EAR

ENROLLED ACTUARIES REPORT

The *Enrolled Actuaries Report* is a quarterly publication of the American Academy of Actuaries.
www.actuary.org

VOL. 41, NO. 4 — DECEMBER 2017

Lifetime Income—An Important Role for Pension Actuaries

By Ted Goldman
Senior Pension Fellow

I RECENTLY HAD A BIRTHDAY, and as my own retirement date looms larger on the horizon it adds to my perspective as a pension actuary about the importance of lifetime income. If you haven't already, I encourage you to read the Academy's recently released position statement, "**Retirement Income Options in Employer Sponsored Defined Contribution Plans**." Our society is rapidly aging—the percentage of people age 65 and over is expected to increase from 15 percent in 2017 to nearly 25 percent by 2060—along with individuals' propensity to live longer (see the Academy co-sponsored **Actuaries Longevity Illustrator**). These factors have created an urgency to put effective education, resources, and tools into the hands of those who will soon face the challenge of drawing down their lifelong retirement earnings. As actuaries, we should use our expertise to assist the millions of Americans who will soon be facing the critical decision of how to manage their retirement nest eggs.

Speaking of birthdays, I have reached the magic age that requires me to commence receipt of benefits under one of my two defined benefit plans from my prior employers. I can't tell you how comforting it is to know that I have lifetime income streams from these two pensions, in addition to my Social Security. The "making-

GOLDMAN, **PAGE 2 >**

Inside this issue

3-4 Annual Meeting Pension Sessions

5 Issue Brief: State-Based Retirement Issues

6 Webinar Looks at Lump-Sum Benefits

6 Comments to PBGC on Multiemployer Plans

Academy Releases Position Statement on Lifetime Income

THE ACADEMY RELEASED A **position statement** in support of policy and educational initiatives to increase retirement income options within employer-sponsored defined contribution (DC) plans.

Academy membership was **asked for input** early this year on a proposed advocacy statement on lifetime income. The amount of work that Academy volunteers on the pension and life practice councils and the Lifetime Income Risk Joint Task Force have done in addressing lifetime income options and issues in the past several years has been **wide-ranging and significant**. The proposed advocacy statement was one that those who have worked in this area perceived to be an umbrella or capstone for summarizing much of the work in that area. After extensive discussion and review over several meetings, the Board decided that, as a Board, it would adopt a position statement that clearly indicates Academy support for policies and educational initiatives that increase the availability of retirement income options within employer-sponsored DC plans.

LIFETIME INCOME, **PAGE 5 >**

GOLDMAN, FROM PAGE 1

it-last" challenge is a lot easier for me knowing I have these pieces at the ready. However, I realize not everyone will have the luxury of a meaningful pension. The vast majority of retirees will be faced with a lump sum nest egg at retirement, likely comprised of multiple 401(k) and individual retirement accounts (IRAs). Many individuals will be faced with flipping the "heads I win, tails you lose" risk coin of life—the risk of overspending and running out of money with plenty of life left to live, or a decision to underspend and settle for a lower standard of living than what might have been possible. Neither is an optimal outcome.

One of the findings from the Academy's joint work **comparing retirement readiness in the United States, United Kingdom, and Australia** indicated that fewer than half the people in the three countries are expecting a comfortable or flourishing lifestyle in retirement. I find it disheartening—and alarming—that some people seem to have given up the fight even before they reach retirement.

In my view, lifetime income strategies should include structured and systematic ways to draw down investments in combination with the use of annuities of all sizes, shapes, and colors. The Academy position statement points out that qualified, employer-sponsored, defined contribution (DC) plans should play a larger role in delivering retirement security. Legislation and regulations are needed to enable and encourage employers to provide retirees with the education, tools, and payment options within DC plans that will help them achieve a secure lifetime income. Regulations need to minimize fiduciary concerns so that employers are comfortable selecting providers, developing and offering solutions, educating employees, and implementing income strategies.

