Session 3B Discussant Comments

Robert Brown

Presented at the Living to 100 Symposium

Orlando, Fla.

January 8–10, 2014

SOCIETY OF ACTUARIES
LT100
Session 3B – Societal Changes and Adaptations
as a Result of Longer Life Spans

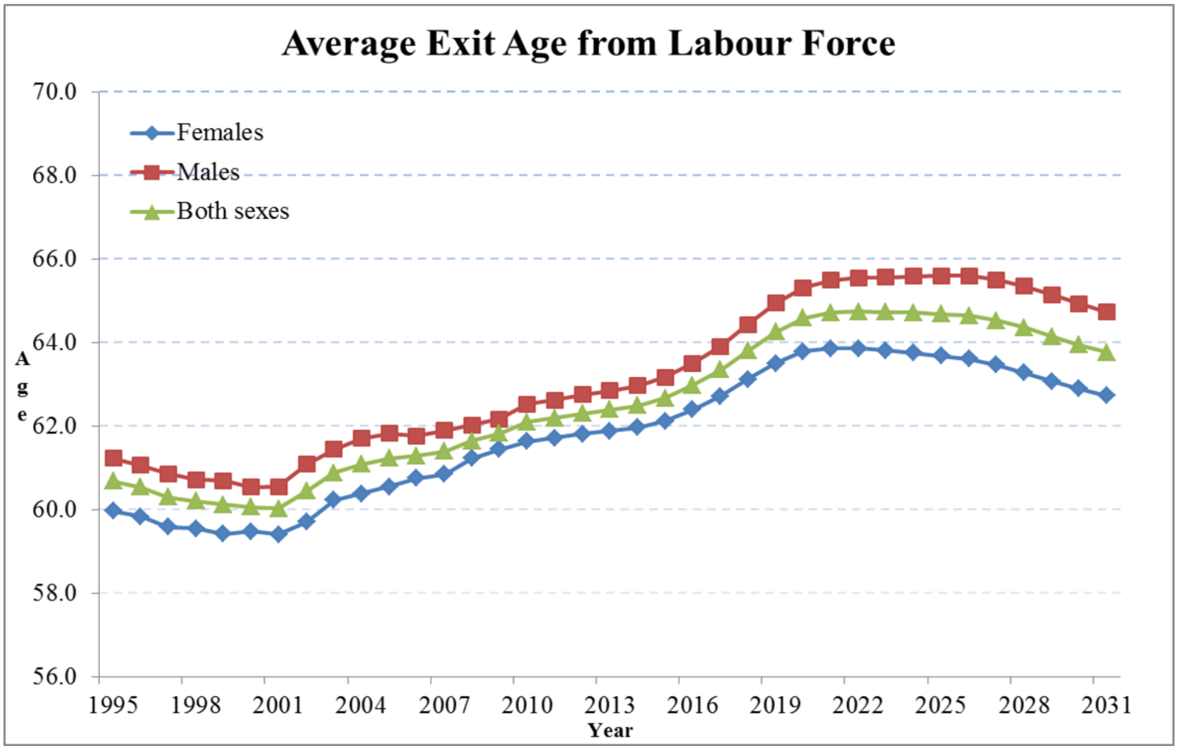
Discussant Comments

ROBERT BROWN: I had a little "a ha" moment coming to this session. I think one of the strongest constituents of improvement in life expectancy and, in fact, predicting life expectancy, is the element of financial security. Financial security drives longevity, and I think as an actuarial profession, we need to shine a light on that more often because you go to conferences like this, and you get talking about longevity, and there's a long list of subtopics, but what you don't very often see highlighted is a person's financial security as a predictor of longevity.

Now, to the extent that the actuarial profession is responsible for the provision of financial security, I think we should take just a nano-second and pat ourselves on the back. We are doing as much for longevity as the other professionals that we're mixing with here at this conference. Let's take some credit for that.

I will present my discussion in the order of the presentations. What I'm going to do with Anna Rappaport's report "How Well Have Retirement Systems Adapted to Longer Life?" is show you the parallel information for Canada. Anna has said the retirement age had fallen significantly in the United States, but is now rising slowly, and I can show you the same thing is happening in Canada. Around 2001, the declining retirement age bottomed out and is now starting to slowly climb back up, as shown in this graph provided to me by the Canada Pension Plan (CPP) actuary.

