Retirement for the AGES

Building Enduring Retirement-Income Systems

American Academy of Actuaries
Forward Thinking Task Force

January 17, 2014 Capitol Hill Briefing

AMERICAN ACADEMY
of ACTUARIES

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Panelists

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American Academy of Actuaries

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Overview of the AGES

- What is Retirement for the AGES?
  - Follow-on to “Retirement 20/20”
  - American Academy of Actuaries initiative
  - A framework for retirement system design
- What are the AGES principles?
- What else is involved?
  - Scorecards!
  - Forum on April 28

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The Spirit of “Retirement 20/20”

- Society of Actuaries initiative launched in 2006
- Design a retirement system from the ground up
  - Questioned whether either DB or DC systems really work
  - Focused on best ideas from around the world
    - *What could be; principles* - *rather than solutions*
    - *What we need to achieve* - *not how to achieve it*
- Over 4 years and 3 conferences
  - Identified key drivers of successful retirement systems
  - 2010 conference presented models:
    - Retirement systems that embodied these ideas
    - Demonstrated how principles could work

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Retirement for the AGES

- American Academy of Actuaries (Academy) initiative
  - In 2010, the Academy's Pension Practice Council decided to:
    - Create a "Forward-Thinking Task Force"
    - Build on ideas from Retirement 20/20
    - Identify guiding principles for a robust retirement system
    - Introduce these principles into policy discussions
  - Focuses on retirement plan design principles
  - Does not address universal coverage or adequacy
  - Presumes Social Security system remains in place
- "Retirement for the AGES" synthesizes Retirement 20/20 ideas into 4 key categories

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AGES: Why Should You Care?

- Retiree income affects U.S. economic performance
- Ability to retire securely also provides:
  - Less reliance on community and family
  - Opportunities for younger workers
- Goal: to facilitate retirement security for all Americans
  - Address shift in roles/risks to employers and employees in voluntary system
  - Retool laws, rules, regulations and practices to support AGES principles

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AGES: Why Should You Care?

- What is America's "Retirement Income Policy"?
- 4 in 10 retirees rely primarily on Social Security benefits
- Lifetime income coverage (DB) decline
- Public sector pension plan stress
  - Inability or unwillingness to fund
  - Pension reform efforts
- Multiemployer system under stress
  - PBGC insurance fund headed towards insolvency
  - Legislative changes urgently needed