There are significant benefits to retirees when income strategy options within DC plans are offered. The power of pooling longevity risk is reason enough to spend time developing lifetime income strategies. In addition, value is added through providing access to institutionally priced financial products and services that will have lower expenses and thus deliver greater benefits. The ease of delivering retirement income directly from the DC plan and avoiding the added step of an IRA rollover is also a valuable benefit. In addition, relying on the employer to provide the due diligence in selecting qualified providers and products assures that the plan offerings are of high quality and have been carefully vetted. Finally, the employer, through the DC plan, is well positioned to offer guidance on retirement income planning through educational materials and tools.

Next Steps

So my message to fellow pension actuaries is that we have a key role to play. We should educate policy makers, the financial services industry, and the general public, and continue to innovate and develop new solutions. I'm excited about the release the Academy's position statement on lifetime income. But this should only be the beginning. The Academy's Lifetime Income Risk Joint Task Force has worked diligently to bring this important issue to the forefront and continues to develop new intellectual capital that relates to the lifetime income challenge.

The task force is exploring the value of deferred income annuities—qualifying longevity annuity contracts, or QLACs. Also, keep your eyes open for an online educational quiz on retirement income designed for the general public. The set of stakeholders to be reached is vast. It includes policymakers, employers, investment and product providers, financial advisers, and the public. Join the effort; we have important work to do. ▲

In the News / Media Activities

- ***Time*** magazine published a story covering the Academy's jointly published international **survey on retirement readiness**. ***Your Life Choices*** (Australia) also cited the survey.
- A ***Plan Sponsor*** story cited the Academy's **position statement** in support of policy and educational initiatives to increase retirement income options within employer-sponsored DC plans. The story was reprinted by ***Plan Adviser***.

Pension Breakout Sessions Offer Practice-Area Insight

ATTENDEES OF THE Academy's Annual Meeting and Public Policy Forum, held in Washington, D.C., Nov. 14–15, took in a packed program of sessions tailored for specific practice areas, including pension breakout tracks on several key issues.

And while it was not a dedicated pension session, several pension-area actuaries took part in the "Professionalism Under Pressure" plenary, which was moderated by past Academy President Tom Terry and included panelists Sherry Chan, chief actuary in the New York City Office of the Actuary; Bill Hallmark, the Academy's outgoing vice president, pension; and Janet Fagan, past chairperson of the Actuarial Board for Counseling and Discipline. Alberto Mora, senior fellow at the Harvard Kennedy School of Government's Carr Center for Human Rights Policy, and 2006 recipient of the John F. Kennedy Profile in Courage Award, gave the session's opening address.

Bill Hallmark, outgoing vice president, pension, and Sherry Chan, chief actuary, New York City Office of the Actuary, participate in a professionalism plenary session at the Academy's Annual Meeting and Public Policy Forum

Click here to the see the pension breakout-session slides; which are available free to those who attended the Annual Meeting.

Multiemployer Pension Plans

This session focused on various mitigating approaches aimed at fixing critical and declining multiemployer plans and the challenges, barriers, and possible outcomes. The session was moderated by Jason Russell, chairperson of the Academy's Multiemployer Plans Committee, and included Stan Goldfarb; Michael Scott, executive director at the National Coordinating Committee for Multiemployer Plans (NCCMP); and Kevin McDermott, senior labor policy adviser at the U.S. House of Representatives' Committee on Education and the Workforce.

After Russell delivered his introductory comments, Goldfarb gave an overview of multiemployer and single-employer plans, noting that single-employer plans and multiemployer plans are "different beasts and in different conditions" and stressing that "1 million plan participants are at risk of being in plans that are going insolvent."

Scott discussed federal loan programs generally and NCCMP's proposal aimed at helping to solve the looming insolvency crisis. No matter what solution is selected, Scott stressed that "we need something soon [and] it must maximize the probability of success."

When asked about the congressional point of view, McDermott said that we would have to wait and see if there "is a political will in Congress to respond" to the looming crisis, but he did note that his office has been "pressing this issue because there is currently a $70 billion economic impact and a broad impact on social safety networks."

