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PERSPECTIVES FROM ANNA

THINKING ABOUT THE FUTURE OF RETIREMENT AND OF EMPLOYER SUPPORT FOR RETIREMENT

By Anna M. Rappaport

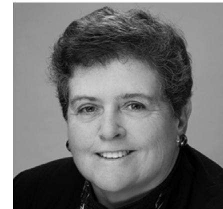
The 2014 Pension Research Council annual conference was titled "Reimagining Pensions: The Next 40 Years." A number of the papers presented have been posted on the Pension Research Council Website. I co-authored a paper with Andy Peterson for the conference titled "Risk Sharing Alternatives for Pension Plan Design." The paper can be downloaded and sometime in 2015, there will be a conference volume published including the papers.

This paper looks at a broad range of risks and a broad range of plan designs, without being limited by current regulatory constraints. It draws on several major sets of research, *Retirement 20/20*, Retirement for the AGES, and the Mercer Melbourne Pension Index for ideas. Some of the ideas are applied in two case studies—the new Shared Risk Pension Plan from New Brunswick, Canada, and the Retirement InSight™ plan from Buck Consultants. One is DB and one is DC. When we merge the background together, it lays a foundation of ideas for the future of a retirement system that will work well. Key ideas from the research foundation include:

- Retirement for the AGES – Four basic principles for a successful retirement system are alignment, governance, efficiency and sustainability.
- *Retirement 20/20* – Pay attention to aligning skills and interests of stakeholders, self-adjusting systems and risk-sharing designs.
- Melbourne Mercer Index – Pay attention to retirement ages, working longer and providing lifetime income.

There has been a major shift from DB to DC, which reduces retirement program risk for the plan sponsor, and shifts that risk to the participant. Such a shift often reduces plan sponsor cost, but it also reduces benefits paid to participants. Such a shift may seem to be a clear win for the plan sponsor, but it is not so simple. Employees may not be able to afford retirement and they may be reluctant to retire. Workforce management problems created for plan sponsors by the shift to DC were discussed by Haig Nalbantian of Mercer at the 2014 Society of Actuaries Living to 100 Symposium, and they were again discussed at the 2014 SOA Annual Meeting & Exhibit. Most traditional DB plans include built-in longer-term disability protection, often in the form of continued benefit accruals. This protection is generally lost when a plan converts to DC and many people working with pension plans forget about this risk. More investigation reveals that longer-term risk management is often out of sight, and that there are other major gaps in risk management.

The paper is a mix of ideas that are "woven together." Some are very basic, and others that seem basic may often be forgotten. I would like to share with you a few of the ideas discussed in the paper. The paper sets forth general ideas for sharing risks. In many discussions of risk sharing we think about risk being allocated between plan sponsors or employers and plan members or employees, but risk can also be pooled among plan members, or shared between different groups of plan members. These methods of risk sharing overlap. Plan design defines the benefits and the obligations of the parties. The financial structure of the plan defines who pays for the benefits and how the cost is shared. Plan design and the financial structure operate together to define how the risk is allocated between the plan sponsor and the plan members. Self-adjusting systems offer methods of adjusting benefits and/or contributions based on circumstances defined by the arrangement. Self-adjusting systems modify the method of risk sharing. Risk pooling spreads risk over participant groups. Plans that cover the employees of more than one employer, or



Anna M. Rappaport, FSA, MAAA is an actuary, consultant, author, and speaker, and is a nationally and internationally recognized expert on the impact of change on retirement systems and workforce issues. She can be reached at *anna@annarappaport.com*.

cover employees in an industry can be structured to share risk among employers or plan members or a combination. The plan structure again defines the risk sharing. Guarantee funds or third party guarantees, such as insurance, share some of the risk with the guarantee fund or insurer. When we think about this range of potential options for risk sharing and for combining various elements of risk sharing, that opens the question, what options should be available to plan sponsors for structuring of benefits?

