

# **SSA's ESTIMATES OF ADMINISTRATIVE COSTS UNDER A CENTRALIZED PROGRAM OF INDIVIDUAL ACCOUNTS**

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## Overview

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Over the past several years, a number of policymakers have proposed creating national individual accounts (IAs) for retirement whose assets would be individually owned and directed among investment options. Some proposals would create an IA program outside Social Security; others would integrate IAs into the Social Security program itself. All IA proposals, however, would entail administrative functions, costs, and considerations. Identifying and recognizing those administrative elements are important steps in assessing the desirability, feasibility, and optimal design of IAs.<sup>1</sup>

Drawing on the Social Security Administration's (SSA's) considerable administrative experience to further the discussion about IA proposals, this paper:

- Summarizes the administrative operation of Social Security today,
- Provides SSA's estimated administrative costs for two hypothetical IA programs (that is, only the costs that SSA could experience, not those that employers, other agencies, and other parties could incur), and
- Highlights major considerations raised by IA administrative costs and choices.

Although the costs of administering an IA program would be passed on to workers and consumers in one form or another, features other than administrative costs could have a greater effect on the level and distribution of individual benefits. SSA is interested in analyzing the administration of IAs because some proposals have explicitly called for SSA to administer them.<sup>2</sup> Other, less explicit IA proposals have called for centralized administration, which could depend on SSA's information, processes, and systems. Despite SSA's potentially central role in IA administration, previous analyses have lacked the information needed to address the agency's costs in detail.<sup>3</sup>

### **A Centralized, Wage-Based, Mandatory, National IA Program**

To date, IA proposals have not specified administrative functions to the level of detail needed to estimate administrative costs. On the basis of SSA's administrative

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<sup>1</sup> IA proposals raise critical issues for the Social Security Administration. Estimates indicate that by 2010, over 28,000 of SSA's Federal employees will retire and another 10,000 will leave the agency for other reasons. That is more than half of the current workforce. Meanwhile SSA workloads will increase as baby boomers in the general workforce enter their disability-prone years and retirement. This analysis assumes that SSA's workforce would be sufficient to meet the cost and workload estimates described.

<sup>2</sup> The [National Committee on Retirement Policy] NCRP recommends that the burden of record-keeping for each individual be assumed by a bureau "within the Social Security Administration created for and dedicated to this purpose" (Center for Strategic and International Studies 1999, p. 62). Also, for example, the Social Security Solvency Act of 1999 (S. 21, 106<sup>th</sup> Congress) proposes the creation of a Voluntary Investment Fund Board that would be "established and operated in the Social Security Administration."

<sup>3</sup> See, for example, General Accounting Office 1999a and 1999b; Salisbury 1999; Olsen and Salisbury 1998; Goldberg and Graetz 1999; James, Ferrier, and Smalhout 1999.

experience, this analysis makes assumptions about those missing details and focuses on two hypothetical IA programs under which SSA's experience is particularly useful for developing cost estimates.

One hypothetical IA program would provide a basic level of services; the other, a higher level of services. Analysis of the two programs highlights trade-offs between administrative costs and level of services and demonstrates the types of considerations that surround two different general approaches to IA administrative design. In effect, they are intended to represent two ends of a realistic spectrum of centralized administrative policy options.

The hypothetical programs examined are assumed to be wage-based, mandatory, and national. A wage-based system determines workers' IA contributions on the basis of their earnings. For example, some plans have called for IA contributions equal to 2 percent of annual covered earnings. A mandatory and national IA program would require the participation of all workers and self-employed persons who are obligated to contribute payroll taxes.

Despite the specific nature of the hypothetical IA programs, identified functions and administrative considerations are often applicable to other types of IA programs. Hence, the examples illustrate the potential administrative impact of many possible IA proposals other than those examined in this analysis. For example, although the two hypothetical examples are mandatory programs, the broad functions required to administer them are the same as those needed to administer a voluntary program. Both types of programs would need to collect and invest funds, provide customer services to participants, ensure program compliance, pay out benefits, and provide public information about the new IA program.

The current costs of SSA's workforce, systems, and operations form a reliable basis for estimating administrative costs under a centralized IA program. SSA collects detailed data on administrative costs on a regular basis from all components of the agency. Detailed program and administrative assumptions were developed for the two hypothetical IA programs, drawing from the agency's own experience with similar administrative functions. SSA's Office of Budget then applied the actual FY 1999 cost data to those assumptions to estimate the administrative costs in this analysis—the same method that is used to prepare other SSA administrative cost estimates.

## **Key Findings**

We examined only SSA costs and found that if SSA was to administer the two hypothetical IA examples, the following results would apply:

- SSA's one-time start-up costs could range from \$1.2 billion to \$2.3 billion, and SSA's start-up time would range from 3 to 3.5 years. Costs and start-up time are not estimated in this analysis for other parties—such as employers and investment

managers—that would incur additional administrative costs under the two IA examples.

- An IA system could be implemented more quickly by basing IA contributions on earnings before the year in which an IA program was enacted. Under that scenario, IA contributions would have to remain in a default fund until SSA was able to develop and implement processes for crediting contributions to individuals, and workers would be able to direct their account assets among a choice of investment options.
- SSA’s additional ongoing annual administrative costs for the functions identified in this analysis could range from \$0.7 billion for the basic example to \$3.0 billion for the higher-service example. If IA contributions equaled 2 percent of earnings covered under the Old-Age and Survivors Insurance (OASI) program in 1999, the ongoing SSA administrative costs would represent between approximately 95 and 400 basis points in the first year.<sup>4</sup> As the IA program matured, however, administrative costs would drop as a percentage of IA account accumulations.
- For the functions identified in this analysis, SSA would require an estimated 7,735 to 33,630 additional permanent employees under the basic and higher-service IA examples, respectively.<sup>5</sup> (Those additions are included in the cost estimates given above.)
- In order of importance, the three major determinants of ongoing administrative costs under the basic example are customer service, payout, and collection; under the higher-service example, they are collection, customer service, and payout. That is, the relative costs of the functions depend on administrative design. No one function can be labeled most costly in all IA program scenarios.
- Administrative issues raise many considerations with regard to the design of IAs. For example, infrequent wage reporting (such as under the current system), errors, or both could delay the time between when IA contributions are withheld from pay and when they are credited to individual IAs. Delays could be minimized, as they are in the higher-service example. However, SSA’s administrative costs would increase as a result, and employers would have more frequent and strict reporting requirements.

Generally, the costs of administering an IA program increase as the level of the program’s services, features, and choices provided to participants increases. Likewise, a program that offered fewer services, features, and choices for participants would be less costly to administer.

Although this analysis makes significant strides in informing policymakers about the range of SSA’s administrative costs and their key determinants, it is not definitive for the following reasons:

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<sup>4</sup> This estimate is based on 1999 OASI trust fund income tax contributions of \$396.4 billion (10.6 percent of taxable payroll). Because SSA does not process annual wages for one year until the next year, IA contributions for 2000, for example, would be based on 1999 wages (Board of Trustees 2000).

<sup>5</sup> SSA currently employs approximately 19,600 employees to administer the OASI program.

- Estimates are based on a centrally managed, wage-based, national, mandatory program of individual accounts. Alternatively, IAs could resemble a decentralized system of individual retirement accounts or 401(k) plans, and contributions could be voluntary or not based on wages.
- Estimates reflect only costs to SSA. Individuals, employers, and other government agencies could also incur additional costs.
- Estimates are preliminary and will continue to evolve as assumptions are modified and refined. Because it is hard to anticipate every possible cost under an IA system, this analysis delineates what the cost estimates include.

In the end, however, administrative costs are only one factor to consider in assessing a proposal for individual accounts.

## **Social Security Today**

Individuals “enroll” in Social Security when they are assigned Social Security numbers (SSNs). Once they begin to work, their names and SSNs are reported to SSA along with their annual covered earnings on Form W-2 (Wage and Tax Statement), which employers are required to send annually on behalf of all employees with covered earnings that year.

Individuals and employers contribute to Old-Age, Survivors, and Disability Insurance (OASDI, or Social Security) through payroll taxes equal to 12.4 percent of taxable earnings (up to \$80,400 in 2001). Those contributions are made and processed through the annual wage reporting process. (See Appendix A for an overview of this process.)