Public Pension Plans

The sustainability of state and municipal retirement programs was the focus of this session. In particular, the speakers looked at data to explore the characteristics and patterns of plans that are sustainable as well as those that may have problems in the short, intermediate, or long-term—and why. They also shared their perspectives on how pension plans are evolving in response to growing pension costs and risks, and how to maintain a sustainable plan against sometimes competing priorities of running a state or local government.

The session was moderated by Bill Hallmark, the Academy's immediate past vice president, pension. He was joined by Alex Brown, research manager at the National Association of State Retirement Administrators; Don Boyd, director of fiscal studies at Rockefeller Institute of Government; and Thomas

ANNUAL MEETING, PAGE 4 >

< ANNUAL MEETING, **FROM PAGE 3**

Don Boyd speaks at a session on public pension plans

Aaron, vice president and senior analyst at Moody's Investors Service.

Brown noted that "there is no common characterization of public pension plans," and discussed key factors affecting public pension funding conditions and sustainability and the common features of a well-funded public pension plan. Boyd noted that investment returns have fallen and that the incentives that government and plans have led plans to take more risks.

Boyd quoted the California Public Employees' Retirement System (CalPERS) *Annual Review of Funding Levels and Risks* report and stated that the best way to impact policy makers is to underscore the fact that "unless changes are made, it is likely that there will be a point over the next 30 years where the funded status of many plans will fall below 60 percent. … There is about a 15 percent chance that we will see funded statuses below 40 percent."

Aaron closed out the session with a discussion on balance sheet unfunded liabilities, declining return expectations and accelerating budgetary costs, and the important role that pension asset performance plays on government credit quality.

National Retirement Policy

In this session, speakers discussed what U.S. national retirement policy objectives should be and assessed the adequacy and efficiency of the current policies in achieving these objectives. The session was moderated by Academy Senior Pension Fellow Ted Goldman and included Frank Todisco, chief actuary at the U.S. Government Accountability Office (GAO) and a former member of the Actuarial Standards Board; Andrew Biggs, resident scholar at the American Enterprise Institute; and Josh Gotbaum, guest scholar at the Brookings Institution.

Todisco followed up Goldman's introduction with a presentation of the GAO's recently released report on the state of retirement in America, including a very rare recommendation that Congress consider establishing an independent commission to comprehensively examine the U.S. retirement system and make recommendations on how to improve it. Biggs then took the helm and discussed why he believes the retirement "crisis" is overblown, saying he believes claims that Americans are under-saving are generally mistaken. He emphasized that getting an accurate picture of the current state of retirement was dependent on accurate data, which he believes is lacking.

Both Biggs and Gotbaum provided their own solutions for the retirement issue. While Biggs focused on fixing Social Security, PBGC and state/local plans, and making small changes to 401(k)s, Gotbaum highlighted coverage for those who do not have a retirement plan, improving defined contribution plans, and preserving defined benefit plans where possible.

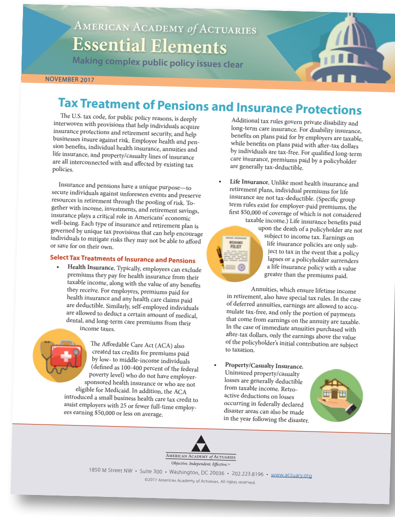

Senior Pension Fellow Ted Goldman moderates a session on national retirement policy objectives

Academy Releases Essential Elements Paper on Tax Reform

THE ACADEMY IN NOVEMBER released a new *Essential Elements* paper, "**Tax Treatment of Pensions and Insurance Protections**," a cross-practice report that highlights select tax treatments of pensions and insurance protections and outlines the potential public policy trade-offs of changes to the U.S. tax code.

The *Essential Elements* **series** is designed to make actuarial analyses of public policy issues clearer to general audiences.

