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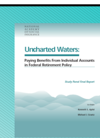
NATIONAL
ACADEMY
OF•SOCIAL
INSURANCE

Children, Life Insurance, and Bequests



Maya MacGuineas, New America Foundation

- ❖ Current Social Security benefits for children
- ❖ Possible changes in children's defined benefits with individual accounts
- ❖ Children's rights to their parents' individual accounts
- ❖ Bequests to heirs other than spouses and dependent children

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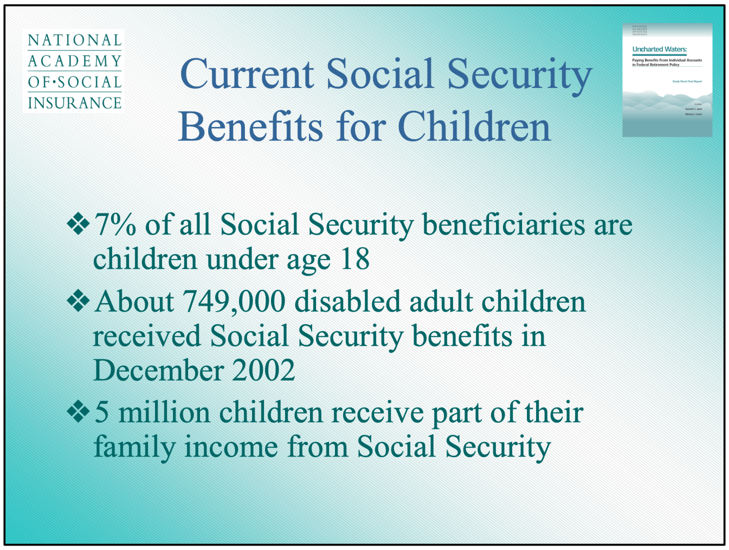

About 3 million children under age 18 received Social Security in December 2002. These child beneficiaries represent about 7 percent of all Social Security beneficiaries and 4 percent of all children in the United States. About half of child beneficiaries are survivors of deceased workers, 38 percent are dependents of disabled workers, and about 12 percent are children of retired workers. Another 2 million children live in families in which another member receives benefits from Social Security.

Adults who have been severely disabled since childhood (before age 22) are eligible for benefits on the same terms as minor children, becoming eligible for benefits when a parent dies, becomes disabled, or retires. About 749,000 disabled adults—the majority of whom were diagnosed with mental retardation—received these benefits in December 2002. Like minor children, disabled adult child beneficiaries could be considered for special protections in the design of an individual account plan that is part of Social Security.

In total, 5 million children receive part of their family income from Social Security.

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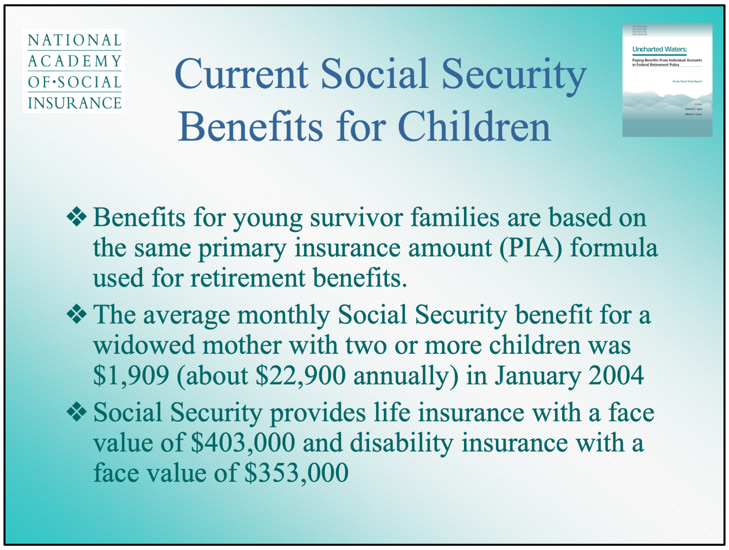

Benefits for young survivor families are based on the same primary insurance amount formula used for retirement benefits.

