

COST OF ADMINISTERING AND ANNUITIZING A PRIVATE SYSTEM

Administering a privatized Social Security system would be an incredibly difficult and complex task, the cost of which would have a significant impact on workers' retirement security. In the words of the Employee Benefit Research Institute, "Adding individual accounts to Social Security could be the largest undertaking in the history of the U.S. financial market, and no system to date has the capacity to administer such a system."

- Under a system of private accounts, workers would likely lose between 20 to 40 percent of their accounts' value to administrative charges and management fees.
- An annual fee equal to 1 percent of assets under management would absorb 20 percent of a worker's individual account over the course of a 40-year career.
- An annual fee of 2 percent would eat up 40 percent of a worker's account during his or her working years. According to Investment Company Institute data from late 1998, the average administrative cost for mutual funds is 1.49 percent per year.
- Administrative costs under the United Kingdom's voluntary individual account system reduced the account balance of the typical worker by 36 percent (relative to the balance that would have accumulated without any administrative costs).
- Social Security administrative costs equal less than 1 percent of the value of benefits, compared to the 20 to 40 percent for individual accounts. Unlike private investment funds, which charge their costs against an individual's account, Social Security's administrative costs have no effect on benefit levels.
- Workers' account balances would be further reduced by the cost of purchasing an annuity. Social Security provides a guaranteed stream of benefit payments for as long as a retiree (and his or her spouse) lives. To replicate this stream of life-long benefits and to ensure that they do not outlive their individual account balances, workers would need to purchase an annuity with their individual account balances. In a report issued in 1999, the GAO found that the cost of purchasing an annuity could consume up to 15 percent of workers' account balances (on top of any losses due to costs associated with investing the funds up until retirement).
- The administrative costs of a system of individual accounts would depend on a number of factors, including the extent to which fund management was centralized, the range of investment options available to workers, the level of customer service offered under such a system (e.g. telephone access to account information, frequent account balance

statements, etc.), and the rules and regulations governing the accounts. Advocates of individual accounts have not discussed these types of administrative details with sufficient specificity to be able to determine how expensive it would be to administer the accounts.
