Social Security Individual Accounts: Design Questions

Many recent Social Security proposals call for American workers to accumulate contributions in individual accounts as a source of retirement income. Proponents of this approach want workers to be able to invest in the stock market, seeking greater returns and helping the economy, with direct control and ownership of their accounts. Opponents are concerned about disrupting traditional Social Security benefits and the payroll taxes that support them.

Neither side in this debate has focused clearly on all the design questions that may be critical to the success or failure of individual accounts. Without taking sides for or against individual accounts, we believe that such questions have important implications, such as limiting free choice in order to hold down costs. Hence, this issue brief is intended to shed light on issues that policymakers would need to address if they were to create an individual account program, as illustrated by the questions below.

■ Should workers’ use of individual accounts be mandatory or voluntary?
■ Should individual accounts just be added on, or should they replace part of the current program?
■ How should the program provide basic benefits that adequately cover lower-paid workers?
■ How should the program grandfather the existing benefits for older workers and retirees?
■ How should the program preserve the current benefits for disabled workers and their families?
■ Should the individual accounts be managed and invested centrally?
■ How many investment alternatives should workers be offered, and what should they be?
■ How would workers be enabled to make informed investment decisions?
■ Would workers have access to funds in their accounts before retirement?
■ Would payout of benefits by lifetime annuities be mandatory or voluntary?
■ How would payout annuities be designed and administered?
Background and Scope

Individual accounts would bring major changes to Social Security benefits and administration.

**Benefits:** The current system is a defined benefit (DB) social insurance program in which an individual’s benefits are only indirectly related to his or her total contributions. The contributions of all workers are pooled and available to pay benefits to any worker or dependent. In contrast, individual account balances are based directly on a worker’s contributions plus investment earnings and are available only to pay benefits to that worker and his or her dependents. A pure individual account program cannot readily duplicate Social Security’s additional benefits for disabled workers, lower-paid workers, other family members, etc., although it is possible to allocate funds for such purposes. It appears more feasible to pay such benefits from a basic DB program patterned after traditional Social Security, as discussed below.

**Administration:** The current Social Security program is relatively simple to administer, with little need to track each worker’s earnings and contributions closely before benefit payments begin. In recent years Social Security has been sending out individual statements of workers’ annual earnings and estimated benefits, and this process has highlighted errors, omissions, and delays in employers’ reporting of earnings. Even so, many workers lack basic knowledge about Social Security, often waiting until near retirement to learn about their benefits. In contrast, individual accounts require accurate and timely record keeping so that funds can be invested and workers informed about their account balances. Workers would have an ongoing need to keep track of their individual accounts, learn how to make good investment choices, and actively participate in planning their retirement income.

**Add-ons and offsets:** Some proposals during the 1990s would have left the current system essentially intact and supplemented it with individual “add-on” accounts derived from additional contributions. A pure add-on plan would give participating workers greater benefits, but by itself would not help finance Social Security. To strengthen Social Security financing, Congress must either find more revenue for the trust funds or reduce the commitment to pay defined benefits.

More recent proposals would shift part of a worker’s ongoing payroll taxes to an individual account and later pay a reduced traditional Social Security benefit. The benefit reduction or offset is based on the estimated value of the worker’s contributions that were diverted to the individual account. Advocates of this approach expect it to produce greater investment return, helping strengthen the system while perhaps increasing benefits. Typical proposals would shift about 2 percent of earnings from participating workers’ contributions to individual accounts, reducing the combined Social Security payroll-tax rate from 12.4 percent of pay to 10.4 percent. That level of contributions would let workers fund meaningful amounts of retirement benefits without greatly disturbing the existing system.

Converting even a portion of Social Security to individual accounts would be a formidable task administratively, financially, and politically. This issue brief will assume that a primary objective of any proposal that includes individual accounts is to make Social Security financially sustainable, so that the individual accounts would use only a portion of the payroll tax and would be accompanied by offsets that reduce the individual’s defined benefits.