As is the case with employee contributions to employer-sponsored defined benefit pension plans, workers do not own their Social Security contributions and cannot specify how they are invested. In fact, Social Security today is a largely pay-as-you-go program. In calendar year 1999, about 84 percent of net payroll tax contributions were paid to Social Security beneficiaries, leaving about 16 percent to be invested by the U.S. Secretary of the Treasury in special-issue Treasury bonds (Board of Trustees 2000).

Enforcement of whether or not tax contributions and reports are correctly sent by employers falls within the shared jurisdiction of the Internal Revenue Service (IRS) and SSA. Errors below one wage credit (\$830 in 2001) will generally not affect an individual’s Social Security benefit, so SSA usually does not take action on errors in employer reports that fall below that amount, or “tolerance level.”<sup>6</sup>

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<sup>6</sup> Errors equal in value to amounts below the dollar threshold for earning a wage credit are unlikely to prevent a worker from receiving a wage credit in any given year, and the amount is so small that it is unlikely to reduce a worker’s career-average indexed earnings (highest 35 years of earnings, indexed to growth in wages), which is the basis of Social Security’s traditional benefit formula.

Social Security payroll tax revenue is credited to the Social Security trust funds on the basis of liability, rather than on the basis of taxes actually collected.<sup>7</sup> Even in instances in which an employer fails to report earnings, workers who can provide evidence of those earnings have them credited to their record.

Individuals must file a claim in order to receive Social Security benefits, which are paid every month for as long as individuals remain eligible for benefits. Benefits are based on formulas specified by the Social Security Act; the formulas are applied to individuals on the basis of their status as an eligible beneficiary. For example, retired workers with a sufficient number of quarters of coverage over their lifetime are eligible for retired-worker benefits, and certain of their dependents may also be eligible for benefits.

## **IA Program Examples**

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For its analysis, SSA developed two hypothetical programs of individual accounts. The **basic IA program** would require minimal new information and processes and would offer minimal services to participants. By contrast, the **higher-service program** is intended to represent an IA program that would provide participants with as many features and services as those offered today by leading providers of financial services and by employers who offer defined contribution plans like 401(k)s. It would therefore require more extensive new information and processes.

The main requirements to administer both the basic and higher-service programs would involve all of Social Security's current *major functions* as well as a new major function, *investment*. New information and processes would need to be developed for *collecting* and *investing* participants' contributions and providing additional *customer service* to both participants and employers. SSA would also have to develop a system of *compliance*, a *payout* mechanism for distributing IA benefits, and a *public education* campaign about the new IA program (on both a start-up and an ongoing basis).

### **The Basic IA Program**

Under the basic service proposal, which is based on the annual wage-reporting (AWR) process, employers would not separately report the portion of payroll taxes devoted to IAs. Generally, the portion of the payroll tax revenues credited to IAs would be determined mathematically after the AWR process had been completed (a relatively minor modification to the existing AWR software).

As a result, the only significant additional costs that would arise for SSA under the basic program relative to the current AWR process would be those for enrollment and customer service. Participants would have to enroll in the program so that SSA would know which

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<sup>7</sup> The liability is computed by applying the tax rate for the year in which wages and self-employment income were reported to the record of such wages and self-employment income maintained by SSA. See the Social Security Act, §201.



investment funds they had chosen for their account contributions. Customer service activities would remain at about the current level for employers and workers. Public education efforts would be necessary, although they would not be as detailed or far-reaching as those envisioned under the higher-service IA example.

In general, contributions would be credited to specific individuals' IAs within 7 to 22 months after being deducted from workers' earnings.<sup>8</sup> Participants would select among as many as five investment funds. An IA Investment Board would tell Treasury how much to send to each of the approved investment fund managers. The amount would be based on the aggregate of all participants' individual investment selections.

IA benefits would be based on contributions and investment earnings thereon. (The basic example assumes that participants would not be able to withdraw funds before retirement and that the retirement benefit would be an annuity.) SSA would process payout applications for mandatory IA annuity benefits at the same time as other Social Security benefits, and both amounts would be combined into one monthly deposit or check per beneficiary.

The hypothetical basic IA program would cost approximately \$1.2 billion in start-up costs and \$0.7 billion in additional annual administrative costs on an ongoing basis (see Table 1). SSA would require an estimated 7,735 additional full-time workers to carry out the program. In order of importance, the major cost drivers under the basic example are customer service, payout, and collection.

### **The Higher-Service IA Program**

As with the basic program, new information and processes would need to be developed for the higher-service one. Most significantly, quicker processing of contributions, which would be part of the higher-service example, would require accelerating the frequency of the AWR process. Employers' responsibilities for sending and reporting payroll contributions would grow in number and frequency. All employers would submit account contributions electronically. In addition, the level of compliance required of employers is assumed to be "to the penny" under the higher-service IA example.

Customer service and public education activities would be expanded significantly. Participants would use personal identification numbers (PINs) and passwords to access IA balances through an unlimited 800-number or the Internet. In addition, the number of calls would be unlimited, and the operating hours for teleservice would be 7 days a week, 24 hours a day.

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<sup>8</sup> Under the current annual wage-reporting process, a dollar withheld in payroll taxes from a worker's January earnings of one year may not be attributable to his or her individual earnings until October of the next year—a delay of up to 22 months.

**Table 1.**  
**Total costs and equivalent full-time employees under Social Security today and the basic and higher-service IA programs**

	Social Security Today (OASI)	Additional Costs and Workers Needed for IA Program	
		Basic	Higher-Service
Costs (billions of dollars)			
Start-up	n.a.	1.2	2.3
Ongoing	1.8	0.7	3
Employees (Permanent FTEs)	19,600	7,735	33,630

SOURCE: Social Security Administration, Office of Budget, 2000.

NOTE: n.a. = not applicable; OASI = Old-Age and Survivors Insurance; FTE = full-time equivalent.

At any time, participants would be able to obtain information about their account balance and allocate accounts or new contributions among 50 available investment options. SSA's public education efforts would be expanded in order to provide investment education tools and materials tailored to different types of participants (such as those with different retirement horizons or education levels).

As under the basic IA example, IA benefits would be based on contributions and investment earnings thereon. However, pre-retirement access would be available in the form of loans, and payout options would be more flexible. Participants could receive traditional Social Security and IA benefits at different times, select among different IA payout options, and have IA and traditional Social Security benefits paid through different monthly deposits or checks.

The higher-service IA program would cost approximately \$2.3 billion in start-up costs and \$3.0 billion in ongoing (annual) administrative costs. SSA would need the equivalent of an additional 33,630 full-time workers on a permanent basis (see Table 1). In order of importance, the major cost drivers under the higher-service program are collection, customer service, and payout.

## **Methodology**

SSA collects detailed actual data on administrative costs on a regular basis from all components of the agency. For the analysis of the two hypothetical IA programs, detailed program and administrative assumptions were developed, drawing from the agency's experience with similar administrative functions. SSA's Office of Budget then applied the actual FY 1999 cost data to those assumptions to estimate the administrative costs in this analysis, in the same manner as other SSA administrative cost estimates are

prepared.<sup>9</sup> Following are some examples of existing information that was used in order to obtain administrative cost estimates:

- *Collection.* Data derived from SSA's experience with AWR was the primary source for constructing cost estimates for the collection function. For the higher-service program, we multiplied the costs of AWR by 26 to represent biweekly reporting requirements. We then multiplied that result by 80 percent to account for the fact that not all persons who work during a calendar year are employed for the entire year and to account for anticipated economies of scale.<sup>10</sup>
- *Customer service.* The estimates assume that phone calls under the basic program would last the same amount of time as phone calls to SSA that are answered by a live operator—an average of about 5 minutes—but that the current volume of calls would almost double (one-third of the federal Thrift Savings Plan's experience of one call per year per participant). The estimates also assume that SSA would hire more customer service workers to handle this volume. The number of required additional full-time workers was then multiplied by SSA's overall average cost per work-year of \$77,366 (in FY 1999), which includes average salary, employee benefit costs, and overhead costs (for example, office furniture, equipment, space, and so forth). Then, we added other customer service expenses, such as the cost of quarterly account statements under the higher-service example. To obtain that estimate, we multiplied SSA's cost of sending annual Social Security statements (60 cents each) by three to account for the cost of sending three additional mailings annually. (We assumed that one quarter's mailing would simply accompany the annual Social Security statement.)<sup>11</sup>
- *Payout.* On average, applications for retirement benefits currently take approximately 2 hours—organizing documents, explaining benefits, reviewing forms, and so on. We assume that benefit applications would average an additional 30 minutes to process under the basic program (because SSA staff would need to explain how IA benefits are paid and to process IA benefit claims) and an additional 45 minutes under the higher-service IA program (because SSA staff would need to explain a range of payout options, including multiple annuity offerings).

