

# Retirement 20/20 Update

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September 19, 2008



# Retirement 20/20

- What is Retirement 20/20?
- Overview of work to date
- Measurement Frameworks
- Next Steps



# What 20/20 is Not

- 20/20 is not the result of an eye test
- 20/20 is not a weekly news magazine show on ABC
- 20/20 is not the next year the Orioles will have a winning season (we hope!)

# About Retirement 20/20

- Retirement 20/20 is our initiative to rethink retirement systems
- What's possible?
  - Go beyond the limitations of today's tax code
- How do we achieve the best outcome for the most people?
  - Longer lifespan/fewer workers
  - Companies may not be able to shoulder the (perceived) risk of traditional pension plans



# About Retirement 20/20

- First step: what does the system need to achieve?
- Conference in September 2006
  - 60 participants representing a variety of areas
  - Asked fundamental questions for key stakeholders
    - ◆ Who has what **needs**?
    - ◆ Who can bear what **risk**?
    - ◆ Who can play what **role**?
  - Four key stakeholders: society, individuals, markets and employers



# Stakeholders defined

- **Society.** All citizens – today & future (government as agent)
  - Intergenerational balance, redistribution of wealth.
- **Individual.** The fundamental retirement unit. The person preparing for and then experiencing retirement
- **Employer.** Goal: attract, retain, motivate and retire a workforce
- **Markets.** Where the accumulation and de-accumulation of wealth takes place.
  - Includes intermediaries who offer market solutions (e.g. insurers)



# 2006 Conference Headlines

- Retirement systems should -
  - Be designed to *self-adjust*
  - *Align stakeholders' roles with their skills*
  - Consider *new norms for work and retirement* and the role of the normative retirement age
  - Be better *aligned with markets*
  - Clarify the role of the employer
  - Will not succeed without improvements in the health and long-term care systems (outside scope of 20/20)



# 2007 Conference

- Picking up on 2006 headline: aligning roles with skills
- How do the other three stakeholders (society, markets, employer) best help individuals?
- Each stakeholder playing the right role is critical to success
  - Using knowledge, talent optimally
- Definition of stakeholder roles shapes new designs



# 2007 Conference

- Goal: Role definition
  - Who is best suited to take on what role?
  - How do you allocate roles based on stakeholder skills?
  - How do these role assignments affect other stakeholders?
- Roles are first key step in designing solution



# Role of society (conclusions)

- Role of society is to provide structure to the retirement system
  - Lifetime income
  - Accumulation
  - Facilitate creation of groups
  - Provide oversight
  - But don't change retirement patterns



# Role of markets (conclusions)

- It's important how we use the markets (markets need structure to work best)
  - Groups
  - Proper incentives for agents
  - Standardized products
  - But don't hinder innovation



# Role of employers (conclusions)

- Role of employer: opening possibilities
  - Facilitating savings
  - Employer could elect to play other roles
    - ◆ Purchasing agent
    - ◆ Facilitator
    - ◆ Guarantor
  - Educating and influencing employees
  - Rethinking second tier

# 2008 Conference

- Defining the Characteristics of the 21<sup>st</sup> Century Retirement System
- November 17-18 in Washington, DC
- Focus on discussion of 3 characteristics for successful retirement systems -
  - Changing the signals within retirement systems
  - Self-adjusting mechanisms for retirement systems
  - Optimal strategies for retirement income distribution



# Measurement Frameworks

- Something completely different
- Tool to be able to evaluate designs (existing and potential) based on the “first principles” we’ve uncovered through Retirement 20/20



# Measurement Framework POG

- Cindy Levering – PSC Chair
- Andy Peterson & Emily Kessler – SOA Staff
- Mike Archer
- Rob Brown
- Rowland Davis
- Ron DeStefano
- Elaine Noel-Bentley
- Martha Priddy Patterson
- Lisa Schilling



# Measurement Frameworks: Why?

- We know there are lots of other possibilities out there
- Provides a systematic way to evaluate possibilities using Retirement 20/20 “first principles”
- Allows us to compare & contrast
- Nothing will be perfect, but we can understand strengths & weaknesses

# Framework Design

- Looks at how well the design meets the needs of the four stakeholders
- Drawn largely from the detail of the 2006 report
  - In-depth evaluation (with composite rating)
  - Society, Individuals, Employers, Market



# Framework Design

- Also considers how well design meets headlines from the 2006 report
  - Self adjusting systems
  - Aligning roles with skills
  - New norms, work & retirement
  - Alignment with markets



# Framework Design

- Considers how well the design works “in the perfect world” and “considering moral hazard”
  - Baseline rating based on a perfect world
  - Column that discusses effect of moral hazard & gives a revised rating



# Moral hazard: defined

- When agents take actions that don't align with interests of stakeholders, particularly individuals or shareholders/owners.
- When stakeholders (particularly individuals) can be led to not act in their own best interest
- Regulatory risk is also considered to be a moral hazard (regulators may be guilty of overzealous regulation, affecting the action of individuals, employers and the markets).