**Transition:** Social Security reform proposals almost always provide an ongoing basic defined benefit program. Existing beneficiaries would keep the current system, as would workers above a cutoff age such as 55. Younger workers would get scaled-back retirement benefits, weighted to favor lower-paid workers and offset by expected individual account benefits, plus redesigned disability and survivors benefits.

To finance Social Security without raising payroll taxes, an individual account plan usually needs substantial new income from general revenue, for two reasons. Social Security has a long-range financing deficit. Without substantial benefit reductions, the program is expected to need more revenue eventually to keep paying scheduled benefits. It is important to understand that this need for revenue exists regardless of whether individual accounts are enacted. Additionally, some of the current payroll-tax revenue, which would otherwise be available to pay benefits to retired workers and dependents, would be shifted to provide individual accounts for younger workers, and so the basic DB part of Social Security would soon need even more cash income to pay ongoing benefits and expenses.

Adopting an individual account plan would require critical decisions about how to keep records, invest account balances, pay benefits, and communicate with the public. Accordingly, this issue brief focuses on how to design and
manage the individual account plan. It does not discuss in detail the defined benefit plan or any transition subsidies needed from general revenue, although policymakers should also give careful attention to those other topics.

**Precedents From Existing Programs**

Mindful that individual accounts would raise many new administrative and investment issues for Social Security, analysts may cite precedents under other existing programs.

**Individual retirement accounts (IRAs):** Created as part of ERISA in 1974, IRAs fill an important role as retirement savings vehicles. Individual workers may choose among a wide range of private-sector alternatives to invest and manage their IRA funds.

**401(k) plans:** Employers’ 401(k) plans have spread rapidly since they were first offered in the late 1970s. Employees may be given only a few investment options or a great many options, with one administrator usually handling a plan’s record keeping. These plans often give workers access to their money before retirement in the form of loans or hardship withdrawals.

**Thrift-Savings Plan:** The federal employees’ Thrift-Savings Plan (TSP), enacted in 1986 after Congress considered several alternative designs, is often considered a model for Social Security reform.

- **Investments:** Policymakers across the political spectrum have applauded the TSP’s use of index funds to invest in stocks and bonds because this keeps politics out of investing, gives satisfactory investment results, and holds down investment costs. The TSP now offers five funds, including three stock index funds investing in larger U.S. companies, smaller U.S. companies, and overseas companies, plus a bond index fund and a fund holding Treasury securities.
- **Centralization:** Some proponents of individual accounts also would copy the TSP’s centralized administration, which simplifies record keeping and communications. In creating the TSP, Congress explicitly rejected the “retail” approach used by IRAs as too costly and cumbersome for a single plan covering millions of workers, preferring a structure more like the one used by large 401(k) plans.
- **Independence:** A federal agency (the “Thrift Board”) administers the TSP. Wishing to keep politics out of TSP investment management, Congress gave the Thrift Board great independence, somewhat like the Federal Reserve Board.

Successful experience with IRAs, 401(k) plans, and the TSP has made each of these arrangements a possible model for an individual account plan under Social Security. The accompanying outline on page 4 briefly compares certain features of these three approaches that might be useful in Social Security reform.

**Other nations’ social insurance programs:** The experience in other countries that have adopted individual account programs could also help inform the discussion if such a program is introduced in the U.S. The General Accounting Office (GAO) has analyzed certain features of the voluntary individual account systems used in social insurance programs of the United Kingdom, Czech Republic, and Germany. GAO’s report in March 2003 explains how those three nations handle certain issues:

- All three allow workers to opt in and out of the individual accounts, using a centralized database to track such decisions.
- All three give workers financial incentives to participate through matching government contributions and/or favorable tax treatment.
- The report also noted that a ‘significant education effort may help individuals make informed decisions’ especially in the case of voluntary accounts, where their decisions are much more complicated. Moreover, in the United Kingdom, some private firms have “oversold” their investment products, leading workers to make poor choices.
All these nations rely on numerous private firms to sell and manage the individual accounts. A basic question discussed below is whether the United States would want central facilities to manage the accounts, giving up some freedom of choice to gain economies of scale and pooling of risks. A related question is whether a worker’s participation in the individual accounts should be voluntary, as in these other nations, or mandatory.

