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Author's Response to Comments by Charlene Moriarty

by Donald E. Fuerst

I would like to thank Charlene Moriarty for her kind comments and for the intriguing comparison to the Canadian pension system.

Moriarty correctly classifies the model as essentially defined-contribution. My thinking has evolved gradually to believe the generally level accrual pattern of defined-contribution plans provides equity and portability that the defined-benefit system lacks. Cash balance plans have provided a laudable step in this direction, but still suffer with several of the issues that corporate America has with defined-benefit plans, particularly the affect on the balance sheet and earnings statement.

Moriarty also correctly notes that the model differs greatly from current DC plans by relieving the sponsor of most fiduciary requirements, requiring mandatory contributions, and mandatory investment in inflation-indexed securities. Could such changes actually be implemented? She observes "if the political will were there, these challenges would not be insurmountable." Frankly, I am less optimistic and doubt that such widespread mandates could ever be implemented in the United States.

Despite this pessimism, there is much that can be learned from the model. The traditional fixed annuities that sometimes seem the only way to provide longevity protection for DC plan participants are expensive and provide long-term investment guarantees that I doubt are beneficial to most retirees. Low-cost immediate variable annuities are available in today's market and can be backed by a wide variety of mutual funds, including conservative fixed investment funds. These contracts provide longevity protection without investment guarantees, thus reducing the need for larger margins to protect the provider against adverse investments.

The substantial cost advantage of widespread longevity pooling is lost in a purely voluntary system. The broad mandates of the model are unlikely to be attained, but smaller versions are possible. Moriarty discusses some variations of this in the Canadian system. In the United States, the best opportunity might be encouraging plan sponsors to make a portion of the employer provided contribution account available only as a fixed or variable annuity. This would enable group contracts to reduce adverse selection risk and improve the pricing and attractiveness of the annuities.