The release was timely, as the House passed the Tax Cuts and Jobs Act on Nov. 16 by a 227-205 vote. Read the **Academy alert**. The House action followed a Senate draft tax reform bill that was released the previous week. Read the **Academy alert**.



AMERICAN ACADEMY *of* ACTUARIES

Essential Elements

Making complex public policy issues clear

NOVEMBER 2017

Tax Treatment of Pensions and Insurance Protections

The U.S. tax code, for public policy reasons, is deeply interwoven with provisions that help individuals acquire insurance protections and retirement security, and help businesses insure against risk. Employee health and pension benefits, individual health insurance, annuities and life insurance, and property/casualty lines of insurance are all interconnected with and affected by existing tax policies.

Insurance and pensions have a unique purpose—to secure individuals against unforeseen events and preserve resources in retirement through the pooling of risk. Together with income, investments, and retirement savings, insurance plays a critical role in Americans' economic well-being. Each type of insurance and retirement plan is governed by unique tax provisions that can help encourage individuals to mitigate risks they may not be able to afford or save for on their own.

Select Tax Treatments of Insurance and Pensions

- **Health Insurance.** Typically, employees can exclude premiums they pay for health insurance from their taxable income, along with the value of any benefits they receive. For employers, premiums paid for health insurance and any health care claims paid are deductible. Similarly, self-employed individuals are allowed to deduct a certain amount of medical, dental, and long-term care premiums from their income taxes.

  The Affordable Care Act (ACA) also created tax credits for premiums paid by low- to middle-income individuals (defined as 100-400 percent of the federal poverty level) who do not have employer-sponsored health insurance or who are not eligible for Medicaid. In addition, the ACA introduced a small business health care tax credit to assist employers with 25 or fewer full-time employees earning $50,000 or less on average.

  Additional tax rules govern private disability and long-term care insurance. For disability insurance, benefits on plans paid for by employers are taxable, while benefits on plans paid with after-tax dollars by individuals are tax-free. For qualified long-term care insurance, premiums paid by a policyholder are generally tax-deductible.

- **Life Insurance.** Unlike most health insurance and retirement plans, individual premiums for life insurance are not tax-deductible. (Specific group term rules exist for employer-paid premiums, the first $50,000 of coverage of which is not considered taxable income.) Life insurance benefits paid upon the death of a policyholder are not subject to income tax. Earnings on life insurance policies are only subject to tax in the event that a policy lapses or a policyholder surrenders a life insurance policy with a value greater than the premiums paid.

  Annuities, which ensure lifetime income in retirement, also have special tax rules. In the case of deferred annuities, earnings are allowed to accumulate tax-free, and only the portion of payments that come from earnings on the annuity are taxable. In the case of immediate annuities purchased with after-tax dollars, only the earnings above the value of the policyholder's initial contribution are subject to taxation.

- **Property/Casualty Insurance.** Uninsured property/casualty losses are generally deductible from taxable income. Retroactive deductions on losses occurring in federally declared disaster areas can also be made in the year following the disaster.

AMERICAN ACADEMY *of* ACTUARIES
Objective. Independent. Effective.™

1850 M Street NW • Suite 300 • Washington, DC 20036 • 202.223.8196 • www.actuary.org

State-Based Retirement Initiatives and the AGES Principles: An Actuarial Perspective

THE PENSION PRACTICE Council released an issue brief, ***State-Based Retirement Initiatives and the AGES Principles***, that explores recent efforts undertaken by individual states to expand retirement plan coverage among their private-sector workers, and evaluates how those efforts align with the Academy's principles of Alignment, Governance, Efficiency, and Sustainability (AGES) for retirement plans.

The issue brief's key points include:

- The U.S. Department of Labor estimates that nearly 70 million workers do not have access to an employer-based retirement plan.
- Over the past several years, eight states have enacted initiatives to expand retirement coverage among private-sector workers, and other states are considering similar legislation.
- State-based retirement initiatives are a helpful step in expanding retirement coverage to workers who do not currently have access to an employer-sponsored plan, though their overall effectiveness in addressing retirement income challenges may be limited.

