

AMERICAN ACADEMY OF ACTUARIES FORUM
Retirement for the AGES: Measuring for Success

Ronald Reagan International Trade Center
Washington
April 28, 2014



The Secure Choice Pension Plan

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AGES Principles

- **Alignment** – a retirement system should align stakeholder roles with their skills
- **Governance** – good governance provides a balance framework for making and implementing good decisions
- **Efficiency** – systems should maximize retirement income while avoiding excessive risk
- **Sustainability** – the system should be designed to support retirement income over all generations of participants while being able to withstand financial shocks such as recession or prolonged inflation.

The Secure Choice Pension (SCP)

What is SCP?

- It is a supplemental DB pension plan
- It was developed by NCPERS and Segal under Hank Kim's leadership
- It is intended to take advantage of the efficiencies in administration and investment that public sector plans have developed
- Its purpose is to develop sustainable lifetime retirement income for private sector employees who have seen most of their retirement security disappear; particularly for employees of small businesses

Guiding Principles of Plan Design

Overriding Principle: A partnership among private sector workers and employers, with the plan sponsor, to address the crisis in retirement savings

- Lifetime retirement security
- Flexibility, portability, predictability, simplicity and sustainability
- Carefully manage and share risk
- Effectively use the investment power of public plans
- Augment (and not replace) existing pension programs

Plan Design

“Multiple-Employer” Plan

- DB “Career Accumulation Plan” (Hybrid): each participant will have an individual account providing for a minimum guaranteed benefit and an opportunity for participation in additional earnings
- Flexibility, portability, predictability, simplicity and sustainability
- Conservative Funding
- Flexibility in Sharing Risk of Underfunding:
 - Improvements in life expectancy
 - Poor investment experience
 - Employer withdrawals

Principles of Retirement Security

Stable Contributions

Equalize Risk

Committed Funding

Universal Retirement Plan Coverage

Replace Adequate Income

Efficient and Transparent Governance

Qualities of Sustainable Pension Plan

Summary of Proposed Secure Choice Pension Provisions (the basic plan)

- Normal Retirement at 65
- Early Retirement at 55
 - Benefit design automatically incorporates early and late retirement adjustments in annuity conversion factors
- 6% Allocation Rate (Contribution Rate)
- 5% Interest Crediting Rate
- Immediate Vesting in accrued benefits
- Individual Accounts
- The Cash Balance is converted to a guaranteed life annuity, or other optional forms, to be actuarially equivalent using 5% interest and the RP-2000 Combined Healthy Mortality Table
- Death Benefit



Additional plan features such as a long-term disability benefit can be added. Also, these parameters can be adjusted to fine-tune the balance between benefits delivered and plan cost.

SCP Estimated Income Replacement

ESTIMATED REPLACEMENT RATIOS WITH A 5% INTEREST CREDITING RATE

Entry Age	Expected Social Security Replacement Ratio ¹	Replacement Ratio from Expected Personal Savings Including 401(k) ²	Total Replacement Ratio with Social Security and Personal Savings Only	Expected SCP Replacement Ratio ³	Total Replacement Ratio with SCP
25	30%	25%	55%	29%	84%
35	26%	18%	44%	21%	65%
45	17%	11%	28%	13%	41%

¹ Calculated using 2011 Social Security bend points and assuming career earnings consistent with national average. For ages 35 and 45, the replacement ratio is prorated to reflect the fraction of a participant's 35 years of covered earnings used in Social Security Primary Insurance Amount calculation which would be earned under their tenure with their current employer if they worked until age 65.

² Calculated using assumed salary increases based on age, an average return of 5% per year, a contribution rate of 6% per year, retirement of age 65, and annuity conversion based on PBGC annuity valuation assumptions.

³ Calculated using assumed salary increases based on age, and an expected credited interest rate of 5% per year.

**Retirement Income Replacement Gap:
Surveys report individuals estimate 60% as
adequate—when 80% to 90% is needed.**

SCP Funding: How It Works

SCP funding takes a “belt and suspenders” approach for protection from adverse experience and flexibility in sharing the risk of underfunding. Four layers of protection are built in.

- **Layer 1:** Benefit Design as Shown Earlier
- **Layer 2:** The Annual Contribution
- **Layer 3:** The Retiree Dividend Reserve Fund (RDRF)
- **Layer 4:** Termination or Withdrawal of An Employer



SCP Funding: How it Works

Layer 1: Benefit Design as Shown Earlier

- Normal retirement at age 65, with no subsidized early
- Basic return credits
- No prior service awarded
- Conservative annuity conversion factors at retirement
- Limited post-retirement increases based on Plan funding results
- Possibility of benefit reduction if experience is negative



SCP Funding: How it Works

Layer 2: The Annual Contribution

➤ **Standard Funding Contribution:**

Normal Cost plus 15-year level dollar closed amortization of any unfunded liability as determined annually but not less than the Normal Cost

➤ **Conservative Funding Calculation:**

Normal Cost plus 20-year level dollar amortization of any unfunded liability as of the valuation date using market value of assets (if less than the actuarial value), the year's crediting rate as the investment return assumption and a 20-year projection of mortality rates



Effective Funding Calculation: 70% of the greater of the above two calculations plus 35% of the lesser but not less than the contribution determined using ERISA multiemployer funding rules.