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<thead>
<tr>
<th>What investment choices do participants have?</th>
<th>IRA</th>
<th>401(k)plan</th>
<th>TSP</th>
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<tr>
<td>Each individual has almost unlimited choice. Can use bank CDs, individual securities, funds managed by financial institutions.</td>
<td>Each plan sponsor decides which choices to offer. Some plans have wide-open choice among mutual funds. More-typical plans offer only a limited number of funds but still cover a wide range of investment opportunities. May include employer stock.</td>
<td>As specified by law, five funds are available for participants to invest in equities or fixed-income. Four of them use index funds to invest in the private sector and the fifth uses Treasury securities.</td>
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| Who holds and manages investments? | A trustee or custodian is responsible under the participant’s direction. | Each plan sponsor is responsible for managing the funds and choosing specific securities. May be done internally, by a single financial institution, or by multiple institutions. | Thrift Board is responsible. Treasury securities are managed internally. The four index funds are run by one or two fund managers in the private sector. |

| Who does the recordkeeping? | Each individual is responsible, with financial institutions offering considerable help. | Employer or other plan sponsor is responsible. Outsourcing to third party administrator is common. | Thrift Board is responsible. It outsources recordkeeping to another agency that was in existence when the TSP began. |

| What is the level of expense charges? | High because thousands of providers try to sell IRAs, they communicate directly with each person, and individual preferences vary widely. | Lower because each employer can easily communicate with its workers, must explain only its own plan, and can use payroll deductions. | Very low because the TSP operates as a very large 401(k)-type plan that offers only a few choices. |

| How do participants learn about investing and other choices? | Individuals are on their own to learn about choices available and use them wisely. Not many Americans understand investments, and the advice they get varies widely. | Employers usually try to help workers understand plan features and make good choices, sometimes using third-party advisors. Federal regulations have inhibited such efforts. | The Thrift Board makes available a web site and printed materials. Each federal agency employs full-time retirement planning specialists to advise its workers. |

## Voluntary or Mandatory?

A voluntary individual account program would have obvious appeal for many workers, and has been endorsed by political leaders in the White House and Congress. Still, a voluntary program has formidable issues that do not arise under a single, mandatory plan.

**Would open seasons be offered?** In virtually all proposals to date, a worker’s decision about whether to participate in individual accounts is one-time and irrevocable. In practice, it seems inevitable that over time the public would insist on having open seasons in which to change their elections. Workers could say that they were not properly informed, that circumstances had changed, etc., especially if either Social Security or the individual account plan has been modified in any way. This is by no means a fatal flaw of voluntary proposals, but it should be recognized and taken into account.

**To what extent would a voluntary plan raise total program costs?** Sources of additional cost include:

- Tracking workers’ choices and maintaining parallel systems for workers opting in vs. opting out.
- Handling initial and ongoing communications with workers about their alternatives.
Paying additional costs caused by workers who expect to gain by opting in or out.

Would workers make rational and informed decisions? Most employers could not do an adequate job of educating employees, so the government would have to create facilities to do this directly. Even so, some workers who found they made the wrong choice would seek to undo it. Experience under other programs such as the TSP suggests that many people who stand to benefit from electing the new plan are likely to stay in the old plan because of inertia. In that event, the new program would not fully accomplish its objective of strengthening Social Security.

