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Forty Years in the Wilderness

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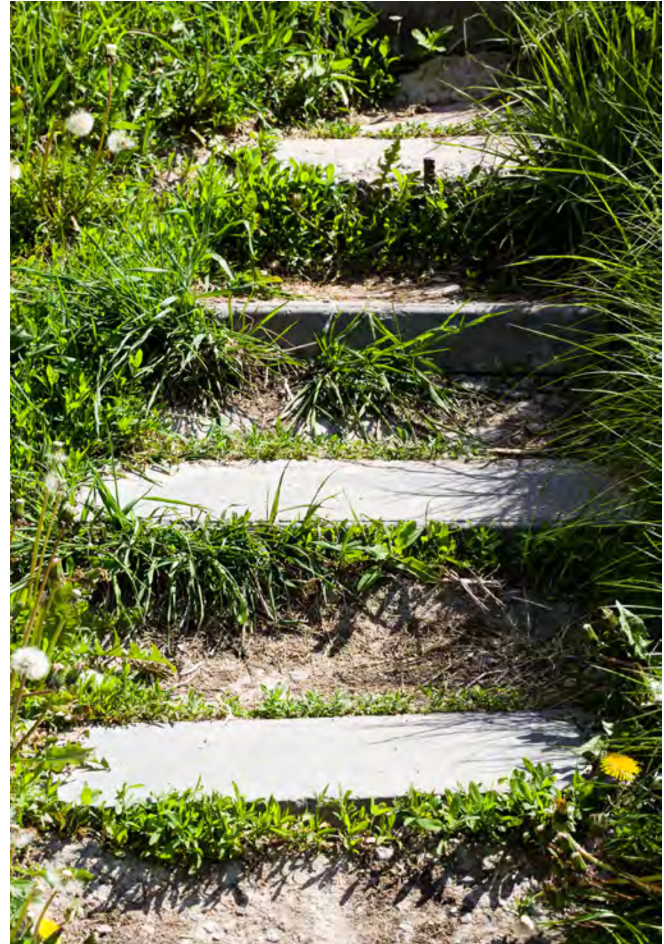

THE EXODUS

Private sector employers are exiting the traditional defined benefit pension plan domain en masse. The number of single-employer defined benefit pension plans and the number of active participants in the United States began to fall in 1984 and continues to fall steadily.[1] At this rate, there will be no active members left by 2036. The total number of plan participants held steady until 2006 because plan sponsors could not discharge obligations to former employees as quickly as they ended the participation of new employees. The total number of participants is now in decline and the total of pension plan assets has reached a plateau and will soon begin to decline. The situation in Canada and the U.K. is similar.

There are two big reasons for this exodus:

1. As the 30-year Treasury rate fell from well over 10 percent in the early 1980s to under 3 percent in the last few years, the cost of a promise to make a payment in 30 years (the price of a 30-year strip) rose from under 6 cents on the dollar to over 40 cents on the dollar. Basic laws of supply and demand meant that employers started buying fewer of these deferred wage promises to employees than they bought in the early 1980s—even if they were prepared to spend a larger portion of their total compensation budget on retirement income. It was hard to tell employees their target replacement ratio was being cut by 85 percent so the solution was to define the contribution rather than the benefit—to focus on the share of total compensation being directed to retirement plans rather than what it might buy in retirement.
2. The Enron debacle in 2001 exposed the problem of off-balance-sheet liabilities and risks. Analysts, accountants and government regulators reacted by demanding increased disclosure and investors reacted by discounting security prices of corporations that had these unquantified risks. The largest and most prevalent off-balance sheet-liabilities for North American corporations were defined benefit pension and retiree medical plans.

LIFE IN THE WILDERNESS

Even with the decline in private sector plans since 1984, retirement plan actuaries have found lots to do, curtailing and de-risking plans and making the best of defined contribution replacements. Work on public sector and multiemployer pension plans continues, since these plans (and their stakeholders) have seemed less sensitive to declining nominal yields and short-term fluctuations in the net obligation. However, we wonder how long this can go on. At least anecdotally, university graduates are less inclined to embark on a career in this branch of actuarial work, out of fear it will dry up.

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> As we endure a few more years in the wilderness, we should know that part of what we're doing is preparing a new generation of retirement actuaries for opportunities to come.

Misery loves company. If there's a bright spot in our dismal situation, it's that today's retirement arrangements for North American private sector workers aren't going to work. U.S. Social Security will require adjustments. Employees left to manage their own saving and investment choices are being overcharged for simplistic undifferentiated advice and are making bad choices. Employers have no pleasant way to manage the departure of older workers with declining usefulness in a constantly changing workplace. Human resource managers—the established clients of consulting pension actuaries—understand all this, but don't expect the solutions to come from actuaries. They know us as the guardians of their defined benefit pension plans, not the architects of new solutions to their problems.

THE PROMISED LAND

One day, perhaps sooner than we think, all the defined benefit pension plan members will have retired. Human resource managers will get used to massive severance payments as the natural end to full-career employment. Downswings in the stock market will bring waves of anguish in the workplace while upswings will bring waves of retirements akin to winning in the office lottery ticket pool. There will be no practicing actuarial consultants who ever designed an early retirement window or prepared costing estimates for a plan improvement.

It is difficult to say what employment will look like. Will major corporations rely on contractors, telecommuters and overseas suppliers, with traditional employment contracts reserved for key individuals whose company experience, client relationships and loyalty are the glue that holds the company together? Will legislation, unionization or labor shortages drive labor contractors and app-based service providers to improved benefits and job security for their piecemeal workers? How will artificial intelligence change the Gini coefficient and mix of occupations?

It is not quite as difficult to say what the next generation of retirement savings plans will look like. Where employment as we know it now persists, employees will be frustrated by high fees, disappointing returns, prohibitive annuity prices, biased advice and investment challenges they don't understand. They will continue to look to their employer for help. Employers will ask what can be done. All options will be on the table—as long as they don't entail DB employee benefit accounting. Persistent low interest rates will continue to make retirement benefits very expensive and so, even though replacement rates and the prevalence plans will be lower than in the 20th century, actuarial liabilities will be larger. That all being said, the actuary's toolkit will still work—risk-pooling, long-term forecasting, liability-driven investing, and professionalism.

Certainly, for private sector employers, the benchmark for new retirement plans will be defined contribution arrangements, not the long-forgotten defined benefit plans of the 20th century. Likely, different employers will find different solutions, depending on their mix of occupations, turnover targets and corporate culture. Some solutions will involve target benefits, longevity pooling and intergenerational sharing of investment risks. Others will involve mass personalization of retirement income planning advice, using big data techniques and employee records. Some employers will see these offerings as an integral part of the value proposition they offer in a hyper-competitive labor market and a tool for defining a unique corporate culture. Others—especially non-traditional businesses—will want to distance themselves from their associates' personal financial affairs, but still using their buying power and expertise to provide access to competitive retirement plans.

There's no point pining for the land of milk and honey. But, as we endure a few more years in the wilderness, we should know that part of what we're doing is preparing a new generation of retirement actuaries for opportunities to come. ■

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Endnotes

1 *https://www.dol.gov/sites/default/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf*

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