Although conceptually straightforward, these methods and techniques involve sophisticated calculations that adjust for complex interactions among variables, such as year-to-year changes in productivity, increasing automation, training needs, employee leave, and many other factors that affect administrative costs. Annual SSA administrative costs are largely workload driven in that they relate directly to the amount of work to be processed in a given year. Costs include salaries and employee benefits;

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<sup>9</sup> The Congressional appropriations process uses the same methods and techniques to determine needs under current law and for legislative proposals.

<sup>10</sup> Unemployment, business terminations, seasonal employment, and other factors must be taken into account when shaping estimates involving multiple reporting cycles. In effect, the number of records reported per individual cycle decreases as the number of processing cycles per year increases.

<sup>11</sup> A separate calculation was made for persons who would have account balances but would be ineligible to receive a Social Security Statement because they are under age 25 or currently receiving benefits. If individuals needed to report any IA information on their income taxes, then IA statements would have to be sent on a schedule different from that of the Social Security statement.

nonpayroll expenses such as space, equipment, supplies, travel, and printing; and computer expenses and telecommunications activities, including ongoing information technology systems (ITS) and major automation initiatives. To the extent that the hypothetical IA programs affect such administrative costs, those costs are reflected in this analysis as costs above and beyond administrative costs under the current Social Security program.

## **Major IA Functions**

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Under the two hypothetical IA programs, administrative tasks generally fall into six major functions: collection, investment, customer service, compliance, payout, and public information.

### **Collection**

Collection is a process by which contributions are collected, records of contributions are kept, and differences between contributions and records are defined and identified as errors. Collection includes enrollment, recordkeeping, employer contributions, enforcement of tolerance levels, and corrections and adjustments. It is the primary cost determinant under the higher-service IA program because that program requires contributions to be collected and processed biweekly. Under the basic program, which maintains the AWR to the greatest extent possible, collection is the third most significant cost driver (behind customer service and payout functions).

Estimated start-up costs for the collection functions described below would range from \$375 million for the basic IA program to \$480 million for the higher-service program (see Table 2). Estimated ongoing costs would range from \$90 million to \$1,350 million, respectively. The number of required additional full-time workers would range from 500 (basic) to 16,670 (higher-service) (see Table 3).

**Enrollment.** Generally, workers “enroll” in Social Security once they have been assigned a Social Security number and SSA begins receiving their earnings information, as reported on Form W-2. Under both the basic and higher-service examples, IA enrollment would require more information about individual workers than Social Security does today, and that information might change over time.<sup>12</sup>

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<sup>12</sup> For example, it would probably be necessary to maintain an electronic copy of enrollment forms so that SSA could verify individuals’ changes in beneficiary designations, asset allocation, and so on (so as to avoid the need to hire handwriting experts to verify signatures in dispute).

A single investment plan based on a percentage of earnings or adjusted gross income without the ability to designate a beneficiary would not require an enrollment process. Those who had earnings or filed an income tax return would automatically have an investment record established.

**Table 2.**  
**Estimated additional costs and employees under the basic and higher-service IA programs, by function**

Function	Basic IA	Higher-service IA
<i>Additional Costs (millions of dollars)</i>		
All functions		
Start-up	1,200	2,300
Ongoing	700	3,000
Collection		
Start-up	375	480
Ongoing	90	1,350
Investment		
Start-up	5	5
Ongoing	3	10
Customer service		
Start-up	550	730
Ongoing	440	1,250 <sup>a</sup>
Compliance		
Start-up	n.a.	n.a.
Ongoing	30	120
Payout		
Start-up	n.a.	n.a.
Ongoing	125	180 <sup>a</sup>
Public information		
Start-up	60	225
Ongoing	5	5
Other		
Start-up	220	845
Ongoing	21	50
<i>Employees (permanent full-time equivalents)</i>		
All functions	7,735	33,630
Collection	500	16,670
Investment	20	80
Customer service	4,965	12,470
Compliance	350	1,525
Payout	1,550	2,340
Public information	10	15
Other	340	530

NOTE: n.a. = not applicable.

a. The estimates exclude non-systems-related ongoing costs for loans because SSA has no proxy for estimating loan-processing costs.

**Table 3.**  
**Differences between the current Social Security program and the hypothetical programs with individual accounts, by function and subfunction**

Subfunction	Social Security Today (OASI)	Basic	Higher-service
<i>Collection</i>			
Enrollment	Via assignment of Social Security number	Enrollment form is mailed with the Social Security statement; no acknowledgment	Separate from Social Security statement; acknowledgment includes PIN and password <sup>a</sup>
Recordkeeping	Traditional defined benefit Social Security	Traditional defined benefit Social Security and IA program with basic features and services	Traditional defined benefit Social Security and an IA program with many features and high-level services
Employer Contributions and Reporting			
Frequency	Depends on tax liability and pay schedule (from daily to annually)	Same as today	At least weekly
Method	Electronic, magnetic media, or paper, depending on tax liability	Same as today	Electronic submission mandatory for all employers
Contribution report schedule	On W-2	None; SSA extracts contribution amounts from W-2 Forms	Every 2 weeks
W-2/W-3 changes	Not applicable	None	IA contribution reported separately
Establishing tolerance levels and making corrections and adjustments			
Tolerance levels	One wage credit, or \$830 in 2000, per employer report	Same as today	Zero (to the penny)

(Continued)

**Table 3.  
Continued**

Subfunction	Social Security Today (OASI)	Basic	Higher-service
<i>Collection (cont.)</i>			
Establishing tolerance levels and making corrections and adjustments (cont.)			
Corrections and adjustments	70,000 corrections/ adjustments each year, 5 million to 7 million new items are added to unreconcilable file	Same as today	More frequent postings would increase percentage to an uncertain degree
Frequency	Annually	Same as today	Biweekly
<i>Investment</i>			
Who handles?	Not applicable	Investment board	Investment board
Fund choices	Not applicable	5 (default fund for those without a fund selection)	50 (default fund for those without a fund selection)
Allocation options	Not applicable	Single fund	Up to 10 funds
Valuation	Not applicable	Monthly	Daily
<i>Customer Service</i>			
Telephone service	Telephone service representatives (TSR) available 15 hours/day Monday through Friday; auto attendant for ordering forms is available	Availability and type of service would remain the same as today, with additional staffing to handle increased call volume. Forms for IAs could be ordered by phone.	24-hour, 7-day TSR service with auto attendant that allows access to IAs and to change account allocations, fund choices, etc., using PINs/passwords

(Continued)

**Table 3.  
Continued**

Subfunction	Social Security Today (OASI)	Basic	Higher-service
<i>Customer Service (cont.)</i>			
Internet service	Some Social Security forms are available for downloading today and participants can apply for retirement benefits online. Beginning 12/1/00, employers can transmit wage reports (Forms W-2/W-3) to SSA via the Internet.	Same as today, but IA-related forms could be downloaded (but not completed) online	Same as today, plus unlimited ability to make changes and get information using PIN/password
Asset allocation changes	Not applicable	Participants can allocate to a different fund once a year	Unlimited (including balance transfers)
Posting IA performance	Not applicable	Monthly update valuation	Daily update valuation
Statement frequency	Annual Social Security statement (sent to workers ages 25 and older approximately 2 months before their birthday)	Annual—either on the Social Security statement itself or as a separate document included in the same mailing as the Social Security statement <sup>b</sup>	Quarterly—totally separate from the Social Security statement
Employer service	SSA provides a variety of employer services to assist in wage reporting	Same as today	Enhanced
Miscellaneous updates (change of address or beneficiary, IA balance requests)	SSA relies on IRS files for address information for Social Security statements; SSA provides printed benefit information that beneficiaries may need when applying for loans; change of beneficiary not applicable to Social Security	SSA would continue to rely on the IRS for address information; SSA would establish mechanism to update beneficiary information and to provide printed IA balances upon request	SSA would develop address database and establish mechanism for updating it; SSA would establish mechanism to update beneficiary information and to provide printed IA balances upon request

(Continued)