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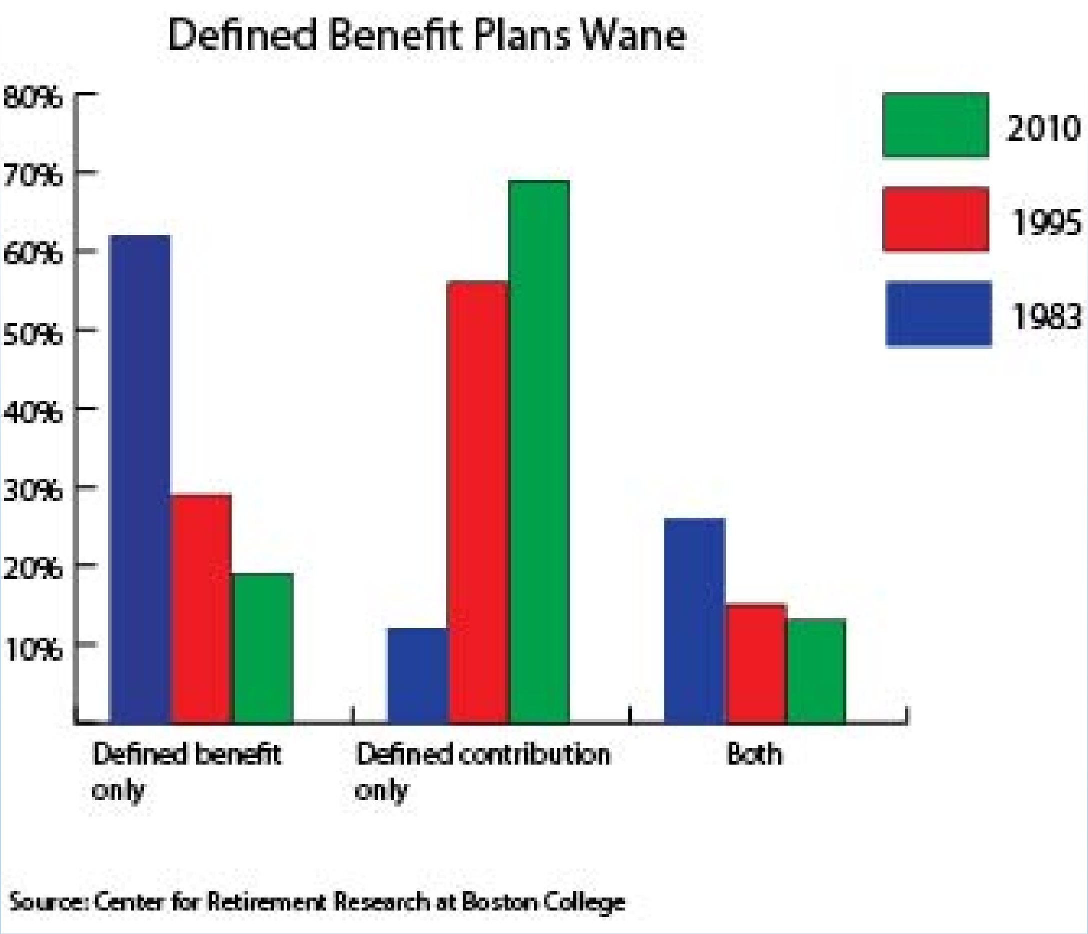
AGES: Why Should You Care?



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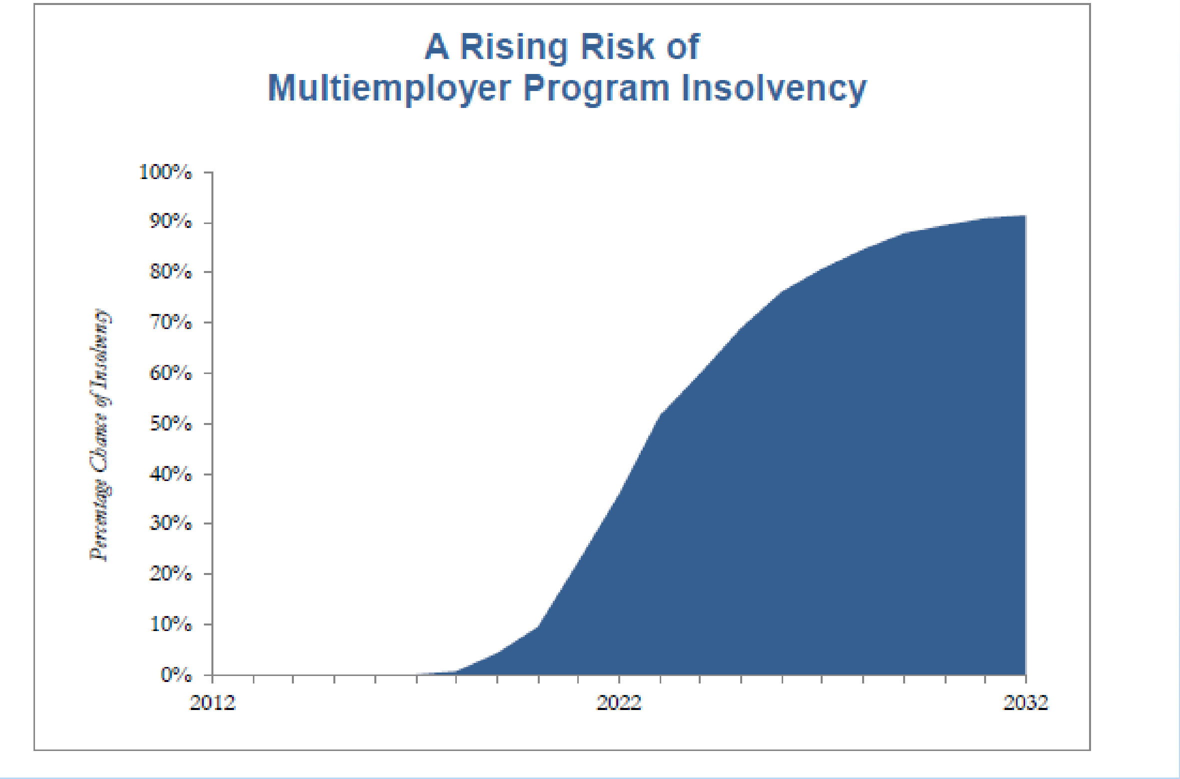

