during the early years of the program, and no elderly Alaskans (with full participation) will receive less.

6. Residency Questions. The bill has no residency requirements for receipt of annuity payments. Permanent fund dividends are, of course, only available to Alaska residents -- so that an individual must be an Alaskan to contribute to an annuity account. 12/

7. Federal Income Tax Considerations. Currently, both the permanent fund dividend, and the ALB, are taxable as ordinary income under the Internal Revenue Code. The committee engaged tax counsel to determine whether the result would be any different under the committee bill. Specifically, the committee asked whether a person will be taxable on the cash he could have received as a dividend even though, under the new program, he is only credited with the right to receive a future annuity from the state. Counsel advised the committee that, because the annuity

12/ The longevity bonus program will still require that an individual be a one-year resident to receive a bonus.

program is unique, there is no legal precedent which provides a definite answer.

Based on analogous federal tax authorities, tax counsel believes that a crucial factor in determining whether or not an Alaskan receiving an annuity credit will avoid current federal income taxation is the amount with which the legislature "front-loads" the annuity credit in the year the credit is granted. If the legislature provides a substantial front-load to the annuity credit for a particular year, an Alaskan receiving a credit that year should not be subject to tax until annuity payments are actually made on retirement. However, if the legislature provides little or no front-loading in a particular year, there would be a substantial risk that those receiving annuity credits would be taxable immediately on the amount of cash they could have elected in lieu of the credit.

Tax counsel also advised the committee that available precedent does not provide firm guidance on the minimum front-load necessary to support deferred tax treatment of annuity credits. There is an example in the IRS regulations which suggest that a front-load of 25% or more of the annuity credit would be sufficient; however, tax counsel believes that a lesser amount may suffice. Because of this uncertainty, tax counsel suggests that if the committee proposal is enacted, it would be in the state's best interest to obtain an advance ruling from the Internal Revenue Service on the question.

The uncertainty surrounding the tax status of annuity credits, and the substantial risk of taxability when front-loading ends, did not weigh heavily in the committee's recommendation. This is because, at worst, Alaskans would be required to pay taxes on the amount of the dividend just as they do now. Moreover, the committee saw its job as finding an alternative to the ALB program which met the basic goals expressed in this report. It was not charged with simply finding a tax shelter.

Finally, apart from the potential taxability of a permanent fund dividend credited to an annuity account, two favorable tax aspects of the committee proposal should be mentioned:

1. All interest income credited to individual annuity accounts would, under current IRS regulations, be taxable only as it is paid out after reaching age 65; and

2. Front-loading credits would not be currently taxable.

8. Annuity Credits Are Not a Vested Right. The committee bill provides that an individual does not receive a vested or property right to an annuity payment until that payment is made. Funds must be appropriated annually by the legislature from the annuity account to make annuity payments. Although the clear legislative intent of the bill is to provide annuity payments to those who have participated in the program, the committee bill neither binds future legislatures nor creates a dedicated fund. Thus, the legislature may legally appropriate annuity funds for any public purpose. An individual's right to an annuity payment

prior to dispersal is an unfunded, unsecured promise of the state. Thus, a future annuitant is in no better legal position than any unsecured creditor of the state.

As a result, the bill is silent with regard to the garnishment of annuity credits. Prior to annuity payments, there is nothing to garnish or attach, nor anything that can properly be regarded as "income" or an "asset."

9. Protection of Alaska's Existing Elderly. As noted previously, persons who reach the age of 65 before 1986 will not be required to forego their permanent fund dividend in order to receive a \$250 per month Longevity Bonus, inflated 3% annually. The committee decided to integrate this aspect of "stair-stepping" because it concluded that many retired Alaskans have come to rely upon both the ALB and the permanent fund dividend, and -- since they are now retired -- would be unable to make adequate arrangements to mitigate the impact of an abrupt denial (or reduction) in either payment.