**Table 3.  
Continued**

Subfunction	Social Security Today (OASI)	Basic	Higher-service
<i>Compliance</i>			
Reconciliation between employers and SSA	Annually	Annually	Quarterly
Reconciliation between investment funds and SSA	Not applicable	Annually	Monthly
Appeals	Appeals process deals mainly with disability claims	Appeals would increase for retirement claims, relative to current program	Appeals would increase for retirement claims, relative to current program
<i>Payout of Benefits from Individual Accounts</i>			
Options	Life annuity	Mandatory annuitization at time of Social Security retirement benefits	Annuity, periodic distributions, or lump-sum withdrawals as early as age 59½
Loans	Not applicable	None	Yes
Early withdrawals	Not applicable	None except for terminal illness tied to disability	Under limited circumstances
Application and payment	Must file for Social Security; benefits are paid in a single monthly check	Must file for traditional Social Security and IA benefits at the same time; benefits are paid in a single monthly check	Could file for IA and traditional Social Security benefits separately; payments could be made separately
<i>Public Information</i>			
Level of IA public education materials	Not applicable	Basic	More specific
Public service campaigns	None, not authorized by Congress	Basic	Extensive

(Continued)

**Table 3.  
Continued**

Subfunction	Social Security Today (OASI)	Basic	Higher-service
	<i>Other</i>		
Training staff, maintaining software, and obtaining facilities	Those necessary to carry out the above functions under current law.	Those necessary to carry out the above functions under the basic IA program example	Those necessary to carry out the above functions under the higher-service IA program example

- a. Personal identification number that can be used for phone and Internet account inquiries and changes.
- b. An alternative IA statement would be sent to those under age 25 or already receiving Social Security benefits.

At the inception of a national, mandated IA program, 155 million persons would need to be enrolled (assuming no minimum or maximum age limitations). Estimated start-up costs would include the new systems that SSA would need to develop, new staff that would have to be hired and trained; and new office space, furniture, equipment, and so forth would need to be obtained.

After initial enrollment, the remaining administrative costs for this task would be the ongoing costs of enrolling the 4 million to 5 million new workers who enter the workforce each year and processing changes in information provided on the original enrollment form, such as changes in beneficiary designation(s) and address. Estimating these ongoing costs are included with those for customer services.<sup>13</sup>

*Basic IA Program.* Enrollment under the basic example would be on a rolling basis throughout the year, via the annual Social Security statement, which would include an IA enrollment form.<sup>14</sup> An enrollment package would be sent to each worker. Workers would complete the forms and return them to SSA for processing. Either SSA or a contractor would process the forms, and the data would be used to establish an investment record for each worker who enrolled.<sup>15</sup>

*Higher-Service Program.* Under the higher-service scenario, enrollment forms would be mailed separately from the Social Security statement and all at once so as to most quickly enroll workers. A confirmation of the enrollment data processed would be sent to each

<sup>13</sup> The cost estimates for enrollment under either program do not include the activities necessary to deal with workers who need a representative payee because they are either a minor or are incapable of making investment decisions for themselves. SSA would have to determine when a worker needed a representative payee—or, in the case of IA investment, a representative advisor. Processes involving representative payees are costly.

<sup>14</sup> Working individuals who are aged 25 or older and are not currently receiving Social Security benefits receive a Social Security statement about 3 months before their birthday.

<sup>15</sup> Processing would involve scanning computer-readable information, manually keying in unreadable information, and converting all data to microfilm as well as to electronic files.

worker for whom SSA processed enrollment. A unique PIN/password (assigned when the investment record was established) would be included in the confirmation. Enrollment cost estimates are the same as those for the basic program except for the additional costs of sending enrollment confirmations with established PINs and passwords and the cost of enrolling workers separately from the Social Security statement.

*Considerations.* The extent of enrollment would have a major effect on administrative cost. We assume that all 155 million covered workers would be enrolled under the hypothetical IA program. Covering more or fewer workers could affect per-participant enrollment costs.

In choosing between a basic and a higher-service enrollment process, a chief consideration is the trade-off between outreach and cost. Under the basic example, many people would not be enrolled in a timely manner. On the basis of SSA's experience with the annual Social Security statement, we assume that approximately 25 percent of the initial mailings would be returned for having incorrect or invalid addresses. Individuals not receiving a package would need to either call the 800-number or visit a field office, library, post office, or some other location. Getting information to participants who were not reached by the initial enrollment mailing could represent a substantial cost.

Even if the basic program reached 100 percent of workers, workers could not be enrolled as quickly as under the higher-service example. Because enrollment forms would be sent with the annual Social Security statement under the basic scenario, and workers only receive the statement once a year, the enrollment process would take about 15 months. With the higher-service scenario, the enrollment forms could be sent out in a mass mailing, and the process could be completed in perhaps less than 6 months.

**Recordkeeping.** SSA would have to perform a significant number of additional recordkeeping functions. First, even though SSA already keeps earnings records on all covered workers and beneficiaries, an IA program would require new systems to record account balances, changes in allocations, transfers of balances to other funds, and any corrections or adjustments made to the amount of contributions or the amount of earnings (losses). Those records would also be needed to serve as the basis for periodic statements to participants. Second, SSA would need to keep earnings that are credited for traditional Social Security (insurance) benefits separate from IA cash contributions and returns (investment). To do that, SSA would need to design and maintain a number of new processes and systems.<sup>16</sup>

With the exception of a PIN/password system that would be needed for the higher-service program, the difference between the two scenarios in terms of recordkeeping is not in the systems that are needed but rather in the design of those systems. For example, a

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<sup>16</sup> Such processes and systems might include those for adjusting, correcting, or updating a record; an unverifiable file that would contain monies for individuals whose name and SSN did not verify; a record of any passwords and PINs; and payout records. Security systems to protect individuals' personal information within any new systems would also need to be established.

recordkeeping system that kept track of payout under the higher-service example (which would offer a choice of programmed withdrawals, lump-sum withdrawals, and annuity payments) would cost more than the system that kept track of payout under the basic example (which would offer annuity payments only).

We estimate that the recordkeeping systems needed to administer the basic IA program would require about 3 years to build and test before they could be fully implemented. By comparison, the systems needed to administer the higher-service IA program would require approximately 3.5 years for full implementation—although part of the IA program could begin sooner (such as the collection of contributions in the first year), and SSA could catch up with crediting accounts once its necessary administrative functions were fully in place.<sup>17</sup>

**Employer Contributions and Reporting.** Recall that IA *contributions* in this analysis are assumed to be based on earnings (for example, 2 percent of taxable earnings), just as Social Security *benefits* today are based on earnings. Under the two hypothetical IA programs and under Social Security today, employers would be required to report workers' earnings information to SSA. The frequency and methods by which employers are required to submit individual workers' earnings information and taxes (or IA contributions) are key determinants of administrative costs.<sup>18</sup>

The current AWR system generally requires employers to submit individuals' earnings information for the previous year at the beginning of the next year via Form W-2 and W-3 reports. Because those reports are submitted only once a year, a dollar generally takes between 7 and 22 months from the time it is earned until it is posted to a worker's Social Security earnings record.<sup>19</sup> For example, \$1 earned on January 1, 1999, would not be reported until a Form W-2 was filed by, say, the end of January 2000 (a 13-month delay).<sup>20</sup> After the reports are submitted, SSA processes them. SSA finishes posting the majority of W-2s from the end of July through the end of September—up to 9 months after the W-2 is submitted. Hence, \$1 withheld on January 1, 1999, may not be posted to an individual earnings record until September 30, 2000 (13 months' delay in reporting plus 9 months' delay in posting equals a 22-month delay). Similarly, \$1 earned at the end of December 1999 would be reported on Form W-2, say, at the end of January 2000 (up

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<sup>17</sup> By comparison, the Federal Employment Retirement Systems Act, which created the 401(k)-like plan for federal workers, the Thrift Savings Plan (TSP), was signed into law on June 6, 1986. The Federal Retirement Thrift Investment Board views the start-up time frame as beginning on October 1, 1986, when President Reagan appointed the initial chairman and two members of the board. On April 1, 1987, the TSP became operational with an initial investment of \$148 million and approximately 600,000 participants. Investment choice and loan features were not available until 1988, and additional benefits have been made available since that time.

<sup>18</sup> A significant cost not reflected in the estimates presented in this analysis is the cost of developing collections and reporting processes for groups that would need special accommodations, such as many self-employed persons and—if covered—workers who are not covered under Social Security today but who may be enrolled under the IA program.

