

About the plan being evaluated:

- This is modeled on a 401(k) style defined contribution plan. We are assuming that the employee may contribute up to legal maximums, with the employer contribution being paid as a match of 50% up to the first 6% of employee contributions (maximum employer contribution of 3%). No other employer contributions are made. The individual makes all investment decisions and typically has options for stocks (including employer stock), bonds and money market funds, including target date or lifecycle funds. The plan has auto-enrollment (3% of pay, no future contribution increase) and enrolls participants in a target date fund. The individual has discretion at retirement as to how funds are disbursed; the individual can annuitize only through individual annuity purchase (annuity not available through the plan). There are no requirements for spousal consent on account distribution. Note that we are not considering the particular advantages or disadvantages of stock option plans, ESOPs or other more specific defined contribution designs.
- We are not considering the voluntary nature of the system which means, primarily, that not all individuals have access to coverage. We have considered the ability of the employer to set and adjust contribution levels (including setting the employer contribution as a match) in setting ratings.

About the ratings

- The overall ratings were done assuming a “perfect world” where actors understood and took advantage of the best features of plans. They do not consider moral hazard on behalf of stakeholders & agents.
- A second set of ratings were developed considering the effects of moral hazard. Moral hazard is defined in this application as when stakeholders (particularly individuals) can be led to not act in their own best interests based on a lack of understanding of features & consequences or, when agents take actions that don’t align with interests of stakeholders, particularly individuals or shareholders/owners. While regulatory risk is its own category, we’ve considered regulatory risk as another moral hazard (elected officials, including the judiciary, may be guilty of overzealous regulation, affecting the action of individuals, employers and the markets).

Traditional DC Plan

About the Framework

About the categories

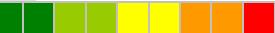
- Each of the stakeholder categories has a different number of subcategories, from 6 to 11 subcategories.
- The example below shows you how to read the summary of the individual category, with both the composite and sub-category ratings.

	<p>The average rating of yellow is a composite of the eleven individual subcategories.</p>	<p>The ratings for the eleven subcategories are shown in the color line. They are color grouped so you can see how many of each rating were received.</p>	<p>Ratings for each subcategory were adjusted for the effects of moral hazard. This shows the new composite rating after moral hazard as well as the new color line.</p>
Individuals (composite rating)	<p>Meets individuals' needs and risks.</p> <p>Yellow</p> <p>Individual criteria ratings:</p>  <p>Puts risks to individuals, although plans could offer mechanisms for individuals to hedge their risks better.</p>	<p>Red-Yellow</p> <p>Individual criteria ratings after moral hazard:</p>  <p>Individuals not sophisticated enough to use sophisticated hedging instruments, even if made available. Individuals also susceptible to products that claim to provide risk protection but do not.</p>	

Traditional DC Plan Summary

Summary			
Criteria	Description	Evaluation	Effect of moral hazard
Society (composite rating)	Meets society's needs and risks.	<p>Yellow</p> <p>Individual criteria ratings :</p>  <p>Allocates costs directly, doesn't push costs of pensions to future generations. However, economically cyclical and creates winners and losers (generally aligned with economic status).</p>	<p>Red-Yellow</p> <p>Individual criteria ratings after moral hazard:</p>  <p>Put society at risk if individuals plan poorly or are caught by economic downturns; can it survive a large-scale economic downturn?</p>
Individuals (composite rating)	Meets individuals' needs and risks.	<p>Yellow</p> <p>Individual criteria ratings:</p>  <p>Puts risks to individuals, although plans could offer mechanisms for individuals to hedge their risks better.</p>	<p>Red-Yellow</p> <p>Individual criteria ratings after moral hazard:</p>  <p>Individuals not sophisticated enough to use sophisticated hedging instruments, even if made available. Individuals also susceptible to products that claim to provide risk protection but do not.</p>

