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SELF ADJUSTING PENSION DESIGNS

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I like guaranteed traditional pensions. Someone once said people with DB plans are the luckiest people in the world. My parents were two of those people. However, as we watched the single employer ERISA DB world decline, the SOA's *Retirement 20/20* project looked for more sustainable options than traditional DB or DC plans. *Retirement 20/20* defined the needs/risks/roles for the four key stakeholders and expanded on the concept of self adjusting systems. If you want to read one paper on self adjusting plans from the project I would recommend the Don Fuerst paper in the 2012 *Pension Forum* (you could also read my 2004 SOA article on a Group Variable Annuity Pension design, but start with Don's). Yet at the end of the last *Retirement 20/20* meeting a few years ago I was a bit depressed as it seemed that nothing could be done politically until the system burned down some more. We may now be at the edge of seeing more self adjusting systems being created. However, there are barriers:

1. I was hoping to see these plans emerge in the ERISA single employer space where they may be needed most. I don't see this group as being a leader and the sponsors enjoy the more employer-friendly DC plan options.

2. In the ERISA multiemployer space we see some recent movement in this direction, but most plans are largely focused on the issue of legacy cost and need the support of future contributions.

3. In the public sector space, I see even less movement than in the private sector in part due to competitive pressures, special needs for public safety employees and the better ability to take risks compared to the private sector (there are always limits).

4. Congress/IRS may have to provide rules.

5. Employee expectations of what benefits cost (or are worth) do not align well with true cost in a low interest rate world.

However, at some point we will see more of these designs being implemented. Mercer's 2008 Retirement Shares design (December 2008 *Pension Forum*), Senator Harkin's USA Retirement Funds proposal and the 2013 NCCMP variable annuity proposal give me hope. Possibly the NCPERS Secure Choice Pension (2011) for those without a traditional plan may also be in this category. We may need to have a period of time with a large variety of designs, some being more risky than others.

At one extreme, you can create a group variable annuity design that fully adjusts benefits annually and never has unfunded liabilities. As you try to protect retirees or assume a minimum guaranteed interest rate you need to look around for someone who will provide the guarantee. Maybe the

employer will provide the guarantee since the risk is likely much less than under a traditional plan. Maybe there is a market based solution that one day more people can accept. Under the *20/20* concepts, the employer might not be the plan sponsor. Maybe the participants will end up being the sole guarantors but if they are, when might the plan become a Ponzi scheme?

So my questions are:

1. How do we control these designs and set limits on the guarantees under different circumstances and should we as a profession even try?

2. How do we set standards on actuarial disclosures to be sure all of the stakeholders understand the risk?

Answering these questions is not the responsibility of a single person as we all have a voice in this debate. As with creating specific designs, the devil is in the details and the more specific you are the easier it is to criticize the details. Here are a few broad answers I would suggest.

1. Any plan that does not have a guarantor other than the participants should have no guarantees. What we have is what one actuary referred to as an uncapitalized mutual insurance company. A traditional variable annuity design could work if the plan were large enough. (The direct impact of liability valuations on benefits implies a need for better quality data than is often currently provided for pension valuations.)

2. Promises by the employer to cover guarantees go a long way to justifying guarantees. Even something as simple as a 5 percent minimum interest rate (common in more than one self adjusting design proposal) requires some support. The NCPERS proposal falls into this category.

3. A union fund with the ability to call on a portion of future contribution to support unfunded liabilities (that emerge in the future) could support some minimum contributions. However, communicating the type of support the plan might need (when the ratio of assets/contributions is projected to be mature) should be disclosed at the outset.

4. Plan design and investments may be more linked than with traditional plans. Some designs may let employees select their risk level.

5. Good governance is a must.

These are my thoughts. What are yours? ■