Under last session's House bill, those who had reached the age of 60 before 1986 would have received a full ALB for life, although the amount of that bonus would not be increased in future years. The committee considered and rejected the option of extending this protection to 60-year-olds for three reasons:

1. Assuming a retirement age of 65, those under that age will have 1-5 years to make necessary arrangements to accommodate either the loss of a cash dividend, or incremental reductions in the ALB payment. Current retirees, on the other hand, have

little or no ability to alter their financial condition. Thus, while any age group might be said to have some "expectancy" to both an ALB and a cash dividend, that "expectancy" is more immediate, and more critical, for existing retirees;

2. Exempting 60-year-olds from the ALB reduction of the committee bill would not simply postpone the inevitable financial disparity between two groups of Alaskans -- it would aggravate it. Under the House bill, the first reduction in payments would occur in 1991. Because of the growth in the "maximum possible annuity" by that time, the initial difference in monthly ALB payments between an exempt recipient, and a non-exempt recipient who did not forego his dividend, would be \$67.21 per month. Conversely, under the committee bill, differential payments will begin in 1986, and will initially be \$11.92 per month. The committee felt that if some smaller differential were felt immediately, the need to begin participation in the program now would be more apparent to non-exempt recipients. In other words, immediate "stair-stepping" may well encourage higher annuity participation, which in turn will reduce the actual differential treatment between exempt and non-exempt recipients; and

3. The ALB program cannot go on forever. Indeed, it has been a goal of the committee to develop a proposal which phases out general fund obligations near the turn of the century -- when oil revenues are predicted to dramatically decline. If the bill were to protect existing 60-year-olds, the committee projects that the state would still be making general fund ALB payments of

\$74.9 million in the year 2000, and general fund obligations would not end until the year 2029. Moreover, extending the bill's protection to 50-year-olds would cost an additional \$330 million over the life of the program. In drawing the necessary dividing line between those who can continue to receive the full benefits of existing law, and those who cannot, economic feasibility plays an appropriate role. For the reasons above-stated, the committee believes that the line is best drawn at age 65.

10. Possible Participation Rates. The committee attempted to estimate likely participation rates for the legislation's annuity program. Currently, participation rates in certain voluntary employee retirement plans exceed 50%. There are, however, differences between those plans, and the annuity program established by the committee's bill. Under most employee plans, contributed funds can be withdrawn upon termination, or in case of substantial hardship. Under the committee bill, however, no benefits can accrue until retirement. Additionally, high participation rates in employee plans are, in large part, a function of intensive educational efforts which cannot be duplicated on a statewide basis -- particularly in Alaska. Finally, participation rates for employee plans may be irrelevant in predicting participation by the jobless and very poor.

On the other hand, with front loading, matching contributions which participants receive may be, at least for older Alaskans, substantially more than typical matching payments

by employers. Additionally, under any employee plan, an employee must dedicate a portion of his or her regular monthly salary -- each dollar of which may already have been budgeted for regular family needs. The permanent fund dividend, on the other hand, is an irregular source of income which (for some Alaskans) is not a component of the regular family budget, and hence more readily disposable.

Given these differences, and the unique nature of the annuity program established by this bill, the committee does not believe that any meaningful projection, or even range of projections, can be provided.

If participation rates are very high, by the year 2003 state Old Age Assistance payments may be substantially decreased. Indeed, it is conceivable that a successful annuity program could virtually eliminate the need for old age welfare payments. For example, by the year 2010, every elderly Alaskan who has fully participated in the program will be receiving a monthly annuity of \$1,047.88.

On the other hand, if participation is very low, the state may experience increased old age assistance obligations as the residual longevity bonus phases out.

The only way to guard against future increases in OAA clientele is either to maintain the existing ALB program -- an option which the committee believes is cost-prohibitive -- or convert the ALB itself into a form of welfare. Other options studied (including stairstepping) would not simply threaten, but

inevitably lead to higher OAA obligations. The committee bill, on the other hand, offers Alaska's future elderly at least the opportunity to ultimately avoid the need for OAA assistance -- an opportunity which at least some Alaskans will accept. In other words, even with modest levels of participation, the result would be better than under "stair-stepping."

11. Impact Upon Eligibility For Old Age Assistance and Medicaid.

If an elderly Alaskan earns \$586 or less per month, he or she is eligible to receive federal Supplemental Security Income and/or state Old Age Assistance. There are currently some 2,450 elderly receiving this assistance, and the average benefit is \$240 per month.

Elderly who are eligible for OAA are also eligible for Medicaid. Medicaid benefits are accessed by almost half of the OAA recipients, and the average non-nursing home benefit is \$2,500 per year.

If an elderly Alaskan earns less than \$900 per month, he or she is eligible for nursing home benefits under Medicaid. These benefits are substantial -- averaging \$135 per day, or \$50,000 per year for each individual.