Traditional DC Plan Summary

Summary			
Criteria	Description	Evaluation	Effect of moral hazard
Employers (composite rating)	Meets employers' needs and risks.	<p>Yellow</p> <p>Individual criteria ratings:</p>  <p>Shareholders don't hold investment or longevity risk, but do hold fiduciary and legal risk. Plan adapts well to new norms for work and retirement</p>	<p>Yellow</p> <p>Individual criteria ratings after moral hazard:</p>  <p>Simplicity of the plan means that regulatory hazards are less than with other types of design.</p>
Markets (composite rating)	Meets markets' needs and risks.	<p>Red-Yellow</p> <p>Individual criteria ratings:</p>  <p>Costs are transparent to shareholders but lack of fee disclosure to individuals. Transfers risk to individuals.</p>	<p>Red-Yellow</p> <p>Individual criteria ratings after moral hazard:</p>  <p>No incentive for sponsors or investment firms to make fees transparent to individuals.</p>

Traditional DC Plan
Society

Society's Needs & Risks (Composite rating: Yellow ■)			
Criteria	Objective	Evaluation	Effect of moral hazard
Adequate	Protects vulnerable citizens.	Red-Yellow Low-paid individuals may have difficulty earning the match. Match signals participants that the contribution to earn the maximum match plus the match contribution create adequate retirement savings. Participants vulnerable to poor investment choices, swings in markets. No risk pooling. Individual accounts have higher administrative fees than pooled accounts.	Red Regulators may be susceptible to lobbying by investment firms to make investment choices available that aren't always in individuals' best interest. Program adequacy dependent on employer paternalism.
Affordable	Does not take resources from other social needs. Ensures risk pooling done efficiently.	Red-Yellow Individuals' lack of skill in retirement planning and investing will lead many individuals to do poorly, drawing on social resources. No risk pooling.	Red-Yellow Moral hazard not significant.
Sustainable	Sustainable across and within generations. Equitable across and within generations.	Yellow Creates high risk of failure, particularly for low paid and cohorts retiring during economic downturns. Low levels of contribution may create false sense of sustainability.	Red-Yellow Intergenerational risk transfer occurs if future generations must provide additional social benefits for inadequate savings by previous generation.

Traditional DC Plan
Society

Society's Needs & Risks (Composite rating: Yellow )			
Criteria	Objective	Evaluation	Effect of moral hazard
Robust	Fair, covers great majority, creates shared economic growth, avoids moral hazards	Yellow A design that focuses on matching favors wealthier individuals who are more easily able to save. Very hard to create shared growth for low paid.	Red-Yellow Plans require participants join and set robust contribution levels, often higher than what is signaled by employer. Target investment funds may offer more risk than some participants can take.
Does not promote economic risk	Efficiently allocates resources and encourages labor force participation.	Red-Yellow While it does not encourage early retirement and promotes longer work-force participation, it is structurally anti-cyclical (during economic booms, when workers are needed, more will retire, while during economic slowdowns, few will be able to retire). Plan design encourages employees to terminate to access funds.	Red-Yellow Moral hazard not significant.
Does not promote political risk	Promotes fiscal/political integrity and political stability.	Yellow-Green Relatively little political risk, except possibly for influence of investment managers in favor of high risk/high fee products	Red-Yellow Politicians may see reducing the tax shelter as potential revenue decreasing ability of individuals to save. Generations of individuals retiring with small account balances during economic downturn could create political pressure for more social benefits.

Traditional DC Plan
Society

Society's Needs & Risks (Composite rating: Yellow ■)

Criteria	Objective	Evaluation	Effect of moral hazard
Does not lead to system failure	Withstands shocks, not prone to instability or moral hazard.	Yellow	Red-Yellow Shocks hit poorer individuals most acutely (lower level of savings, less ability to save in good times). Prolonged economic downturn could put pressure on system for other solutions if generations cannot retire as needed.
Addresses imperfections of other stakeholders	Promotes strong individual decision making and covers lack of market instruments.	Red-Yellow	Red Auto enrollment and target date funds assume one plan fits all. Does not account for ability of individuals to take or not take risk. Target date funds do not hedge risks, particularly longevity risk.
Promote social solidarity/integrity	Ensures basic standards of living; ensures risks are shared.	Red-Yellow	Red As DC plans arose as an "add-on" contribution, levels started low and haven't increased.