SCP Funding: How it Works

Layer 3: The Retiree Dividend Reserve Fund (RDRF)

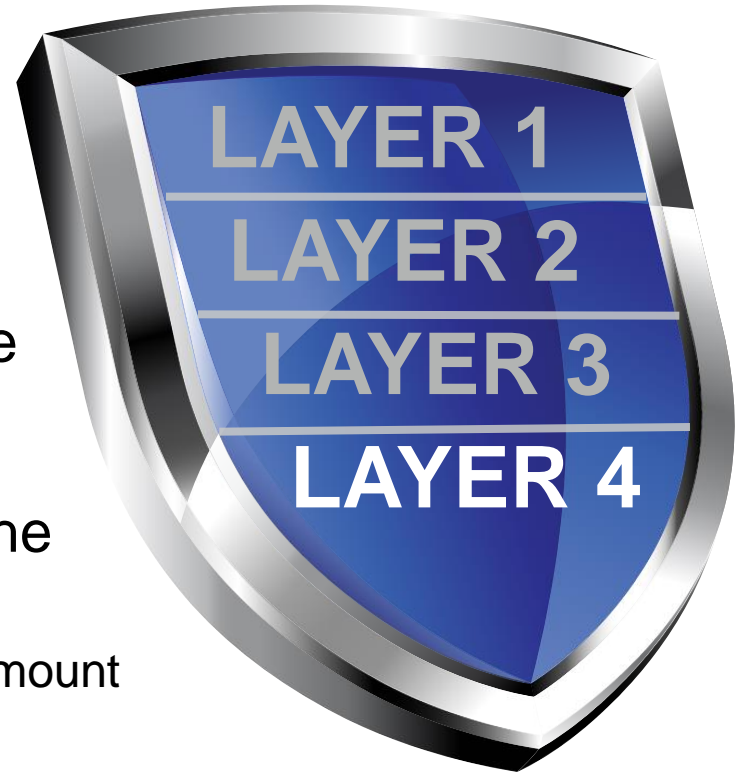
- Nothing is allocated to the RDRF until the market value of assets exceeds the Conservative Funding Calculation accrued liability by 10%.
- 70% of assets in excess of 110% of the Conservative Funding Calculation accrued liability is held in the RDRF.
- This reserve is available, at the discretion of the Plan sponsor, either to grant a retiree dividend or, in the event of negative experience, to provide funding relief.
- Dividends granted from the RDRF may be reduced if future experience does not support their continued payment.



SCP Funding: How it Works

Layer 4: Termination or Withdrawal of an Employer

- The SCP provides flexibility for sharing the risk of underfunding as follows
- Should a participating employer terminate for any reason, and that employer's total liability is not fully funded, then the Plan sponsor may implement one or more of the following options:
 - Assess the terminating employer a withdrawal amount similar to ERISA multiemployer plans
 - Establish an insurance pool using premiums which provides termination coverage
 - Cover the liability from a dedicated Plan Sponsor reserve account for this purpose
 - Determine the amount of employee benefits supported by the assets at termination



Issues to Be Addressed and Resolved

- What will the relationship be between the SCP, the sponsor, the employers and the participants?
- ERISA single employer funding rules currently apply to multiple employer plans. Can this be changed to allow SCPs to fall under multiemployer plan rules?
- How will initial development and start-up costs for an SCP plan be paid? How will ongoing administrative expenses of the SCP plan be paid?
- How will contributions to a SCP plan be made? By employers, employees, or both? Can employee contributions be pre-tax?
- Should eligible employers be restricted? (With less than 100 employees ERISA reporting requirements are less onerous.)