Until 1984, and by virtue of a specific exclusion in federal law, ALB payments did not count as "income" in determining eligibility for SSI or Medicaid. See 42 U.S.C. §1982a(b)(2)(B). However, when the ALB program was changed in

1984, Congress also amended the exclusion to protect only those who:

1. are 65 years of age on or before September 30, 1985; and
2. have 25 years of continuous residency in Alaska by that date.

This change in federal law has had the following effect on the SSI, OAA and Medicaid eligibility in Alaska:

1. Some 750 current recipients of OAA will experience a loss or reduction in benefits because they are now eligible to receive the ALB, but fall outside the amended federal exclusion. These individuals have not, however, suffered a net loss in cash benefits, since ALB payments have merely replaced previous OAA/SSI payments. While these individuals are the subject of discrimination, since they cannot retain both their ALB and their previous OAA/SSI benefits (as can long-time Alaskans), that discrimination is solely the product of federal law. If the state undertook to cure this discrimination by replacing lost federal SSI benefits, \$1.4 million would be required for FY 1986.

2. Some 314 of the 750 affected OAA/SSI recipients will also lose non-nursing home Medicaid coverage -- a benefit which averages \$2,500 per year. This is a substantial loss which is not compensated for by the ALB program. The amount of lost federal Medicaid benefits to these 314 individuals is only \$413,847 for FY 1986. The state could therefore compensate for these lost federal benefits at relatively small cost.

3. The most substantial impact of the recent federal law change is upon nursing home patients. 36 elderly Alaskans who are currently in nursing homes may lose their Medicaid nursing home coverage as a result of this change. To pay these individuals' nursing home costs entirely through state funds would require a \$720,000 additional appropriation in FY 1986.

The committee bill neither alleviates nor aggravates the problems associated with OAA/SSI benefit reductions, or reductions in non-nursing home Medicaid payments. Unless the legislature were to adopt a needs-based ALB program, virtually any option which the legislature might chose would leave the affected elderly in the same position as under current law. 13/

The committee proposal would, however, probably benefit existing nursing home residents. Under the bill, persons residing in a nursing home are ineligible to receive the ALB. This exclusion, the committee believes, is consistent with and furthers the intent of the ALB program. Its effect is to benefit existing nursing home residents who will lose access to the \$250 a month ALB, but at the same time will retain their eligibility for \$50,000 per year nursing home payments.

13/ Under current federal law, payments which are predicated on need are not counted as "income" for federal assistance purposes. Thus, the means test proposal discussed earlier may avoid the problems discussed in this section -- assuming that federal officials were willing to treat a \$25,000 income limit as truly differentiating the "needy" from the "non-needy."

12. Costs of Various ALB Alternatives. The committee has estimated the costs of various alternatives. Although population figures (and hence program costs) in future years are difficult to predict, several of the alternatives studied -- including the stair-stepping approach and the means test proposal -- envision general fund expenditures well into the next century. The committee felt that it was particularly important to at least estimate costs beyond the year 2000 for two reasons.

First, it has been a goal of the committee to develop a program which phases out general obligations after the turn of the century -- when oil revenues are projected to dramatically decline. Estimating post-2000 expenditures is thus particularly important.

Second, some options envision higher immediate investment in return for lower long term obligations. Others involve smaller near-term expenditures -- an attribute which is paid for in the years to come. A fair comparison, then, can only be made by looking at total expenditures over the life of each alternative.

Chart 1 indicates the costs of making continued ALB payments under four alternatives. This chart assumes that -- whatever program is chosen -- an escalation in the ALB payment will be made as the years go by. As the chart indicates, the cost of continuing the current, expanded ALB program is prohibitive. The second option, the "Annuity Program," reflects the committee bill without grandfathering Alaska's existing elderly. Under this

option, in order to receive the target amount, existing elderly would be required to forego their permanent fund dividends.

The third option -- the "Annuity Program w/1986 Stairstep" -- reflects the ALB costs of the committee bill itself. The "Stairstep" approach refers to last session's legislation, which would begin stair-stepping in FY 1991. Finally, projections on the means test proposal which assume escalation have not been run.