Figure 1. Projected average exit age from the labor force based on the assumptions of the 25th CPP report



Source: Office of the Chief Actuary, Canada

They are projecting even further rises in retirement age. This is because there is a real sense in Canada right now that we are going to face labor shortages as the baby boom retires. There is going to be pressure for people to work a little bit longer.

Anna also pointed out that for Old Age, Survivor and Disability Insurance (OASDI), or Social Security, the normal retirement age was raised from 65 to 67. The same thing is happening for one part of the Canadian social security system, the democrat payment, or Old Age Security, which includes the Guaranteed Income Supplement. This will start in 2023. I have to tell you there was no sustainability reason that forced this to happen. The system was healthy, is healthy and is sustainable. Further, by delaying the implementation to 2023, it has no impact on the vast majority of the baby boom, which is the group you should really be worrying about in terms of not paying out benefits unnecessarily.

Finally, when this happened, there was an immediate response from the social scientists noting that this amendment is regressive. Poor people die sooner, rich people live longer. You’re exacerbating the regressive transfer of money from the poor to the rich by raising the age of eligibility.

Anna has said that moving from defined benefit (DB) to defined contribution (DC) shifts the longevity risks to the worker. Clearly that is true, and she further states we could have kept DB plans if we had put in an automatic shift in the retirement age, that is to index it to life expectancy. By not raising the normal retirement age, benefit values rise with life expectancy, and even in some amended plans, with a rising normal retirement age, you still have more years in retirement. Here is some Canadian data to support what Anna had for the United States.

Table 1. Changes in the active-life-to-retirement ratio for Quebec

Year	Active life (years)	Retirement (years)	Ratio
Males			
1980	42.8	16.7	2.6
1990	41.7	19.4	2.2
2005	41.9	21.7	1.9
Females			
1980	42.5	21.9	1.9
1990	41.2	24.3	1.7
2005	40.7	26.0	1.6

Source: Actuarial report of the Quebec Pension Plan as of Dec. 31, 2006

Even if we leave the labor force somewhat later, we still spend a higher proportion of our lives retired than ever before.

I agree that DB plans are better than DC. My own preference is target benefit pension plans, as opposed to an automatic index to life expectancy just to have more flexibility, and also because indexing benefits to life expectancy is regressive.

Anna mentions that the OASDI earnings test has been liberalized. The same thing has happened in Canada. In the Canada Pension Plan, as recently amended, you can work and collect CPP benefits at the same time, but you then contribute to the Canada Pension Plan on those earnings. This is mandatory at ages 60 to 64, voluntary at ages 65 and beyond. It used to be that the day you qualified to collect CPP, you never contributed again, even if you went back to work. Now, you will contribute and you will reap enhanced benefits that are actuarially equivalent.

Returning to the idea of a DB plan with an automatic balancing mechanism for life expectancy, there are a couple of caveats here. We need to be sure there are jobs for older workers, and they need to be appropriate. They can't be physically demanding, but also we should offer differing employment opportunities "post-retirement." Just because you are now the manager of 25 employees, it shouldn't be that the only job you can have is to continue to be a manager of 25 employees. Workers will want a lot more flexibility, and they don't mind if you give them less responsibility. At least that's my reading of the literature.

One of the reasons we are facing many of these problems today is the financial crisis of 2008-09 and the response to the financial crisis, that is, monetary easing. One of the unintended consequences—at least, I imagine it was unintended—is that savings reap virtually no net return now. What's the phrase, you can have a risk-free rate of return or you can have a return-free rate? We're not getting any return on our savings dollars. So this is really tough on savings, it's really tough on pensions and it's really tough on the price of annuities. I can't imagine that the government did this with full intention and full understanding of the implications on savings, pensions and annuities. In my opinion, a little bit of inflation might be OK just about now.

Moving to Doug Andrews and his paper: "Mapping the Adequacy of Care and Support for the Elderly in Developed Countries." Doug talked a lot about long-term care risk. He says one possible mitigating factor is to introduce a demogrant benefit, as we have in Canada in our Old Age Security. (And our third speaker, Jonathan Forman likes this idea as well) to pay for long-term care. It could be clawed back from the wealthy, but then you have to ask yourself the question: Are you going to claw it back based on income or are you going to claw it back based on income and assets? Depending on the claw back, you'll get a societal response that will try to game the system. Whatever you do, somebody is going to try to do an end run around the rules.