<sup>19</sup> The delay is between 16 and 22 months for the approximately 15 million self-employed individuals who generally report earnings information on their personal tax returns at the end of the tax year.

<sup>20</sup> Most workers' Form W-2 reports are due in January or February, with the exact date varying from year to year.

to a 1-month delay). The delay would equal 7 months if the earnings were not posted until July 31, 2000 (1 month's delay in reporting plus the 6 months' delay from the end of January to July equals 7 months).<sup>21</sup>

The lag in crediting a dollar earned to a Social Security earnings record has no long-term repercussions on benefits for workers who file for current-law Social Security benefits.<sup>22</sup> Under an IA program, however, benefits are determined by contributions and investment returns thereon. Employers, under AWR today, send aggregate taxes on a predetermined schedule that does not usually coincide with W-2 reporting. Therefore, if AWR was maintained in its current form under an IA program, a time lag of 7 to 22 months would exist between when IA contributions would be deducted from pay and when SSA would be able to credit those contributions to individual workers. That lag is referred to as a "float period," and it could affect benefits by reducing the amount of time that contributions have to accrue investment earnings based on workers' individual fund choice(s).

The method of reporting information about individual investment contributions is also a key administrative cost factor that raises major considerations. Today, of the 6.5 million employers, approximately 5.5 million (82 percent) report wage data via paper reports, while the remaining 1 million (18 percent) report via some form of magnetic media (such as diskette, magnetic tape, or cartridge).<sup>23</sup> The method of reporting is a key administrative cost determinant for SSA, which has to process those reports. Changing reporting methods also would raise considerations in regard to the employers who would have to submit the reports.

*Basic IA Program.* SSA would maintain the current employer contribution and reporting rules, which involve processing some 240 million pieces of information. When SSA received its annual W-2 and W-3 data for employees, it would determine the amount of the aggregate Social Security tax liability that was creditable as IA contributions and would credit that amount to workers' IAs as their W-2 information was processed. A float period of up to 22 months would exist, as we assume that no one would be credited with IA contributions until the end of the processing year.<sup>24</sup> We assume that the U.S. Treasury would hold the contributions during the float period and invest them in government bonds.

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<sup>21</sup> If SSA had additional resources, processing the majority of reported W-2 earnings to earnings records could theoretically be performed within 2 to 13 months of the date payroll taxes were withheld from a given paycheck. For example, if SSA finished processing W-2 reports by the end of February rather than September, then payroll taxes withheld in January of the prior year could be credited to individual workers within 13 months of the date they were withheld. Similarly, payroll taxes withheld in December of the prior year could be credited to an individual worker within 2 months of the date they were withheld.

<sup>22</sup> If earnings are not credited to an individual's earnings record, and he or she has proof of the earnings, a correction or adjustment can be made to that record.

<sup>23</sup> Magnetic media reporters can also submit reports via SSA's Bulletin Board.

<sup>24</sup> At the end of the processing year, all reports received that can be posted to earnings records are posted, and the remainder are assigned to an unverifiable file, where they remain until resolved.

The public might perceive differences in when IAs are credited as unfair if crediting took place as soon as W-2 reports were processed throughout the processing year.

*Higher-Service IA Program.* Employers would need to report participant-level information to the government at least every 2 weeks via an IA contribution report. Employers would still need to submit that information on W-2 and W-3 reports. As a result, SSA would process approximately 3.25 billion contributions records, almost 14 times more data than it processes today.<sup>25</sup> However, unlike today, employers would submit all information electronically.

Up to 3 weeks would lapse between the time when some contributions were withheld and when they were posted—1 week for the employer to report that the funds were withheld from a given individual's earnings and 2 weeks for SSA to credit those contributions to that individual (assuming no errors in reporting or processing). Errors would cause delays or force incorrect amounts to be credited to accounts, which would result in SSA's having to take away excess contributions and earnings thereon (which would be possible though administratively difficult). Once the process was started, workers would see funds added to their IAs every 2 weeks and start earning returns.

So that the U.S. government would have the contribution amounts needed to credit IAs and send them in aggregate to investment managers, employers (usually smaller and mid-size) and self-employed persons who are currently sending in tax contributions less often than weekly would be required to start sending IA contribution amounts to the government at least weekly or on some other expedited time frame. Employers would be required to separately report IA contributions on W-2 and W-3 reports, just as they must separately report Social Security and Medicare taxes under current law.

*Considerations.* Unless a system is devised to credit accounts with funds not yet received, to credit participants' investment returns on amounts not yet individually invested, or to credit both, the decision whether to require employers to report and send amounts to the government more frequently is a clear trade-off between balancing requirements imposed on employers and the level of services provided to IA participants. A float period of up to 22 months—and longer in case of errors—could mean an opportunity cost for participants who might lose investment income while they waited for their contributions to be credited to their individual IAs. On the other hand, employers would incur additional administrative costs from having to report more frequently.

The burden of more frequent periods of reporting would fall disproportionately on the self-employed, small employers (over 80 percent of the employer universe), and employers who prepare records manually. That is, 82 percent of employers would be

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<sup>25</sup> The plurality of the wage force is paid on a biweekly basis, with the remainder split almost evenly between weekly and monthly payrolls. A biweekly average of the yearly number of items processed on a payroll basis would be the equivalent of everyone in the labor force being reported on a biweekly payroll. This analysis assumes that the average self-employed person would report contributions four times per year. That combined employed/self-employed universe of individuals is equal to approximately 147 million persons, which was adjusted for such factors as unemployment, seasonal employment, part-time self-employment, and lower reporting frequency for the self-employed. Taking those factors into account, the average number of items reported on a biweekly basis could be 125 million records. Multiplying that figure by 26 to reflect biweekly reporting yields 3.25 billion, which is a very conservative estimate.

required to convert from paper to electronic reporting.<sup>26</sup> Employers could be compensated for the additional requirements, however, through a reduction in tax liability or other incentives. In addition, delays caused by errors in employers' reporting might eventually lead to a requirement that contribution data be submitted electronically through a third party who first standardizes all data before it is sent to SSA in order to keep processing current for IA participants.

**Establishing Tolerance Levels and Making Corrections and Adjustments.** Social Security today is a credit-based program. In calendar year 2001, a worker will earn a credit (up to a maximum of four each year) for every \$830 earned. In processing W-2 and W-3 information, a processing tolerance is applied that generally does not affect benefit levels. (A tolerance is the amount by which reported information can differ without the employer's having to make a correction.) In contrast, because the hypothetical basic and higher-service IA programs are wage-based, the investment contributions—and therefore benefits—would be directly dependent on the amount of wages reported and amounts contributed. Tolerances would therefore affect participants' benefit levels, all else being equal (see Box 1).

*Basic IA Program.* The basic IA example would maintain current-law levels of tolerance. As a result, employers would not be required to reconcile their data to any degree greater than under current law. And because frequency of contributions and reporting would remain the same as under current law, employers would experience no increase in the number of reports and contribution levels that must match.

This analysis assumes that error rates under the basic IA program would be the same as today—three ten-thousandths of one percent (0.0003 percent) in posted money amounts—or about 72,000 worker-initiated corrections per year.<sup>27</sup> We also assume that SSA would continue to contact 500,000 employers per year to resolve differences between W-2/W-3 reports and IRS data. However, note that this is a very optimistic assumption. Since the link between benefits and earnings is exact under IAs as opposed to under the traditional Social Security benefit formula, people may pay closer attention to their investment performance statements than they do to their Social Security statements. We also assumed that earnings-related appeals would increase.

*Higher-Service IA Program.* No tolerance would be allowed under this example, just as employers who offer 401(k) plans are afforded no error tolerance. As a result, processing costs would significantly increase for SSA, which would have to identify all errors and work with employers to correct them. Unresolved discrepancies could lead to appeals

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<sup>26</sup> Although requiring all employers to submit electronically may appear to be an optimistic assumption, it is consistent with actions currently under way at the Internal Revenue Service to increase the frequency of electronic reporting. Specifically, as mandated by the Restructuring and Reform Act of 1998, the IRS's Strategic Plan was designed to eliminate barriers, provide incentives, and use competitive market forces to make significant progress toward two goals: the overriding goal of having 80 percent of all tax and information returns filed electronically by 2007, and the interim goal that, to the extent practicable, all returns prepared electronically should be filed electronically by 2003 (see IRS 1998).