Preferred Federal Legislation

- Define each SCP as a single, multiple-employer plan (MEP)
 - Current DOL rulings indicate MEP with unrelated employers may not be treated as single “employee benefits plan” under ERISA. Options:
 - Amend ERISA to allow SCP as MEP; or
 - Amend ERISA and IRC to treat SCP as multiemployer plan
- Allow SCP to use multiemployer minimum funding requirements
 - Multiemployer rules provide less volatile funding requirements and increase administrative efficiency of SCP
 - Need to amend ERISA and IRC to accomplish this
- PBGC applicability options, both will need ERISA and IRC amendments
 - Exempt SCP from PBGC coverage
 - Offer alternative benefits safety net (e.g., State reinsurance by statute)
 - Or subject SCP to multiemployer PBGC requirements
 - Provides for lower premiums and lower benefit guarantees

Current SCP State Initiatives

- Several states have begun looking at SCP type initiatives. These include:
 - Massachusetts – enacted legislation (prior to SCP; covers not for profit entities)
 - California – enacted SB 1234 (first SCP legislation; pooled IRA construct)
 - Connecticut – task force discussed
 - New York – Comptroller discussing retirement security for all
 - Maryland – legislation introduced and hearings held in the Senate (pooled IRA construct)
 - Minnesota – has held hearing on the concept of SCP type plan
 - Ohio – preliminary studies performed; legislation introduced
 - Washington-has held hearing on potential legislation

- NCPERS can provide which other states are considering additional initiatives

How Does SCP Stack Up to AGES Principles?

- **Alignment** – assigns investment decisions to those with expertise; focuses on sustainable lifetime benefits
- **Governance** – the structure places governance in the hands of professionals with skills and experience; balancing the complexities of broad coverage DB plan with pooled investment resources
- **Efficiency** – SCP provides a frame work for employers that is unavailable at present; utilizing existing public sector plan structures will limit initial costs
- **Sustainability** – SCP has been initially stress tested on investment returns and tested reasonably well; additional testing and refinements will be able to assure long-term sustainability



Questions

SCP Stress Testing

The following tables illustrate a sample projection of an employer group over a 10-year period

- The employer group assumes:
 - 25 employees
 - Ages uniformly distributed over the working career
 - Average salary of \$40,000
- Modeled investment return and crediting rates are as shown in the tables

SCP Stress Test 1

The projection below models an investment market assuming the valuation assumptions as described earlier are exactly met.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Effective Contribution %	6.01%	6.03%	6.04%	6.04%	6.04%	6.03%	6.00%	5.99%	5.93%	5.89%	5.88%
Funded %	100.00%	137.77%	138.12%	138.42%	138.68%	138.73%	139.20%	139.12%	140.41%	141.09%	140.38%
Unfunded/ (Overfunded) Liability	0	(18,717)	(39,644)	(62,865)	(88,463)	(116,011)	(146,953)	(178,109)	(216,429)	(255,008)	(286,433)
DRF	0	0	0	0	0	0	0	0	0	0	0
Investment Return	—	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Total Payroll	1,000,000	1,035,181	1,071,091	1,107,363	1,144,006	1,181,031	1,210,979	1,240,228	1,247,629	1,268,236	1,290,993

SCP Stress Test 2

The projection below models an investment market using actual returns for the 1990 to 2000 period.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Effective Contribution %	6.01%	6.04%	5.98%	5.98%	5.96%	6.00%	5.67%	5.45%	4.97%	4.51%	4.32%
Funded %	100.00%	136.60%	140.12%	141.51%	142.51%	142.12%	140.52%	138.59%	134.23%	134.51%	139.30%
Unfunded/ (Overfunded) Liability	0	(17,047)	(40,455)	(66,519)	(95,704)	(124,574)	(150,316)	(174,103)	(181,973)	(212,750)	(277,111)
DRF	0	0	0	0	0	0	13,062	32,012	76,994	121,387	152,960
Investment Return	--	2.45%	19.36%	7.37%	8.20%	4.08%	22.31%	14.72%	19.97%	17.13%	13.58%
Total Payroll	1,000,000	1,035,181	1,071,091	1,107,363	1,144,006	1,181,031	1,210,979	1,240,228	1,247,629	1,268,236	1,290,993

SCP Stress Test 3

The projection below models an investment market using actual returns for the 2000 to 2010 period.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Effective Contribution %	6.01%	6.05%	6.12%	6.25%	6.14%	6.12%	6.14%	6.05%	6.06%	6.74%	6.47%
Funded %	100.00%	135.65%	133.60%	129.58%	130.08%	130.72%	131.27%	132.69%	135.56%	127.52%	127.38%
Unfunded/ (Overfunded) Liability	0	(16,603)	(33,879)	(47,404)	(67,731)	(90,861)	(116,011)	(147,462)	(189,025)	(169,664)	(193,094)
DRF	0	0	0	0	0	0	0	0	0	0	0
Investment Return	--	-1.25%	-2.95%	-8.39%	16.69%	7.73%	4.51%	10.17%	5.01%	-16.30%	15.71%
Total Payroll	1,000,000	1,035,181	1,071,091	1,107,363	1,144,006	1,181,031	1,210,979	1,240,228	1,247,629	1,268,236	1,290,993