The average monthly Social Security benefit for a widowed mother with two or more children was $1,909, or about $22,900 a year in January 2004. The benefits keep pace with inflation and continue until the child reaches age 18, or 19 if he or she is still in higher school. Surviving children are eligible for a benefit equal to 75 percent of the deceased workers' PIAs. A family maximum limits the total monthly benefits payable to a family of three or more.

Social Security is the main source of life insurance for most families with children. According to actuaries at the Social Security Administration, Social Security protection had a net present value equivalent to a life insurance policy with a face value of $403,000, and a disability policy with a present value of about $353,000 for a young average earner with a spouse and two young children in 2001.

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As Steve Goss explained earlier, reductions in traditional Social Security benefits due to the creation of individual accounts can be designed and applied in a variety of ways. Chapter 8 in our report considers some options if policymakers wanted to avoid applying offsets to benefits of surviving children and disabled adult children. Similar to the options described by Marty for dealing with benefits for disabled workers and their families, the options for children's benefits include shielding children's benefits from any reductions, mandating the purchase of private life insurance, and providing no special protections for child beneficiaries.

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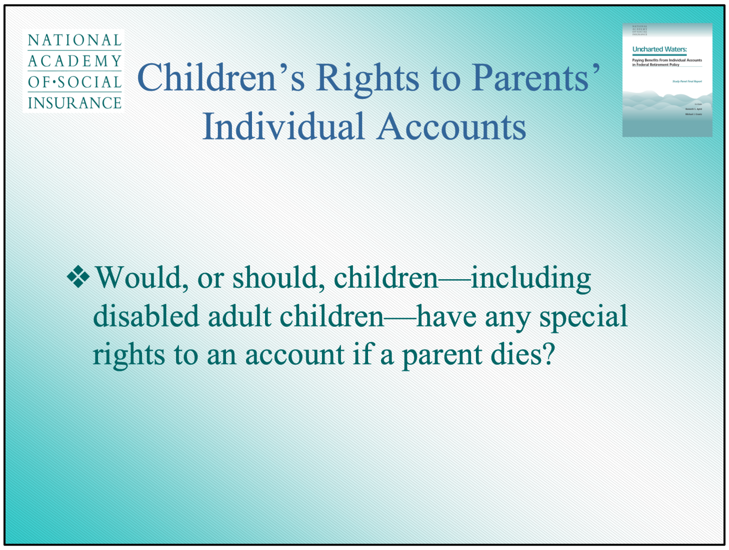

Chapter 8 also considers whether, and to what extent, children would have any special rights to, or claims on, their parents' accumulated individual accounts.

As Joan explained earlier, wives and husbands often have certain minimum inheritance rights under state law, and ERISA spells out additional rights of spouses to pensions accumulated under tax-favored employer-sponsored retirement schemes. Would, or should, children, including disabled adult children, have any special rights to individual accounts in the event that a parent died before retirement?

Most individual account plans specify inheritance rights only for widowed spouses and only for a current spouse. If there were no spouse, most plans would let the account holder pick anyone he or she chose as the death beneficiary. In this case, the account holder could name someone other than dependent children, or name only some children and leave out others. As we saw with spousal rights, policymakers will need to decide whether to have uniform federal policies concerning children's rights or to leave the issues to state jurisdiction. In addition, members of Congress will need to address the following questions:

Would a widowed spouse with children have access to the inherited funds for immediate needs?

If children and a widowed spouse live in separate households, how would interests of each be accommodated?

How would child support requirements affect distribution of accounts at a parent's death?

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Almost all individual account proposals allow account holders to bequeath their funds to heirs if death occurs before retirement. At the same time, proposals financed with Social Security taxes usually limit or foreclose bequests by such features as mandatory annuitization, or mandatory transfer of the account to a widowed spouse or, as suggested earlier, special inheritance rules for children. These constraints on bequests are generally motivated by a desire to preserve benefits that Social Security now provides (such as income for life and financial protection for widows). To the extent that funds from Social Security taxes are paid to heirs who would not otherwise be eligible for Social Security (such as non-disabled adult children, siblings other relatives, friends, or institutions), either more money would be needed to pay eligible beneficiaries or the account recipient's benefit would need to be offset in some way.

In conclusion, this Uncharted Waters Panel is a major contribution in thinking through the technical details of individual account proposals. The attention to payouts from accounts – and in particular to payouts for spouses, children, and disabled workers – is an important aid to policymakers.