Traditional DC Plan
Society

Society's Needs & Risks (Composite rating: Yellow )			
Criteria	Objective	Evaluation	Effect of moral hazard
Adjusts to changing demographic and economic conditions	As demographic and economic conditions shift, plan can respond to meet societal needs.	Red-Yellow While plan automatically adjusts to changing life spans, individuals may not understand they need to work longer to save more/shorten their retirement period. Anti-cyclical economically – individuals will likely continue work in a down economy when it may be better to pare down the number of workers.	Red Individuals may not understand the need to adjust retirement plans for changing lifespans (leading to inadequate retirement income) or realize may be less likely to be able to retire in down market.

Traditional DC Plan
Individuals

Individual's Needs & Risks (Composite rating: Yellow )			
Criteria	Objective	Evaluation	Effect of moral hazard
Guaranteed income	Provides substantial level of income protection.	Red-Yellow Typical contribution (6% employee with 3% employer match) does not provide adequate income for most individuals. Cumbersome and expensive for individuals to convert account balances to guaranteed income; conversion can also have negative tax consequences	Red Individuals may be sold products that provide unneeded features, or that do not provide true longevity guarantee. Cost of conversion at an individual rather than group rate harmful for less wealthy individuals with small account balances.
Predictability of income	Facilitates retirement planning.	Red-Yellow Works better for wealthier rather than less wealthy individuals (who can afford professional advice). Difficult to manage and understand value of account balance, particularly small balances.	Red-Yellow Moral hazard not significant.
Retirement flexibility	Allows choice of retirement age, including possibility to phase into retirement.	Green Unrestricted ability to choose retirement age.	Yellow-Green No protection for individuals who find they might have to retire early due to disability or other impairment.
Portability	Minimizes loss upon employment termination.	Green Perfect portability	Yellow Leakage is common, as participants take small account balances in cash on termination.

Traditional DC Plan
Individuals

Individual's Needs & Risks (Composite rating: Yellow 			
Criteria	Objective	Evaluation	Effect of moral hazard
Sensitive to employment conditions	Benefits may vary in line with employment conditions.	Yellow	Red-Yellow As noted earlier cannot ease out individuals during time of economic downturn.
Sensitive to family needs	Benefits may vary in line with spousal and children needs.	Yellow	Yellow Moral hazard not significant.
Requirement for individual skills	Level of knowledge required to plan for retirement.	Red-Yellow	Red Individuals could be susceptible to poor advice and poor decisions made could lead to society having to make up difference.
Investment risk	Protects against fluctuations in market returns.	Yellow	Red Individual always bears full brunt of investment risk. Hedging products aren't always available, and when they are individuals don't know how to use them. Professional advisors may encourage investments which maximize advisor income, which are often complicated and risky.



Traditional DC Plan
Individuals

Individual's Needs & Risks (Composite rating: Yellow )			
Criteria	Objective	Evaluation	Effect of moral hazard
Longevity risk	Protects against possibility to outlive assets.	Red	Red Individuals may not understand need for longevity protection, and may be confused by strategies that only appear to offer protection.
Inflation risk	Includes both pre and post retirement inflation.	Red-Yellow	Red No incentives for plan sponsors to provide inflation linked strategies; investment firms will tend to favor equity over inflation protection.
Premature retirement risk	Protects against forced early retirement due to disability, family circumstances, and involuntary termination.	Red	Red Over-saving is an inefficient way to prepare for retiring early than expected and a strategy not realistically used by poorer individuals. Could affect ability to educate children.

Traditional DC Plan
Employers

Employer Needs & Risks (Composite Rating: Yellow )			
Criteria	Objective	Evaluation	Effect of moral hazard
Supports primary business purpose	Enhances core purpose of the employer's business.	Yellow-Green Allows employer to focus on core business, although still requires employer sponsorship with some HR and administrative costs.	Yellow-Green Moral hazard not significant
Workforce management: attraction & retention	Enhances business value by allowing attraction and retention of the "right employees".	Yellow Existence of a plan more important than actual design. Better at attracting younger rather than older employees. Does not generally enhance retention.	Yellow Moral hazard not significant
Workforce management: transition of employees	Enhances business value by facilitating the orderly transition of employees.	Red-Yellow Little incentives for employees to stay or retire on a voluntary basis. Cannot encourage or discourage behavior.	Red-Yellow Moral hazard not significant
Supports new norms for work and retirement	As needed, supports shifting norms for work and retirement, e.g. phased retirement, return to work, etc.	Yellow-Green Easily supports new norms for work and retirement. Does not easily support different retirement ages for classes of workers with different retirement needs	Yellow-Green Moral hazard not significant