One of the things I've always thought about OASDI is that it has a split personality or perhaps a multiple personality complex. It is trying to do many things with one formula, and this is especially true given how tiny the Supplemental Security Income (SSI) is. OASDI is trying to do all these things: give a minimum benefit and also be a replacement of earnings benefit. If you had a separate demogrant benefit, it would really allow OASDI to be clearly one animal or the other, but not this split or multiple personality. Perhaps Doug would think about Canada expanding its demogrant payment, Old Age Security, when, in fact, it is now being reduced by raising the age of eligibility.

We should have long-term care insurance. This is pretty important stuff, and it is not something that many people think or talk about. Certainly the average Canadian doesn't think about or talk about or act on buying long-term care insurance. So given that privately we are not taking care of this, should we do it collectively through some social system? Doug says we could do it through Social Security. Germany would probably do it through a mandated insurance program. That would work. It would be fine, but there should be a sense, ultimately, that there would be universal coverage. I think this is particularly important given the demographics because the probability of families providing chronic care for parents is going down. It is no longer like living on the farm and having grandma and grandpa in the granny flat. It's just not the way things are done any more.

Another recommendation of Doug's is to raise the last survivor pension to a 70 percent benefit. It is now 55 percent in Germany and Sweden and 60 percent in Canada. When you do research into the cost of living in retirement, and you go from a one-person to a two-person family unit, it is universally accepted that the cost factor to use is 1.4. If you do the inverse, that would lead you to a survivor benefit of 71.4 percent. So, I think 70 percent is supported by the research.

Now, I'm moving to Jonathan Forman's paper: "Supporting the oldest old: The role of Social Insurance, Pensions and Financial Products." Let's keep in mind he was talking about people age 90+ and what can we do to help them.

We could have a guaranteed minimum income either through negative income tax or other provisions, such as expanding SSI, by expanding Social Security or by making it easier to get Social Security. One of the responses we are going to have to be prepared for, however, is that we are talking about people, 90+, who demographically have the highest incomes and the best education, of all the elderly. So how do we make this argument to help those who are capable of helping themselves?

One counterargument is to recognize how many more "average" Americans are going to make it to age 90. It will not just be those who are highly educated and have high incomes.

Another recommendation is to encourage workers to save more and invest better, by having better default options in the work place and making saving mandatory like the defined contribution social security systems in Australia or Chile. At the very least make enrollment automatic. If you are going to do that (and Jonathan mentions this), you are going to run into high management expense ratios (MERs), and they are killers. They are just outrageous. Here is the impact depending on the management expense that you face. If you had no management expenses and you had saved $10,000 a year for a 40-year career, where your average income was $50,000, your replacement ratio on retirement would be a 90 percent replacement ratio, but if your management expenses are 3 percent (300 basis points), that replacement ratio is cut in half to only 46 percent. This is the same worker saving the same $10,000. This is a huge impact. Plus, I don't know how you justify MERs of 300 basis points, but those are being charged in Canada today.

If we look at a collective approach to providing retirement income security, you will find that large funds can operate with much smaller expense ratios. We should be bringing in rules and regulations to say that the maximum MER cannot be more than 40 basis points. Big plans can and do satisfy that criterion.

Another of Jonathan's recommendations encourages workers to work longer. This has a double impact: First, it removes a retiree from the dependent numerator and then it puts them into the productive denominator. It really has a double effect. It is a very, very powerful tool. You could encourage this by raising the OASDI normal retirement age and the earliest age of eligibility. (Again, you'll get some feedback that this is regressive.)

Another thing you should do if you're going to get people to take their OASDI later, is to let them know the plan is not going to go bankrupt in 2031. In other words, you've got to solve this sustainability problem.

You should also encourage workers to annuitize: Make an annuity option mandatory for employers, make annuities the default option, give annuities tax preference, promote inflation-adjusted annuities. This is difficult to achieve. Jonathan showed you the figures. They appear to be expensive to the potential annuitant.

Is this a private sector failure?

We can remove or insure the longevity risk, perhaps through government longevity bonds or through deeply deferred annuities. Jonathan points out that if you buy a deferred annuity which kicks in at age 85, it will only take 16 percent of your capital accumulation, and then you know you only have to manage your funds until age 85. That's defined and known and you can take care of it. This is really important in a DC world.

Such deeply deferred annuities should be widely available. They are not. If the private sector doesn’t meet the needs of society, society will complain and maybe it will end up being done by the government. A commission in Quebec has already recommended that there be a supplement to the Quebec Pension Plan which kicks in on a deferred basis. There are many potential benefit models here.

I thank all three speakers for their marvelous input, and I look forward to an active period now of Q&A. Thanks. (Applause)