What benefits would participants get who stay in traditional Social Security? Social Security is expected to be unable to pay benefits in full within a few decades, and this raises difficult questions if individual accounts are voluntary. Should workers who opt out of individual accounts get a scaled-back version of Social Security? Should workers be told that the program they choose is subject to unspecified changes?

Should the government guarantee the greater of the benefits under the old and new programs? Although some proposals make such a guarantee, it adds to benefit costs and complicates program administration. It also could encourage workers to invest as aggressively as possible, knowing that they can't lose if the investments turn out badly, unless investment options were severely limited.

Adequacy vs. Equity

Social Security has always tried to balance social adequacy with individual equity by redistributing income among workers. Adequacy means that the program gives all workers and their families a basic level of protection against loss of income because of old age, death, or disability. Equity means, in essence, that each worker gets what he or she paid for, with expected benefits being proportional to the worker’s contributions plus investment earnings. Covered workers now contribute to Social Security at the same percentage of taxable earnings, although expected benefits may vary widely based on a worker’s earnings, age, sex, marital status, or number of dependents.

How would Social Security preserve its “adequacy” features? Social Security benefits are only loosely related to a worker’s contributions. Certain provisions now clearly favor workers who have low income, gaps in employment, or dependent family members.

- The Primary Insurance Amount (PIA) formula helps lower-paid workers by giving more weight to lower amounts of average earnings (wages) over a worker’s career.
- The PIA formula also helps workers who have gaps in employment by counting only the highest 35 years of indexed earnings. This gives workers credit for a full career who have had a few years of absence from the work force for education, child-rearing, layoff, early retirement, etc. And the weighted average gives more than proportional credit to workers with fewer than 35 years of employment (e.g., someone working 30 years gets more than 30/35 times the benefit for a full 35-year career).
- In addition, spouses, former spouses, children, and other family members get benefits under certain conditions without any additional worker contributions.

Cutting back some of the defined benefits, and replacing them with individual accounts that are proportional to earnings, would seem to cut back some of these “adequacy” features. Without careful benefit design that makes up for such cutbacks elsewhere in the program, the public might be displeased. Some new adequacy issues also may need to be addressed:

- Administrative expense charges based on actual handling costs may be unreasonably high for small accounts. It may be deemed preferable to charge expenses as a flat percentage of assets, thus letting large accounts subsidize small ones to some extent.
- The government might offer incentives for workers, particularly the lower-paid, to participate (e.g., using general revenue to provide matching contributions or tax incentives, or to help pay administrative costs). Alternatively, the plan could reallocate some of the individual account contributions from higher-paid to lower-paid workers.
Amounts of Contributions and Benefits

Open seasons: Workers may expect to be able to change investment options and (under a voluntary plan) their contribution rates, perhaps once a year. A voluntary plan may also have open seasons to opt in or out of the individual account feature periodically. Such choices would require creating suitable communications vehicles and tools, contacting all workers, explaining options, and updating records.

In a voluntary plan, would workers with long careers be motivated to limit their full participation in the defined benefit part of the program, knowing that Social Security credits only the best 35 years of earnings? In the absence of strong incentives for workers to do otherwise, lawmakers should expect such behavior.

Defined benefits: Presumably, any transition to individual accounts would preserve much of Social Security, as we know it. Typical proposals include defined benefit features along these lines:

- Existing beneficiaries would keep any Social Security benefits that are in pay status, including survivors’ benefits and future cost-of living adjustments.
- Older workers (age 55 and over) would keep the current program’s benefits and contributions, including possible future benefits payable to their family members.
- Younger workers (below age 55) would pay into Social Security the current program’s contributions, reduced by the amounts going to individual accounts. These workers and their families would get the current program’s benefits, offset by actual or estimated benefits derived from the worker’s contributions to individual accounts as discussed below.
- Future workers coming into Social Security would get scaled-back defined benefits (e.g., indexing before retirement would be based on consumer price levels instead of wages and the normal retirement age would gradually increase).
- Disability and survivors’ benefits would be restructured, consistent with the reduced levels of defined benefits and the additional benefits available from individual accounts.