Traditional DC Plan
Employers

Employer Needs & Risks (Composite Rating: Yellow )

Criteria	Objective	Evaluation	Effect of moral hazard
Responsive to owners	Responds to needs of owners, e.g., shareholders for public companies, which may limit amount of risk to be taken.	Green Known financial commitment. No long-term commitment.	Green Moral hazard not significant.
Business risk	Ability to react quickly to changes in the competitive landscape.	Green Can change contribution level instantaneously, with no long phase-out period.	Green Very little risk that regulations could change business' ability to change future benefits quickly.
Regulatory risk	Allows plan to be operated to fit needs and change to meet conditions easily within regulatory framework.	Yellow-Green Flexible in terms of changes to future design. Because contributions are tax deferred, it does attract regulatory oversight.	Yellow Regulatory framework may be too loose – employers often offer many investment options and more employee choice believing this will mitigate litigation risk. Could see regulators pushing more risk back to employers (e.g. poor investment outcomes).
Fiduciary risk	Allows plan to be easily operated to minimize fiduciary liability.	Red Fiduciary responsibility is complicated and often not well understood. Concerns about liability may lead all employers to act in similar manner, which may be detrimental to both employees and shareholders.	Red Moral hazard not significant.

Traditional DC Plan
Employers

Employer Needs & Risks (Composite Rating: Yellow )

Criteria	Objective	Evaluation	Effect of moral hazard
Litigation risk	Allows management of plan to avoid lawsuits.	Red-Yellow Lawsuits can lead to reputation risk. Individuals who make poor outcomes may look to employer for restitution; cannot cure this systematically through the plan.	Red-Yellow Moral hazard not significant.

Traditional DC Plan Markets

Markets Needs & Risks (Composite Rating: Red-Yellow ■) (includes both financial markets and intermediaries (e.g. insurers)			
Criteria	Objective	Evaluation	Effect of moral hazard
Maximizes use of markets	Effectively uses markets and hedging mechanisms; stakeholders can purchase hedging instruments cost effectively.	Yellow Could be designed to make better use of market mechanisms. Lifecycle accounts are a weak attempt; they don't hedge.	Red-Yellow Little incentive for plan sponsors to maximize use of markets, and little incentive for fund providers to design better market hedges.
Transparent (cost)	Costs of plan are transparent (fees, costs to sponsors, other stakeholders, etc).	Red-Yellow Plans do not disclose fees, so individuals do not know which investments are more costly.	Red Lack of disclosure of fees means plan participants pay high fees relative to other consumers; no incentive for employer or investment industry to change.
Strong Governance	Fiduciary roles of plan sponsors well defined. Plan structure minimizes agency issues, particularly regarding plan investment and risk taking.	Yellow Unclear what fiduciary standards around investments ought to be. Plans may work better when employers make decisions on behalf of employees.	Red-Yellow Lack of clarity around governance standards leads to "follow the leader" where the industry norm becomes best practice.

Traditional DC Plan Markets

Markets Needs & Risks (Composite Rating: Red-Yellow) (includes both financial markets and intermediaries (e.g. insurers)

Criteria	Objective	Evaluation	Effect of moral hazard
Efficiently priced	Market price is well understood and accepted by stakeholders. Plan does not contain features which cannot be efficiently priced. Plans incorporate discipline in pricing.	Yellow Pricing is transparent to plan sponsor; individuals may not understand market risks or fees associated with investment choices.	Red-Yellow Lack of incentive for sponsors to make hard choices about investment options and fees. Little incentive today for employers to disclose fees.
Efficient risk bearing	Plan efficiently pools idiosyncratic risks and hedges systematic risks (both economic and demographic).	Red-Yellow Benefits of mutual funds can lower costs of investing (although they tend to have high fees). Plans do not pool idiosyncratic risk, including longevity risk.	Red-Yellow Moral hazard not significant.
Allocation of risk	Plan efficiently allocates risk across stakeholders, giving each stakeholder the risk he can best bear.	Red Investment risks could be hedged although these investment options typically aren't offered or used. . Demographic risks could be hedged in theory but market instruments aren't available because managers haven't shown interest.	Red Moral hazard not significant.