<sup>27</sup> Such corrections usually occur when workers notice errors on their Social Security statements or W-2 reports.

**Box 1.**  
**Identification of Errors and Application of Tolerances**

Tolerances, from the Social Security Administration's (SSA) annual wage-reporting (AWR) perspective, are applied at two different points. During the initial processing, the dollar amounts from each W-2 are added together to ensure that they match the appropriate dollar amount reported on Form W-3. With magnetic reports, if the amount of earnings from the W-2s does not match the amount of earnings on the W-3 within the tolerance level, the report is sent back to the submitter to be corrected and resubmitted, and the process begins again. Paper reports are accepted "as is," and none are returned to employers. Later, data purification routines and "reconciliation" processes identify reports with errors that exceed the tolerance.

The next tolerance is applied during reconciliation. At different points in the processing year (about April—usually weekly after databases open and processing of W-2s is fully under way), the summed four quarters of the Internal Revenue Service's (IRS) 941 file is compared with the W-3 files that have been processed. If SSA's earnings amounts are greater than IRS's—an indication that not enough taxes may have been submitted—the case becomes an IRS reconciliation case. If SSA's earnings amounts are less than IRS's—an indication that the employer may not have submitted all of its W-2s or that some of the W-2s did not include sufficient wages—the case becomes an SSA reconciliation case. If the amount of the discrepancy is less than \$830 (for 2001), SSA takes no further action. All other cases become "SSA discrepant reconciliation cases." IRS has a similar process that uses an undisclosed tolerance level.

At the end of the AWR processing year, the 941 file and the W-3 file are compared again. This time, SSA is looking for employers that filed 941 reports but did not file W-2 and W-3 reports with SSA. If the earnings amount is less than \$830, no further action is taken (very few instances). All other cases become "SSA missing reconciliation cases." The IRS gives SSA its 941 files, and SSA determines which cases it must investigate. In exchange, SSA gives the IRS its annual wage reporting data (that is, W-2 and W-3 data), and IRS determines which cases they will pursue.

that would mean additional expenses for SSA and employers. Administrative cost estimates under the higher-service IA program therefore include additional efforts to identify and correct errors. The estimates assume 300,000 earnings-related appeals annually (see Compliance, below).



Costs would increase for employers under the higher-service program, not only because employers would be held to a stricter standard in reporting but also because they would have to reconcile a greater number of contributions and reports than they do under current law. We expect that the number of annual worker-initiated corrections would be about 975,000 (as compared with 72,000 today) and that in making the corrections, the time SSA staff spent on the telephone with employers would at least double.

*Considerations.* A key consideration is whether workers would be compensated for errors employers made in sending contributions. Even under a zero-tolerance program, not all of those errors would be resolved. When errors in reported earnings or contributions are not resolved in the current Social Security program, workers' benefits are unaffected if workers have proof of their earnings. In the hypothetical IA programs, however, unresolved errors could affect benefits by affecting contributions and the time they have to accrue investment returns. Much thought would need to be given to processing small tolerances, as it could be more costly to pursue a small amount of money—for example, less than \$10—than it would for Treasury to supplement the contribution amount.

Finally, considerations arise over how policymakers might design an IA program so as to reduce errors. Mandated electronic reporting might be more likely to become a requirement for employers under a system with very low or zero-error tolerance if employers were unable to meet accounting standards through paper or magnetic reporting.

## **Investment**

Under the IA examples described in this analysis and generally discussed by policymakers, individuals would own their contributions, which they would invest according to their choice of funds. The investment function refers to activities involved with investing the contributions—that is, selecting available investment funds and allocating contributions to designated investment funds. (The investment services of allowing allocation changes, posting IA performance, and providing IA statements to account holders are discussed as part of the customer service function, described below.)

Depending on the amount of choice and the frequency of account valuation, the start-up cost to SSA of providing investment services is estimated to be about \$5 million under both hypothetical programs. Ongoing costs would range from \$3 million for the basic program to \$10 million for the higher-service program. An estimated 20 to 80 additional full-time workers would be required for the basic and higher-service IA examples, respectively.

SSA's costs for the basic and higher-service examples do not differ significantly because SSA would not be managing the investments but rather would inform Treasury how much to submit to the investment manager for each investment fund and would credit accounts on the basis of fund returns. The difference in costs is based on the need to transmit more and more frequent data under the higher-service IA example. Because

much of that process would be automated, the additional costs for the higher-service scenario would be less substantial than those for administrative functions involving more manual labor, such as collection. The largest part of ongoing investment costs would fall on the investment providers rather than on SSA and are therefore not included in the cost estimates provided. (The cost for account valuation is included under SSA's estimated costs for customer service.)

Under the mandatory IA programs, all 155 million employees and self-employed persons would be directly responsible for supplying SSA with their choice of investment funds and beneficiary designations. SSA would need to set up interface systems with investment providers in order to process individuals' fund choices, send that information in aggregate to the investment provider, and perform account valuations.

In addition, SSA would need to establish a default fund for workers who failed to provide full enrollment information. Assuming that IA contributions equal 2 percentage points of the current payroll tax rate, \$1 billion could go into the default fund (along with the monies for participants who did not complete an enrollment form) in a single year. This \$1 billion was estimated by applying the percentage of annual unreconciled errors that occur under current law to 2 percent of taxable payroll.

**Basic IA Program.** Individuals would be able to invest their IA contributions in one of five investment funds. At least three of the five would be mixed funds that would combine different investment classes (such as government bonds, corporate bonds, and equities). For example, one fund might consist mostly of aggressive equities to appeal to younger and middle-aged IA participants who are seeking to grow their IA balances. Another fund might contain a greater share of corporate and government bonds for IA participants who are approaching retirement and are seeking to preserve their IA balances.

Under the basic system, valuation would be performed on a monthly basis.<sup>28</sup> That means that a change in market value among IA investments would be reflected monthly, and the participant's changes to fund allocation would not be effective until the end (or beginning) of the month. (Workers would be able to contact a field office or the 800-number for that information, although account statements would only be issued annually.)

**Higher-Service IA Program.** Investment functions would resemble those generally offered by major providers of financial services today. For example, workers would be able to allocate their IA balances among up to as many as 10 investment funds from a selection of 50 funds. In addition, valuation would be on a daily basis.<sup>29</sup> Participants would also be able to reallocate or transfer funds on a daily basis.

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<sup>28</sup> The federal TSP plan currently performs monthly valuation and is planning to switch to daily valuation (See Federal Thrift Investment Board 2000, p. 2).

<sup>29</sup> Although not taken into account in the cost estimates provided in this paper, the funds' performance could be published in a daily newspaper, which might reduce the number of participants' inquiries to SSA to check the performance of the funds in which they have invested their IA assets.

**Considerations.** The basic program outlined here would provide fewer investment options and services than are currently available through financial services providers. IA programs that would make individuals responsible for sending contributions, providing documentation, and selecting providers would entail a number of compliance issues that are beyond the scope of this analysis. Effectively administering such a system would probably involve higher costs than the centrally managed IA examples presented.

## **Customer Service**

Customer service is a key administrative cost driver under the basic IA program, and the second most important one under the higher-service IA program. Customer service functions include providing telephone service, in-person service to participants who visit SSA field offices, Internet service, and changes in asset allocations; posting IA performance; sending IA statements; and providing services to employers that facilitate their meeting the program's requirements. (By contrast, SSA's primary customer service activities today include providing an 800-number, servicing participants' office visits, sending Social Security statements annually, and responding to participants' correspondence.)

A customer service for which only some costs are provided in this analysis is the administration of IAs when major life events occur. Depending on the program's design, SSA may need to distribute IA balances when a participant becomes disabled, bankrupt, or divorced, and those distributions might need to be made to different parties (such as spouses and children) at different times (such as multiple divorce settlements). Aside from specifying that IAs would be inheritable property, many IA proposals have not detailed how other life events, like disability and divorce, would be handled. So, although the estimated costs for customer service presented here do not take into account the full range of life events, having separate administrative rules for the various life events could increase costs substantially, depending on the detail of the rules.

The start-up cost to SSA of providing customer services would range from \$550 million to \$730 million under the basic and higher-service examples, respectively. Ongoing costs would range from \$440 million to \$1,250 million. The number of required additional full-time workers would range from an estimated 4,965 (basic) to 12,470 (higher-service).