Assuming that the legislature provides a 3% per annum increase in the ALB payment, the ALB costs of the options considered are as follows:

Chart 1

ALB COSTS THROUGH 2034
WITH 3% ESCALATOR (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u> ^{14/}
Current Law	13,087	2,501	1,393
Annuity Program	964	605	496
Annuity Program w/1986 Stairstep	1,290	735	584
Stairstep	1,455	745	577
Means Test	N/A	N/A	N/A

^{14/} The term "Nominal \$" is self-explanatory. The term "Constant \$" refers to costs expressed in 1986 dollars -- assuming 6% annual inflation. The term "Present Value" refers to the amount of money which, if invested now, would endow the various options through the duration of each.

Conversely, if the legislature held the amount of the ALB constant over the years instead of providing a regulator escalator, the ALB costs of the option would be:

Chart 2

ALB COSTS THROUGH FY 2034
WITHOUT ESCALATION (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
Current Law	5,419	1,391	880
Annuity Program	619	432	369
Annuity Program w/1986 Stairstep	864	539	444
Stairstep	1,040	586	470
Means Test	3,199	945.9	634.9

In addition to the general fund costs of (1) continuing the current ALB for existing recipients, and (2) providing a gradually reduced ALB for new recipients, the committee bill envisions that individual annuity accounts will be "front loaded" with funds drawn from the earnings of the undistributed income account of the Alaska permanent fund.

Estimating the costs of "front loading" is a three step process. First, the committee assumed that the legislature would provide sufficient front loading to allow those 35 and younger to receive a \$50 base supplement, and those over 35 to receive a supplement which is increased 10% for each year of age up to 65. Second, the committee assumed that participation rates would be very low in younger Alaskans, and extremely high for those older Alaskans receiving the greatest front-loading. The cost of "front load payments" under those assumptions -- with and without

the grandfathering of existing recipients are reflected in Chart 3.

Finally, the effect of front loading is to more rapidly reduce the "target" ALB, and hence reduce general fund obligations. Thus, the net cost of any front loading must be offset by "ALB savings," which are also reflected in Chart 3:

Chart 3

EFFECT OF 3-YEAR FRONT LOADING
(in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
<u>Annuity Program (3% Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	(126)	(69)	(31)
Net Cost (Savings)	<u>(13)</u>	<u>32</u>	<u>65</u>
<u>Annuity Program (No Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	(91)	(57)	(46)
Net Cost (Savings)	<u>22</u>	<u>44</u>	<u>50</u>
<u>Annuity & 1986 Stairstep (3% Esc.)</u>			
Front-Load Payments	79	71	67
(ALB Savings)	(82)	(41)	(31)
Net Cost (Savings)	<u>(3)</u>	<u>30</u>	<u>36</u>
<u>Annuity & 1986 Stairstep (No Esc.)</u>			
Front-Load Payments	79	71	56
(ALB Savings)	(56)	(30)	(23)
Net Cost Savings	<u>23</u>	<u>41</u>	<u>44</u>

The net costs (or savings) of front loading for any particular program can then be added (or subtracted) from the appropriate column of Charts 1-2. From that exercise, it is

apparent that front loading does not materially affect the cost ranking of any of the options considered.

Finally, under stair-stepping, those who do not reach age 65 by FY 1990 will receive no longevity bonus. Of those who are denied the bonus in the future, a portion will apply for state Old Age Assistance. As noted previously, a number of current ALB recipients are apparently eligible for OAA and Medicaid but have not applied because of the bonus. There is thus a segment of Alaska's elderly who are now eligible for OAA and Medicaid, and who might apply for benefits under those programs if the ALB were denied.

It is difficult to predict the number of elderly who would actually turn to state welfare assistance if and when the ALB program were terminated. Currently, one out of every 2.65 income-eligible ALB recipients actually applies for OAA. Under the "moderate low" scenario of Chart 4, one half of those elderly ~~apply~~ apply for OAA. Under the "moderate high" scenario, two-thirds of the eligible elderly would apply for assistance once the bonus program were terminated. Cumulative costs, 15/ in increased OAA and Medicaid benefits, through the year 2010 under these two scenarios are as follows:

15/ The cost estimates in Chart 4 should be viewed as substantially equivalent to constant 1986 dollar estimates. Although they are technically nominal dollars, they assume no increase in OAA or Medicaid benefits as the years go by. If one assumes that OAA and Medicaid benefits keep close pace with inflation, these estimates would then better reflect constant

Chart 4

INCREASED OAA/MEDICAID COSTS THROUGH 2010
(in millions)

Moderate Low

81.3

Moderate High

150.2

It is possible that increased OAA costs would also result from the committee bill. Although, under the bill, the ALB is gradually phased out, rather than abruptly terminated, those new elderly who have not participated in the annuity program may eventually find themselves in need of welfare assistance. The degree of that problem, of course, is a function of participation rates -- which are difficult to determine. However, because -- under the committee bill -- the ALB is phased out, rather than abruptly terminated, 16/ and because a portion of Alaska's population will participate in the annuity program, the committee believes that -- even with low participation rates -- the impact of the bill upon old age assistance programs is likely to be less severe than under the stairstepping approach.