Offsets: In most proposals, an offset representing estimated benefits available from the individual account would reduce the worker’s defined benefits computed under the current Social Security program. This offset often is computed by assuming that the worker’s individual account earns a specified investment return every year — for example, 3 percent more than the rate of inflation — and converting the resulting account balance to a retirement annuity based on that same rate of return. A worker whose account actually earns a higher rate than the 3 percent in this example, on the average, would get higher benefits, although some of the gains could be transferred to the trust funds to strengthen Social Security. Conversely, someone who earns a lower rate would get lower benefits, although some proposals include a guarantee to protect workers against any reduction in total benefits.

The methodology for computing offsets can have a major effect on financial projections and actual long-range costs. Offsets will cost less if they have a high rate of assumed investment return, such as the stock market has earned over long periods based on historical performance data. In practice, many workers will not want to invest 100 percent of their accounts in the stock market, especially after retirement. Moreover, the public may not readily accept a program that requires them to take substantial risks to break even or come out ahead.

Earnings sharing: Some observers have long advocated that Social Security split married couples’ earnings records evenly between spouses. In the event of divorce, each spouse would automatically get half of the benefits earned during the marriage, more or less; depending on how the weighted benefit formulas operate for the couple. Historically, such a proposal has seemed difficult for Social Security’s defined benefit system to administer, but it would seem a bit more workable for individual accounts.

Managing the Individual Accounts

Designing an individual account plan for Social Security presents several administrative challenges. Such a plan should help workers choose among attractive investment options, with an administrative structure that handles their accounts efficiently and economically. Moreover, politicians seem to agree, in principle that such a plan should oper-
ate solely in the interests of participants, not allowing elected officials to help choose the appropriate stocks to buy or sell. A basic question is whether an individual account plan for Social Security could better satisfy these objectives by decentralization as in the IRA model, or by centralization along the lines of the TSP model.

**Ethical and political investment considerations:** Investors sometime want to make a statement that transcends financial considerations, choosing to invest in Company A whose products and practices embody values they want to support, and not Company B whose values they dislike. Accordingly, many “ethical” or “socially responsible” mutual funds will not invest in certain kinds of companies (e.g., those whose products include alcohol, tobacco, or firearms, or who are considered to have poor records on safety, the environment, or employee relations).

Some elected officials may likewise be strongly tempted to inject their own values into an investment process managed by the government. But opinions differ widely about what companies are “good” or “bad,” and focusing on ethical values instead of profits may detract from investment performance. In creating and enacting the TSP, Congress overwhelmingly supported the principle of keeping politics out of governmental investing. Would the same “hands-off” attitude prevail in adopting Social Security individual accounts? Resolving this issue effectively would be a critical step in designing a viable program.

**Centralized vs. decentralized investments:** Compared to the IRA model, a centralized investment structure for the individual accounts has both advantages and disadvantages:

- A centralized plan would limit workers’ freedom of choice. Such a plan could start out offering only a few investment choices and later offer more if desired. Opinions differ on whether offering more choices would represent an advantage or a disadvantage. Offering a smaller number of funds may give workers meaningful choices while limiting the number of funds to explain and administer and allowing a wide range of private-sector investments to be represented in index funds.
- Simplicity and low costs are major advantages of centralization. Private sector specialty firms might have a smaller role than in a decentralized system, acting as outsourcing providers rather than full-service investment brokers or money managers.
- Keeping politics out of investments would be an ongoing problem for a centralized plan. Investment authority could reside in an independent board with broad power to set investment policy and choose investments, although such a board might be difficult to insulate from politics. Alternatively, the TSP has addressed this issue by using index funds to make such decisions more or less automatically under the direction of an independent board with little investment authority.
- Communications and employee education would be extremely important. Centralizing the management of these functions and offering only a limited number of choices may be more cost-effective and reduce problems with independent vendors who over-sell investment products.