**Basic IA Program.** The basic IA program would provide the type of customer services that OASI provides today, although it would need to handle additional inquiries, especially in a prolonged market downturn. Calls to the 800-number, visits to the field office, and correspondence could all increase dramatically. Additional services would include changing asset allocations, changing addresses or beneficiaries, updating account information after monthly valuation, and so forth.

SSA would not provide enhanced services to employers, and additional customer service for IAs would be limited. The investment firm would provide SSA with information on

investment returns on a monthly basis; SSA would use that information to update account balances. Account statements would be sent annually along with the Social Security statement. Changes in asset allocation could be made monthly.

**Higher-Service IA Program.** SSA would continue to provide the same type of service as today and would also provide services that are similar to those offered by major providers of financial services. By using the assigned PINs and passwords that would accompany their enrollment confirmation notices, IA participants would have 24-hour access to their account balances via an 800-number and the Internet.<sup>30</sup> Participants could change their asset allocation and transfer account balances at any time, and the changes would be processed daily.<sup>31</sup> Furthermore, participants would have daily valuation and quarterly account statements—services that major financial service providers typically offer their account holders.<sup>32</sup> SSA would give beneficiaries proof of their IA benefits on request when applying for loans.<sup>33</sup>

SSA would provide employers with enhanced service under the higher-service IA programs. Given that IA contributions and records would need to be reconciled to the penny and that employers would have additional and more frequent requirements, employers would probably place more demands on SSA's customer service systems. The estimates therefore assume that SSA would be given the resources with which to provide the additional service to employers.

Employers would also have 24-hour, toll-free telephone and Internet access to SSA. Through those vehicles, SSA would provide employers with interactive information about relevant requirements, regulations, penalties, and other rules that employers would probably ask about. For example, interactive Web interfaces would enable employers to type in their exact information and inquiries in order to instantly obtain the sections of the requirements that they are seeking, to find out whether their contributions and reports have been received, or to determine the status of an SSA inquiry into the employer's reporting and contribution errors.<sup>34</sup>

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<sup>30</sup> Details are abundant in virtually every subfunction and feature identified in this analysis. For example, although assigning PINs and passwords seems relatively simple, changes to passwords and the assignment of new passwords when originals are lost or forgotten would be complicating factors in maintaining a PIN and password database. Although such details seem relatively trivial, their costs in terms of work-years and additional administrative costs add up across all the subfunctions and features.

<sup>31</sup> A daily cutoff time for changing asset allocation and transferring account balances would need to be established, as is the case with financial entities today.

<sup>32</sup> While SSA would continue to send a Social Security statement to workers entitled to receive it (those aged 25 and older and not receiving benefits), everyone with an IA would receive the four quarterly IA reports.

<sup>33</sup> Under current law, at the end of each calendar year, SSA sends each beneficiary a 1099 that shows the amount of benefits that were paid during the year. Every year, SSA spends millions of dollars responding to requests from participants who are applying for a loan and need an updated benefit verification statement to do so.

<sup>34</sup> Unless an interface from an electronic employer payroll system was connected to the Internet, a higher error rate than today's paper W-2 process might result because typing online would be transcription from a manually maintained system by someone who is not a trained data-entry professional.

Finally, the cost estimates for the higher-service example assume that qualified domestic relations orders (QDROs) would be processed in the event of divorce.

**Considerations.** This analysis indicates that higher levels of customer service do not necessarily translate into a commensurate increase in costs. Under the basic example, costs for customer service are driven by live telephone calls (that is, no automated attendant) and manually processed changes such as changes in beneficiary, moves to another fund, and so forth. Under the higher-service example, costs are driven by longer live telephone calls and additional change actions (for example, changing addresses, PIN/passwords and processing QDROs) but are offset by the use of an automated attendant and Internet (through the use of the PIN/password technology) to make changes or request specific information (like an e-mail system).

## Compliance

Compliance refers to the activities needed to ensure that the collection, investment, and payment functions are completed on a timely and accurate basis. Compliance also acts as an enforcement mechanism and is an element in deterring fraud, abuse, or embezzlement.

If SSA was to administer IAs, the agency would need to establish penalties for employers and service providers who did not comply with their requirements. The analysis assumes that existing legal penalties for failing to submit taxes would apply to IA contributions. Although SSA identifies employers who fail to comply under the Social Security system, penalties are not included in the cost estimates because only the IRS currently has the authority to fine and penalize.<sup>35</sup>

The key factors that affect administrative cost are reconciliation of data and monies and determinations of who is at fault and who must make an account “whole” (see the discussion of establishing tolerance levels and making corrections and adjustments in the section on Collection, above). Under the hypothetical IA programs, SSA would reconcile not only employers’ contribution reports with their earnings reports but also records of monies sent, reported, and received by the investment provider.<sup>36</sup> For example, reconciling data ensures that individual wage reports match an employer’s total reported paid wages. In an IA system, reconciling data and monies would ensure that the monies sent for investment match participants’ asset allocation and correspond to the correct percentage of their reported Social Security payroll tax contributions.

Compliance costs would total an estimated \$30 million to \$120 million in additional funding on an ongoing basis and the equivalent of 350 to 1,525 additional full-time, permanent employees. Start-up costs for compliance have been incorporated in systems

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<sup>35</sup> The estimates assume that penalties would remain an IRS responsibility and that the additional cost of identifying noncomplying employers would be minimal. If SSA was given this responsibility/authority, costs might significantly increase.

<sup>36</sup> When the amount contributed is higher than the amount reported, SSA investigates to reconcile the discrepancy. When the amount contributed is less than would be indicated by the amount of earnings reported, the IRS investigates and reconciles.

development costs, because the mechanism for identifying errors would be built into the computer systems that administer the IA program.

**Basic IA Program.** Compliance activities would remain the same as today but would also include necessary for those ensuring compliance by investment providers and determining who is at fault for account errors. The cost estimates assume that cases in which differences between data and monies were not easily resolved would generate 100,000 earnings-related appeals.

**Higher-Service IA Program.** Because no tolerance would be applied, compliance costs would rise. Whereas SSA contacts about 500,000 employers a year today, it would contact about 1 million employers (15 percent) without any tolerance under the current system. The more frequent submission of contributions and reports under this program may also increase the number of times SSA must contact employers. Similarly, the greater frequency of transactions under the higher-service IA program than under the basic program would also increase the number of required compliance activities.

**Considerations.** Employers' frequent transactions under that program might facilitate identifying the source of errors if compliance activities were also practiced frequently. Presumably, errors are easier to identify and fix if they are caught soon after they are made. In addition, Internet accessibility for performing those transactions may decrease the incidence of errors. However, more frequent transactions increase the possibility for errors, especially when combined with the requirement to reconcile data and monies to the penny.

Errors are not always easily identified, and because more employers would be contacted for compliance purposes, the number of appeals would increase. In cases in which the party at fault was uncertain and penalties were applied, appeals would probably be forthcoming. In some cases at least, the cost of handling appeals could exceed the value of the amounts that are in dispute. Similarly, conflicts could arise between SSA, Treasury, and the investment provider when data and monies did not reconcile and the party at fault was uncertain. The determination of fault would presumably identify the agent responsible for compensating participants for any missed contributions or returns and for claiming any excesses credited to IAs.

Some errors take time to resolve and would therefore be remedied years after the mistakes were made. Placing a statute of limitations on the identification and reconciliation of errors could help speed up resolution, but that solution may create incentives to prolong appeals.

## **Payout**

Payout is a major administrative function that involves the timing and method by which benefits are paid to eligible persons. Major features of this function are the availability of different payout options, loans, and early withdrawals, as well as determining whether IA

participants would be able to apply for and receive IA benefits separately from regular Social Security benefits. The effects of earnings after annuitization, death before or after annuitization, and early withdrawals because of terminal illness are also included in this analysis.

The estimates of payout costs assume that the administration of the Survivors and Disability Insurance programs would remain untouched by IAs. That is, although divorced spouses might or might not have access to IAs, they would still be eligible to receive Social Security retirement benefits as they do today. Should a divorced spouse also have access to IAs, SSA would process qualified domestic relation orders upon divorce and would distribute IA assets to one or more beneficiaries upon the death of the account holder. If an account holder died without specifying a beneficiary, then SSA would work with state courts to decide where to distribute the account balance. In that case, administrative costs would be higher than those provided below.

