

Pricing Personal Account Benefit Guarantees: A Simplified Approach

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Policy Abstract

A number of proposals to introduce personal accounts to the Social Security program contain provisions that would guarantee account-holders against relatively poor investment performance that would make their total benefits fall below the level scheduled under current law. Presently, most policy focus is placed on the expected cost of such guarantees, as few estimates are published evaluating the potential market cost of insuring against the associated risk. Depending on the specific characteristics of the guarantee, “market” costs are likely to be substantially higher than “expected” costs. This paper demonstrates how a simple modification of parameter inputs used to calculate the expected cost of guarantees would allow analysts to estimate the market cost of the underlying risk. Based on an illustrative policy considered in the study – a proposal put forward by Senator John Sununu (R-NH) and Representative Paul Ryan (R-WI) – the “expected cost” valuation of the proposed guarantee is calculated to be 11.3 percent of total benefits to new retirees in 2050, while the “market value” cost is calculated to be 28.2 percent of benefits.