**Independent agency:** The TSP experience to date shows that an independent agency can be difficult to manage. Soon after creating the TSP, Congress had to tweak the law several times to keep the Thrift Board members from resigning because of concerns about fiduciary liability. Other startup problems involved the Thrift Board’s (1) insisting that Treasury issue debt securities with interest yields of long-term bonds but with durations of only one day, (2) submitting its annual budget to Congress without White House review, and (3) deciding how to handle proxy voting for its individual stock holdings.

The Thrift Board’s independence is an ongoing policy experiment that can always be changed by lawmakers wishing to impose their own values. In view of Social Security’s much greater political prominence, it would seem that Congress should give careful thought to any statutory rules about independent government administration of individual accounts, recognizing that a future Congress can rewrite such rules.

**Payout of Funds**

**Loans and withdrawals:** During the accumulation phase, many workers would want loans or withdrawals from their individual accounts. Some of these individuals or their families will have suffered great personal and financial misfortune. Policymakers need to decide at the outset whether to offer access to funds, or instead to rely on other
programs and resources. Making exceptions in hard cases is likely to open the door to other cases, weakening the ability of the plan to fulfill its objectives.

**Lump-sum death benefits before retirement:** In the event a worker dies during the accumulation phase, it makes sense to pay out the account balance as a lump-sum death benefit. In such cases, a surviving spouse and children might be given priority over other individuals in receiving lump-sum death benefits.

**Should annuities be voluntary or mandatory?** That is, should lump sum payments be made available at retirement, or should all workers instead be required to convert their account balances to annuities? The issues noted below suggest that mandatory annuities have advantages that may outweigh the disadvantages.

- Mandatory annuities limit freedom of choice. Such a restriction on the use of their funds could be unpopular among workers with large account balances, other sources of retirement income, great confidence in their own ability to invest profitably, or poor health that limits their life expectancy.
- Mandatory annuities favor people with a longer life expectancy, generally including people in good health, women, high earners, and members of long-lived racial or ethnic groups. People with the opposite characteristics would tend to have shorter lives and collect less from annuities.

Mandatory annuities ensure that retirees do not outlive their resources. Nobody knows how long his or her retirement savings must last, and an annuity removes the guesswork. An annuity also avoids the problem of people spending their money too rapidly, and then living many years in poverty.

Mandatory annuities address the widespread lack of investment skills needed to manage a large sum of money and produce a steady rate of income, even at an advanced age.

Mandatory annuities reduce the cost of annuities. Under the voluntary system that now exists in the individual annuity market, only people in excellent health are willing to buy an annuity. This above-average life expectancy drives up the cost of annuities and makes them impractical for someone whose health is impaired. In contrast, mandatory annuities would cover a cross-section of workers with average longevity, making annuities less costly. Mandatory annuities with standard features also reduce administrative costs that would be reflected in annuity pricing.

Mandatory annuities make unisex pricing feasible. If annuities were voluntary as they are now, a free and competitive annuity market would give women less attractive rates than men. That is, when insurance companies can charge whatever rates they want, women always pay more for an annuity because they tend to live longer. Unfavorable treatment of women could be a major barrier to public acceptance of individual accounts, replacing Social Security benefits that treat both sexes alike.

**Form of annuity:** An annuity could have a great many forms, including payments for a specified number of years, payments over the life of one or more persons, etc. Variable annuities are a possibility, with the amount of income varying with the performance of an underlying investment portfolio, but the accompanying risks seem inappropriate for most workers to understand or accept.

Policymakers may want to consider a standard form of annuity, which may include the following:

- Payments are made for a worker’s life in a fixed amount, not varying with the stock market, but adjusted annually to keep pace with the cost of living.
- After death of a married worker, payments continue at a two-thirds rate to a surviving spouse for life.
- After death of a worker and any surviving spouse, a cash refund is paid equal to the account balance at retirement, less annuity payments already made.