# Why moral hazard?

- We struggled with how to rate designs
  - Based on theory (how well they can work) or reality (how well they do work)
  - Puts new (unknown) designs at an advantage
- Realized that you needed to weigh both what could be and what is
- Highlights the importance of governance structures



# Evaluation criteria

- Evaluate across 38 dimensions
  - Society (9), Individual (11), Employer (8), Markets (6)
  - General headline (4): Self adjusting systems, Aligning roles with skills, New norms for work & retirement, Alignment with markets
- Summary page shows 8 ratings (composite rating for 4 stakeholders plus 4 general headlines)

# Society criteria (9)

- Adequate
- Affordable
- Sustainable
- Robust
- Does not promote economic risk
- Does not promote political risk
- Does not lead to system failure
- Addresses imperfections of other stakeholders
- Promotes social solidarity & integrity



# Individual criteria (11)

- Guaranteed income
- Predictability of income
- Retirement flexibility
- Portability
- Sensitive to employment conditions
- Sensitive to family needs
- Requirement for individual skills
- Investment risk
- Longevity risk
- Inflation risk
- Premature retirement risk

# Employer criteria (8)

- Supports primary business purpose
- Workforce management: attraction & retention
- Workforce management: transition of employees
- Responsive to owners
- Business risk
- Regulatory risk
- Fiduciary risk
- Litigation risk



# Market criteria (6)














- Maximizes use of markets
- Transparent (cost)
- Strong governance
- Efficiently priced
- Efficient risk bearing
- Allocation of risk



# Test Case: DB & DC

- Looked at single employer corporate DB & single employer corporate DC
  - Benchmark
  - Refine the framework design based on something we know well



Traditional Final Pay DB Plan				
US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Effect of moral hazard
Self-adjusting	Automatically adjusts to changing demographic and economic conditions.	<b>Red</b>		
Aligns roles with skills	Aligns stakeholders' roles well with skills.	<b>Yellow</b>		
New norms for work and retirement	Could support flexible work arrangements, e.g. phased retirement, return to work, etc.	<b>Red-Yellow</b>		
Alignment with markets	Could use market mechanisms effectively to hedge risks.	<b>Yellow-Green</b>		Rating after moral hazard: 
Society (composite rating)	Meets society's needs and risks.	<b>Yellow-Green</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Individuals (composite rating)	Meets individuals' needs and risks.	<b>Yellow-Green</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Employers (composite rating)	Meets employers' needs and risks.	<b>Red-Yellow</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Markets (composite rating)	Meets markets' needs and risks.	<b>Yellow</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 



Society's Needs & Risks (Composite rating <span style="color: green;">■</span> )				
Plan being evaluated: Traditional Final Pay DB US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Moral hazard (& adjusted rating)
Adequate	Protects vulnerable citizens.	Yellow-Green	Protects those who are able to hold down employment for long periods of time; less protection for workers who change jobs frequently.	Adequacy depends on employer paternalism including the willingness to maintain benefit levels. Would employers provide benefits to all low-paid employees without statutes requiring such coverage? <span style="color: yellow;">■</span>
Affordable	Does not take resources from other social needs. Ensures risk pooling done efficiently.	Yellow-Green	Private employer sponsorship does not put cost burden on state; however costs are generally tax deductible and tax sheltered pre-retirement. May not pool risks efficiently in markets	Managers may not use market hedging, preferring to gamble on market returns. <span style="color: green;">■</span>
Sustainable	Sustainable across and within generations. Equitable across and within generations.	Green	Can be funded to directly allocate costs back to the current generation of owners/shareholders.	Can be tempting to push costs to future generations of owners/shareholders. <span style="color: green;">■</span>