Source: FY 2012 PBGC Exposure Report

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The AGES Principles

- Alignment
  - Are stakeholder roles, choices and skills aligned?
- Governance
  - Does structure support sound decisions and actions?
- Efficiency
  - Is retirement income maximized, with controlled risk?
- Sustainability
  - How are costs allocated? Are shocks survivable?

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Alignment

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Alignment

- Key stakeholders
  - Employers
  - Individuals
  - Society (current and future taxpayers)
- Proper alignment of roles and skills
  - Redefine employer role
  - Improve individual decisions
  - Protect society from suboptimal outcomes

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Alignment

- Redefine employer role
  - Traditional role – establish, sponsor, administer, and contribute to plans
  - Alternative alignment
    - Use third party to manage and administer plans
    - Improve retirement/financial literacy of employees
    - Collect and transmit employee contributions
  - Advantages
    - Better aligned with core business
    - More transparent
    - Standardized disclosure and fees
    - Not totally dependent on employer

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Alignment

- Improve individual decisions
  - Limit unstructured choices
  - Incorporate “auto” features and defaults
  - Employ professionals
  - Provide incentives in tax and other policies

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Alignment

- Protect society from suboptimal decisions
  - Develop laws and regulations that enhance financial security systems
  - Balance voluntary incentives and mandatory requirements

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Governance

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Governance

- Process by which decisions are made and implemented
- Key attributes
  - Stakeholder participation
  - Transparency
  - Accountability
  - Administration in accordance with law
  - Adherence to policies
  - Effective delivery of benefits

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Governance

- Key building blocks
  - Clearly define roles and responsibilities
  - Reduce real and potential conflicts of interest
  - Recognize and manage competing needs
  - Staff appropriately

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Governance

- Clearly define roles and responsibilities
  - Define purpose and goals
  - Ensure proper funding
  - Monitor operational compliance
  - Establish transparent procedures
  - Ensure execution of roles and responsibilities

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Governance

- Reduce real and potential conflicts of interest
  - Require proper disclosure
  - Emphasize fiduciary responsibility
  - Avoid moral hazard

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Governance

- Recognize and manage competing needs
  - Anticipate unintended consequences
  - Balance competing interests
  - Establish appropriate legislation, regulations, and rules
  - Ensure strong oversight
  - Incorporate disincentives for excessive risk taking
  - Use self-adjusting mechanisms

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Governance

- Staff appropriately
  - Engage independent experts
  - Include representatives of key stakeholders
  - Establish explicit procedures and transparent mechanisms for appointments
  - Disclose remuneration policy and other terms

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Efficiency

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Efficiency

Efficiency promotes maximizing income at sustainable levels

- Lower plan costs
- Broaden participation
- Minimize leakage
- Pool risk
- Narrow variability

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Efficiency

- Lower plan costs
  - Encourage economies of scale
  - Establish regional or national plans that any employer can join
  - Standardize fees
  - Ensure fees are fully transparent

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Efficiency

- Broaden participation
  - Provide employees with access to payroll deduction plan
  - Reduce or eliminate age and service requirements
- Minimize leakage
  - Provide incentives for lifetime retirement income
  - Encourage reporting as lifetime income