This annuity form is consistent with the current Social Security program, paying benefits for life to the worker, with 2/3 of the couple’s benefit paid to a surviving spouse, and with annual COLAs. The cash refund death benefit is consistent with a pre-retirement lump-sum death benefit equal to the account balance, providing similar death benefits if an unmarried worker dies shortly before retirement or shortly after. Low-income individuals make up a
disproportionate share of those with shorter life expectancies, and the lump-sum death benefit ensures that each worker’s family will get back at least the amount the worker paid in.

Who should provide the annuities? This question has at least three reasonable answers: (1) The private annuity market. (2) The federal government by itself, working through an agency such as the Social Security Administration. (3) The federal government, working through private firms.

The TSP now contracts with one insurer to issue annuities to the few retirees who want them, using rates that are the same for men and women. For Social Security individual accounts, some kind of centralized annuity program operated or sponsored by the federal government could have major advantages over the traditional private annuity market, as follows:

- **Gaining economies of scale:** Compared to the existing “retail” annuity market, a centralized “wholesale” system would have substantial expense savings and could cover a cross-section of the population instead of just the healthiest people, permitting annuity rates that are more attractive. Some administrative and financial tasks could be contracted out to private firms or consortia.

- **Avoiding risks of insurer insolvency:** The existing annuity market entails some risk of insurer insolvency that could reduce or stop payment of annuities, though each state sponsors guaranty funds that provide substantial backup. For annuities derived from a Social Security individual account program, any such risk would seem unacceptable. A federal guarantee of private annuities would require a new framework of federal regulation, controls, and occasional bailouts. A simpler and more direct approach is for the federal government to take full responsibility for paying the annuity benefits, similar to the government’s role in the current Medicare program, which uses private insurers to pay claims using government funds.

- **Accommodating inflation-indexed annuities:** Few if any annuity providers in the private sector now issue annuities with full protection against inflation. Meanwhile, the federal government provides annuities fully indexed to the CPI under Social Security, the Civil Service Retirement System, and the Military Retirement System. This experience strongly suggests that the government can readily extend such inflation protection to annuities paid from an individual account program.

- **Permitting unisex rates:** As noted above, unisex rates and options are politically desirable, but are not consistent with a free and competitive private market for individual annuities. The TSP experience shows that the government can contract with private firms for annuities at unisex rates, and perhaps could do so under a much larger program involving Social Security.

**Administration of annuities:** Annuities would be more economical to administer if their payments were combined with payments of other Social Security benefits. Combining the payments would make it feasible to administer annuities derived from small account balances.

A separate issue is timing of annuity purchases, such as by spreading the conversion of the account balance to an annuity over several years to smooth out fluctuations in investment performance and interest rates. This would protect a worker getting ready to retire from sudden changes in investment markets that could sharply reduce the amount of annuity income available. An alternative is to convert any stocks to long-term, fixed-income securities over several years before retirement.

**Conclusion**

The preceding pages present an actuarial viewpoint on plan design concepts similar to those found in recent Social Security reform proposals. Revising the U.S. Social Security system to include individual accounts could be the most extensive and complex benefits project ever attempted. Without taking sides for or against Social Security individual accounts, we would hope that any such plan if enacted is carefully designed and has a successful launch. If this issue brief succeeds in shedding new light on some of the practical issues posed by individual accounts, helping policymakers address such issues constructively, it will have accomplished its purpose.
Endnotes

1 “Social Security Reform: Voluntary or Mandatory Individual Accounts?” (September 2002)
2 “Social Adequacy and Individual Equity in Social Security” (Fall 1998, updated version forthcoming)
3 “Annuity of Social Security Individual Accounts” (November 2001)

These three references, giving more detail on topics discussed herein, are available from the American Academy of Actuaries and are online at www.actuary.org/socsec/index.htm.