LIFETIME INCOME, FROM PAGE 1

Such options, based upon actuarial principles like longevity pooling and other risk mitigation strategies, can help retirees manage their financial security over their remaining lifetime. Rather than denote this statement as one of advocacy for a specific outcome, the Board decided that the Academy issue it as a position statement in support of options of various kinds that address American retirees' needs would be the most appropriate vehicle.

Although there is no single solution to the challenge of Americans' retirement financial security, participants in DC plans could benefit from lifetime income or longevity management options with respect to at least a portion of the account balance, the position statement notes. These options could be permitted or encouraged through guidance from the Department of Labor and provided by employers, insurance companies, fund managers, and others.

While retirees can obtain the income options described above by rolling DC accumulations into individual retirement accounts, the statement notes there are significant benefits to making the options available inside employer-sponsored DC plans. Some of these benefits include:

- **Pricing efficiency.** Employers that maintain DC plans have access to institutionally priced financial products and services. The lower costs provide greater net benefits.
- **Ease of transaction.** A retirement income option can be elected without the need to perform an IRA rollover or seek out potential providers.
- **Provider and product due diligence.** Plan fiduciaries are capable of providing thorough due diligence beyond that which an individual is capable of performing, which can help minimize poor choices in provider and product selection, and strategy implementation.
- **Guidance on retirement income planning and longevity risk management options.** Employer- or plan-provided educational materials and tools could aid in filling any gaps.

Academy Hosts Pension Webinar on Lump-Sum Benefits

MORE THAN 250 PEOPLE attended the Academy's Dec. 8 webinar, "**Valuation of Lump-Sum Benefits**." Moderated by Pension Committee Chairperson Ellen Kleinstuber, the presenters were Aaron Weindling, a member of the Pension Committee and a recent recipient of the Academy's Outstanding Volunteerism Award; Tim Geddes, a member of the Pension Committee; and Pension Committee Vice Chairperson Bruce Cadenhead. Geddes and Cadenhead are also Academy Board members.

Kleinstuber said the Pension Committee is in the process of developing a practice note on lump-sum payments, which it is aiming to release in the spring. Weindling outlined the basic paradigms used for defining and evaluating alternative valuation methods, and the interest-rate fundamentals used to understand and apply those methods. Geddes described approaches for valuing interest-sensitive lump sums and the implications of each method, and Cadenhead covered the determination of interest cost and implications for determining year-end pension benefit obligations.

Slides and audio are available free to Academy members.

Committee Comments to PBGC on Multiemployer Information

THE MULTIEMPLOYER PLANS Committee submitted a **comment letter** to the Pension Benefit Guaranty Corporation (PBGC) on modifications to the instructions for the 2017 Schedule MB (Multiemployer Defined Benefit Plan Actuarial Information) of the Form 5500.

The letter suggested changes to Line 3 (contributions made to plan), offering that the PBGC may want to consider encouraging the plan actuary to distinguish between withdrawal liability payments that are lump sum settlements versus those that are ongoing periodic payments, to the extent the data is readily available.

It suggested several changes to Line 4f (year of projected emergence or insolvency), including in the areas of additional documentation only for plans forestalling insolvency, year of projected emergence as targeted in adopted rehabilitation plan, considering plans with no projected emergence or projected insolvency, and considering using most recent status certification.

PPC Submits Letter to Missouri State Employees' Retirement System Board

THE PENSION PRACTICE COUNCIL sent a **comment letter** to the Missouri State Employees' Retirement System Board regarding the new Terminated-Vested Member Buyout Program adopted as part of state Senate Bill 62 and described in Board Rules 2-18 and 3-17 of the Missouri State Employees' Retirement System (MOSERS).

The letter cited concerns that MOSERS members may not understand that the methodology used under the buyout program results in lump sums that are substantially lower than would be needed to be purchased to replace the forsaken annuity benefits in the private market.

"In order to help members better understand the implications of whether to choose a lump sum, MOSERS may want to reconsider how lump sum offers under the buyout program are communicated to ensure that members have the information needed to make a fully informed choice," the PPC wrote.