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Efficiency

- Pool risk
  - Encourage multiple distribution methods, by for example:
    - Offering a managed account with a longevity annuity
    - Including immediate annuities
      - Fixed or variable income
      - Allow partial annuitization
  - Limit guarantees to what is needed

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Efficiency

- Narrow variability
  - Reduce risk as retirement approaches
  - Dedicate portion of accumulation to retirement income
  - Stress reliability and consistency of income

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Sustainability

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Sustainability

Sustainable systems must address multiple issues:

- Intergenerational equity
- Proper cost allocation
- Market shocks
- Balancing sustainability and adequacy

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Sustainability

- Intergenerational equity
  - Retirement plans are essentially deferred compensation
  - Plans need to be adequately funded to avoid burdening future generations
  - Benefits that are too expensive to fully fund may not be sustainable

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Sustainability

- Proper cost allocation
  - Costs should be reasonably allocated among stakeholders
  - Risk involves uncertainty, costs will also be uncertain but must be fairly allocated
  - Tax incentives affect cost to taxpayers and society
    - frequent changes affect cost allocation

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Sustainability

- Market shocks
  - Financial crises are inevitable
  - Plans need mechanisms to deal with crises
    - Funding cushions
    - Adjustment of funding costs
    - Adjustment of benefits
  - Risk sharing enhances sustainability

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Sustainability

- Balancing sustainability and adequacy
  - Little or no risk in plan enhances sustainability but decreases benefits or adequacy
  - Excessive risk in plan makes crisis inevitable and challenges sustainability
  - Self adjusting systems may enhance both by auto-changing:
    - Allocation or level of cost
    - Retirement ages
    - COLAs or other benefit provisions

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Summary

A set of principles to consider when evaluating retirement systems

- Alignment of roles that properly matches the skills of the stakeholders
- Governance that provides a structure that supports sound decisions and actions
- Efficient systems that maximize retirement income while controlling risk
- Sustainable systems that allocate costs equitably among generations and that can survive market shocks

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Sample Scorecard

Sample For Illustrative Purposes Only

RETIREMENT FOR THE AGES
PROPOSAL/PLAN SCORECARD

DRAFT

PROPOSAL/PLAN	**XYZ Act, S. 1001**		
Description/ Overall Grade (A-F)			**B**
Principle	**Description**	**Comments**	**Grade**
Alignment	• Aligns each stakeholder's role with their skills • Redefines employer's role by placing responsibility for important roles with those appropriate entities • Helps individuals by structuring their choices to be well-defined and enhance good decision making • Develops systemic ways to enhance financial security through appropriate levels of laws and regulations		**A**
Governance	• Clearly defines roles and responsibilities, and acts in accordance with them • Reduces real and potential conflicts of interest • Recognizes and manages competing needs • Staffs boards with financial and other professionals who possess relevant expertise		**B**
Efficiency	• Allows smaller plans to group together, with standard and transparent fees to lower plan costs • Provides consistent opportunities to accumulate assets during working lifetime to enhance participation and coverage • Minimizes leakage for non-retirement benefits during accumulation and payout phases • Encourages pooling and effective risk sharing so funds can provide lifetime income • Incents narrowing the variability of benefits by fostering risk hedging and allowing for pricing benefits and guarantees		**C**
Sustainability	• Promotes intergenerational equity • Allocates cost properly among stakeholders • Withstands market shocks • Maintains balance between sustainability and adequacy		**B**

For each principle:
(+) Feature meets principles
(-) Feature does not meet principles
(*) Feature where there is not enough information to determine impact

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Next Steps

- Scorecard will evaluate existing proposals and plans against AGES principles
- Going forward, Academy will publish new scorecards as new plans/proposals come up.
- April 28 forum in DC
  - Meet with stakeholder representatives of “scored” proposals/plans
  - Discuss current proposals to address shortfalls of current systems
- Website: www.actuary.org/retirement-for-the-ages

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Questions?

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