Payout is the second major cost driver under the basic example and the third major cost driver under the higher-service example. Estimates of ongoing payout costs would range from approximately \$125 million (basic) to \$180 million (higher-service). Start-up costs (primarily systems development) are included under “Other Functions.” SSA would need between 1,550 and 2,340 full-time additional workers under the basic and higher-service programs, respectively.

**Basic IA Program.** The only payout option under the basic program would be an indexed life annuity provided by SSA. Individuals would have no preretirement access to account balances in the form of loans or early withdrawals, with the exception of withdrawals in case of terminal illness (tied to eligibility for disability benefits). Social Security beneficiaries would apply for IA distributions at the same time they apply for traditional Social Security benefits, with payouts from the IA combined with traditional benefits and issued in a single monthly check or automatic deposit.

Because the account would be annuitized, death after retirement would have no effect. If a worker died before retiring, IA monies would be payable to the beneficiary designated by the worker.<sup>37</sup> If a beneficiary was not named, IA monies could become part of the deceased worker’s estate, and the executor of the estate would need to apply for the IA payouts on behalf of the estate.<sup>38</sup> Individuals who continued to work after retiring could claim the IA contribution amount withheld from their wages as a refundable tax credit when filing income taxes.<sup>39</sup>

**Higher-Service IA Program.** IA participants would be given a range of payout options, including various types of annuities (life, indexed, joint and survivor, and so on), periodic withdrawals, lump-sum withdrawals, or a combination of distributions. Consistent with

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<sup>37</sup> Workers would designate beneficiaries on the enrollment form or through a subsequent update action.

<sup>38</sup> The property of account holders who died without legal heirs would escheat according to applicable state laws.

<sup>39</sup> The estimates do not include the administrative cost that the IRS would incur to process such requests for a refund.

IRA and 401(k) plans, distributions could be taken in conjunction with Social Security benefits or at an entirely different time—as early as age 59½. IA payouts and Social Security benefits could be paid by separate checks or electronic deposits.

The higher-service IA program would allow for early withdrawals under specific circumstances and would include a provision for loans. It would also include the same penalties for early withdrawals or failure to repay loans that apply to 401(k) and IRA plans. Estimates in this report include those for establishing the computer systems that would be needed to process loans but not ongoing payout costs raised by the loan feature. Ongoing loan costs not estimated include the cost of reviewing applications, ensuring that loan criteria are met (such as hardship or first home purchase), and enforcing loan repayment (which may be a cost attributed to compliance).<sup>40</sup>

**Considerations.** While the basic IA example would save on administrative costs by allowing IA payouts only in the form of an annuity rather than through a range of choices, compulsory annuitization raises issues that go beyond the scope of this paper.

The whole area of life events—marriage, divorce, remarriage, death before or after retirement, surviving children, and so forth—also needs to be considered from a policy perspective because those events can have a substantial impact on administrative costs. For example, administering a rollover to a surviving spouse could become very complicated and labor-intensive if the deceased worker also had an eligible surviving divorced spouse. That process would be more expensive than making a single payout to the beneficiary(ies) chosen by the deceased.

## **Public Information**

Under any IA program, the public will have questions such as “How do I enroll?” “When can I get my benefits?” and “What are my investment options?” The hypothetical IA programs described in this analysis would cover 155 million workers and affect 6.5 million employers. Clearly, SSA would need to develop and distribute materials to educate workers and employers about the IA program. For example, the U.S. Census Bureau spent \$167 million in its public education program for the 2000 census (Cohn 2000).

Estimated ongoing costs for public information would be \$5 million under both the basic and higher-service programs. Start-up cost estimates range from \$60 million (basic) to \$225 million (higher-service). SSA would need between 10 and 15 additional full-time workers for public information under the basic and higher-service programs, respectively. The number of additional workers is small because the bulk of public information costs

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<sup>40</sup> Adding payout costs for processing loans could significantly increase the cost estimates for the higher-service program. Per-participant administrative costs rose several dollars after the federal Thrift Savings Plan began to permit loan access under restricted conditions during the mid-1990s. However, the cost of loan payout would ultimately depend on the restrictions applied to loan access (if any) and the method developed to process loans (such as Internet applications versus paper applications). To date, SSA does not have a proxy available for reliably estimating loan costs.



would result from the publishing and distributing of information rather than from the personnel needed to keep publications up to date and oversee distribution.

**Basic IA Program.** SSA would create and distribute descriptions of the IA program's features and requirements. It would also provide generic information about investment fund choices and explain investment terms like "rate of return" and "compound interest." Finally, SSA would design and launch a public service campaign to raise awareness of IAs and their requirements.

**Higher-Service IA Program.** SSA would launch the same type of public information campaign, but it would be more extensive than under the basic program. For example, the higher-service IA program would provide more specific information about investment, tailored to participants of different ages and levels of aversion to investment risk. The public service campaign would also be more extensive and use more types of media—the Internet, radio, television, magazines, and so forth—than the basic example.

**Considerations.** Because of the higher level of efforts to provide public information under the higher-service program, compliance on the part of workers and employers would probably be greater than under the basic program. For example, workers would probably be more likely to enroll, designate beneficiaries, select investment funds, and so forth if an extensive public service campaign was launched than if a more basic one was conducted. Similarly, the greater the public education efforts, the more employers would be likely to send contributions on an accelerated schedule under the higher-service program. In addition to increasing compliance, that program's more extensive public service campaign might be more likely to increase public support of the new IA system than would a less extensive effort.

## **Other Functions**

Other administrative functions include training staff, maintaining software, and obtaining facilities. Based on the functions listed above, start-up costs combined range from \$220 million under the basic IA program to \$845 million under the higher-service program. Ongoing costs are estimated to range from \$21million (basic) to \$50 million (higher-service). Additional workers needed for the combined functions range from 340 (basic) to 530 (higher-service).

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## Glossary

**Annual wage reporting (AWR).** The process by which employers and self-employed persons contribute and report income and payroll taxes via the Internal Revenue Service (IRS) form Schedule SE. The IRS provides this information to the Social Security Administration (SSA).

**Annuity.** A product that can be purchased to guarantee payments (or a series of payments) at or over a specified period of time (such as the remainder of one's life or that of a spouse).

**Beneficiary.** In the context of individual accounts (IAs), a beneficiary is the person to whom IA benefits would be distributed in the event of the worker's death. The worker designates the beneficiary at the time of enrollment and may change it at a later date.

**Default fund.** The investment fund assigned to workers who fail, for whatever reason, to specify their IA investment choice(s) during enrollment or whose name or Social Security number (SSN) fails to match SSA records.

**Form 941.** The quarterly report of aggregate income and payroll withholding and contributions that employers send to the Internal Revenue Service.

**Investment horizon.** The period of time between the present and the time at which one will withdraw account balances. Generally, investment advisors recommend less risky investments for shorter investment horizons and more risky (and likely higher-returning in the long-run) investments for longer investment horizons.

**Lump-sum distribution.** In this analysis, a lump-sum distribution is a one-time disbursement of an entire account balance.

**Programmed withdrawal.** A withdrawal that would leave the account invested and pay out to the participant a series of periodic payments until the account is depleted.

**QDROs.** Qualified domestic relations orders are state court orders to distribute account funds to an individual other than the account holder in the case of divorce.

**Social Security statement** (formerly known as personalized earnings and benefit estimate statement). Beginning in 1999, workers age 25 and older who are not currently receiving a Social Security benefit will receive a Social Security statement 3 months before their birthday. The statement lists their annual covered earnings over their work history and estimates the value of Social Security disability, survivors, and retirement benefits.

**Tolerance.** The amount by which W-2/W-3 and 941 information can differ without necessitating corrections by employers. The tolerance level is one wage credit, or \$780,

in 2000. The tolerance is also applied when the sum of all earnings reported on an employer's W-2s differs from the total earnings the employer reported on the W-3.

**Valuation.** Adjusting account balances to reflect actual market activity (such as a rise or fall in the market value of any equity shares or bonds held in an individual account).

**Verification.** The systematic process of verifying a reported name and Social Security number with SSA's master file of names and SSNs.

**W-2 Form.** The annual report that employers send to SSA that shows a person's earnings, income and payroll tax withholdings, and other information. The employer submits a W-2 for each person who worked for the employer during the year.

**W-3 Form.** The annual report that summarizes totals from individual W-2 reports and accompanies the employer's transmittal of W-2 reports to SSA.