Finally, the committee looked at the cost of various options after 1999. As noted previously, it has been a goal of the

dollar costs.

16/ Thus under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever. On the other hand, under the committee bill, a person turning 65 in 1991, and who has not participated in the annuity program, will still receive a longevity bonus of \$222.61 per month.

committee to develop a longevity bonus program in which general fund obligations would be minimized as oil revenues declined. Chart 5 indicates the cost of stairstepping, the means test proposal and the annuity program with and without stairstepping, which would be incurred in the 21st century:

Chart 5

COSTS INCURRED AFTER YEAR 1999
(in millions: Nominal \$)

<u>3% Escalation</u>	
Annuity Program	69.9
Annuity Program w/1986 Stairstep	285.3
Stairstep	588.3
Means Test	N/A
 <u>No Escalation</u>	
Annuity Program	0
Annuity Program w/1986 Stairstep	128.4
Stairstep	291
Means Test	2,486.2

The Benefit Concept's Proposal

The committee investigated an approach proposed by Benefit Concepts, Inc. and Kidder Peabody & Co., Inc. The proposal is essentially an investment program for endowing the longevity bonus program. That is, a substantial investment (approximately \$350 million) would be made in the initial years of the program, and the return from that investment is estimated to be sufficient

to make the declining longevity bonus payments required under the committee's annuity approach. 17/

Benefit Concepts proposes that the state invest in single premium whole life insurance policies (SPL's) taken out on Alaska's elderly. The state would be the owner and beneficiary of the policies. Benefit Concepts' projections indicate that this type of investment would be superior to other options which they believe would be appropriate for such an investment plan, such as guaranteed investment contracts (GIC's), corporate bonds or government securities.

The Benefit Concepts proposal was analyzed by the actuarial firm of Johnson & Higgins at the committee's request. That firm concluded that (1) the costs of the program may be understated when compared with data used by OMB (see footnote); (2) should the state consider "endowing" the ALB program, it should not limit its choices to the low risk alternatives considered by

17/ Subject to available funds, the state could "endow" any program by investing enough cash to produce the revenue to pay the costs of the program. Indeed, the concept of "endowment" is implicit in the "present value" calculations made by the Office of Management and Budget for the longevity bonus alternatives analyzed. Two points deserve attention. First, in order to avoid dedicated fund problems, the income from any such investment would be deposited in the general fund, and subject to annual appropriation to pay program costs. Second, the assumptions used by Benefits Concepts in making their cost estimates differ in two important respects from the assumptions used by OMB. Benefit Concepts used different population projections, and assumed a different interest environment. Both these differences understate the cost of their proposal when compared with programs using OMB estimates. The committee, therefore, cautions against direct cost comparisons.

Benefit Concepts, but should also examine other investment options; and (3) the primary advantage of the SPL approach over other low risk investments is the substantial tax advantage available to some insurance companies in providing this type of policy. These tax advantages are under scrutiny by the federal Treasury Department, and could well be eliminated through revisions to the Internal Revenue Code in the near future. It would be likely that an insurance company would insist on passing any tax changes through to the policy holder, thus removing the advantage of this type of investment.

The committee is unable to make a firm recommendation regarding this proposal to the legislature but believes that the concept may warrant further consideration by the state's financial experts.

The Alaska Pioneers' Home

On July 30, 1984, Governor Sheffield requested the committee to consider expanding its inquiry to include Alaska's Pioneers' Home Program. Because of time constraints, and the fact that the committee developed an alternative to the ALB program which has no application to the Pioneers' Home, the committee was unable to consider alternatives to this program in any depth.

The committee, however, shares Governor Sheffield's concerns over the program. Under AS 47.25.030, an individual must have resided in Alaska for 15 consecutive years, or 30 total years, in