One of the other things that Andy and I realized as we wrote the Pension Research Council paper, is that some important ideas are often overlooked as people talk about pension risk. Many discussions of risk focus on investment, interest rate, longevity, and inflation risk. But we should not forget about business risk, the risk of poor decisions, solvency risk, fiduciary risk and public policy risk. How often do you see these risks discussed as well? The traditional discussion of noncontributory DB plans focuses on the plan sponsor risk. But the participant in most private sector plans bears post-retirement inflation risk, the risk that a plan will be modified or terminated, and the risk of early termination of employment. And in DC plans, the plan sponsor has fiduciary risk particularly if the plan is not managed well, workforce management challenges, and the risk that employees will be unable to retire. We need to be careful to focus on the big picture as we think about these alternatives.

The Reimagining Pensions Conference included a number of papers with interesting ideas, and I recommend that readers look at the Pension Research Council website to find them. In 2015, there should be a conference volume including all of the papers. In her paper, "Changing Frameworks for Retirement Security," Olivia Mitchell provides an overview of the content of all of the papers. Don Fuerst writes about Retirement Shares Plans, and David Blitzstein offers new ideas about the role of labor organizations.

DIFFERENT KINDS OF HYBRID ARRANGEMENTS

Risk adjustment has been applied in practice in the Netherlands, and this was discussed at the Pension Research Council Conference. One of the points made was how difficult it is to apply risk adjustment in practice when the result is a downward adjustment in benefits, rather than just a smaller increase or no increase. In the last *Pension Section News*, a paper on the application of defined ambition concepts in the United Kingdom was discussed by Andrew Vaughn. These ideas have also been applied in New Brunswick, Canada. Andy Peterson and I provide a case study discussion of the New Brunswick Shared Risk Plan. The Pension Section engaged John Turner for an up-to-date review of hybrid plans and that can be found on the SOA website.

There are a variety of ideas and a number of practical obstacles to making them work.

DIFFERENT IDEAS FOR THE FUTURE

We can cluster ideas for the future in several groups.

- Offering new options in DB plans to improve their risk profile for the plan sponsor, and to balance the needs of plan sponsor and plan member in a way that works for both. Our paper shares the New Brunswick case study and there are many more ideas including those used in the Netherlands and laid out in the defined ambition paper.

- Enhancing or supplementing DC plans to improve risk protection and benefit delivery. Our paper shares a case study, and a TIAA-CREF case study is also presented in a Pension Research Council paper. The John Turner paper presents many additional ideas.

- Adding post-retirement benefit management and disability benefits to a DC program.

- Working to get those people not currently covered by the pension system into the system.

While some of these ideas work under existing legislation and regulation in the United States, others do not. The same is likely true in other countries. My suggestion is that future regulatory structures should consider the following:

- Permit both defined benefit and defined contribution plan designs as well as some hybrids

- Don't create unnecessary complexity for the plan sponsor

- Enable and encourage later retirements

- Give plan sponsors access to tools for risk sharing combined with risk pooling, producing a model that is a modification of traditional defined benefit designs

- Mandate effective governance models

- Align interests of stakeholders

- Encourage and enable self-adjusting systems

- Encourage and enable pooling of longevity risk and appropriate management of other risks

- Require a sustainable financial model for all plan structures

- Include fiduciary requirements for plan sponsors

- Authorize mechanisms for small employers to band together.

Policymakers who are addressing the issues of improving the pension system should also keep the following points in mind:

- Policy should encourage and support employer sponsorship of retirement savings.

- Plan options should consider the level of risk to be placed on sponsors and participants and ensure that the risks are appropriate.

- Risk pooling is efficient, but it does not 'create' new money. Rather it allocates the money in accordance with the basic purposes and design of the plan. For risk pooling to work, there must be a reasonably sized pool and a reasonable spread of risk within the pool.

- Plan structures that are authorized need to work for both small and large businesses. Having access to good multiple entity arrangements will be an important factor in making plans available to smaller businesses.

I hope that the readers of this article will use the Pension Section LinkedIn site, and discuss some of their ideas about the future of pensions and how to overcome the practical difficulties in getting there. ■