Employer Needs & Risks (Composite Rating: ■ )				
Plan being evaluated: Traditional Final Pay DB US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Potential moral hazard
Supports primary business purpose	Enhances core purpose of the employer's business.	Red	The employer needs to focus on its core business and not on managing the plan.	Action of accounting standards can add volatility to employer cost. ■
Workforce management: attraction & retention	Enhances business value by allowing attraction and retention of the "right employees".	Yellow	Better at attracting older employees and retaining long service employees. Younger employees are indifferent to plan design, and short service employees are disadvantaged.	Moral hazard has minimal effect. ■
Workforce management: transition of employees	Enhances business value by facilitating the orderly transition of employees.	Yellow-Green	Can provide incentives for employees to stay or retire on a voluntary basis.	As population ages and baby boom retires, do we need people to retire early or work longer? Incentives may be not be set properly for generational shift. ■

# Measurement Frameworks

The average rating of yellow-green is a composite of the nine society subcategories.

The ratings for the nine-subcategories are shown in the color line. They are color grouped so you can see how many of each rating were received.

Ratings for each subcategory were adjusted for the effects of moral hazard. This shows the new color line after moral hazard is considered as well as a new composite rating.

<p>Society (composite rating)</p>	<p>Meets society's needs and risks.</p>	<p><b>Yellow-Green</b></p>	<p>Individual criteria ratings:</p>  <p>Plans protect long-service workers well (less so short-service workers) avoiding the need for more government sponsored benefits.</p>	<p>Adjusted composite rating: </p> <p>Ratings after moral hazard:</p>  <p>System depends on employer paternalism, and employer moral hazards require government regulation, which destabilizes system.</p>
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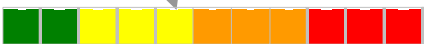
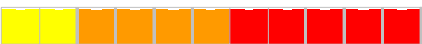



# Why not just show averages?














From the DC framework

The average rating of yellow is a composite of the eleven individual subcategories.

All other things being equal, the rating would be red-yellow, but the average is tilted by perfect ratings in two categories: portability & retirement flexibility.

<p>Individuals (composite rating)</p>	<p>Meets individuals' needs and risks.</p>	<p><b>Yellow</b></p>	<p>Individual criteria ratings:</p>  <p>Puts risks to individuals, although plans could offer mechanisms for individuals to hedge their risks better.</p>	<p>Ratings after moral hazard:</p>  <p>Adjusted composite rating:</p> 
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Traditional Final Pay DB Plan				
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Criteria	Description	Rating	Evaluation	Effect of moral hazard
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New norms for work and retirement	Could support flexible work arrangements, e.g. phased retirement, return to work, etc.	<b>Red-Yellow</b>		
Alignment with markets	Could use market mechanisms effectively to hedge risks.	<b>Yellow-Green</b>		Rating after moral hazard: 
Society (composite rating)	Meets society's needs and risks.	<b>Yellow-Green</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Individuals (composite rating)	Meets individuals' needs and risks.	<b>Yellow-Green</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Employers (composite rating)	Meets employers' needs and risks.	<b>Red-Yellow</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Markets (composite rating)	Meets markets' needs and risks.	<b>Yellow</b>	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 



# How did DB & DC Do?

Ratings before Moral Hazard	DB Rating	DC Rating
Self-adjusting	Red	Yellow-Green
Aligns role with skills	Yellow	Red-Yellow
New norms for work and retirement	Red-Yellow	Yellow-Green
Alignment with markets	Yellow-Green	Yellow
Society (composite rating)	Yellow-Green	Yellow
Individuals (composite rating)	Yellow-Green	Yellow
Employers (composite rating)	Red-Yellow	Yellow
Markets (composite rating)	Yellow	Yellow

# What does this tell us?

Ratings before moral hazard	DB Rating
Self-adjusting	<b>Red</b>
Aligns role with skills	<b>Yellow</b>
New norms work/retirement	<b>Red-Yellow</b>
Alignment with markets	<b>Yellow-Green</b>
Society (composite rating)	<b>Yellow-Green</b>
Individuals (composite rating)	<b>Yellow-Green</b>
Employers (composite rating)	<b>Red-Yellow</b>
Markets (composite rating)	<b>Yellow</b>

DB plans work **reasonably well** designed vis-à-vis stakeholder roles. However they are risky to employers and are middling in use of markets



# What does this tell us?

Ratings before moral hazard	DB Rating
Self-adjusting	<b>Red</b>
Aligns role with skills	<b>Yellow</b>
New norms work/retirement	<b>Red-Yellow</b>
Alignment with markets	<b>Yellow-Green</b>
Society (composite rating)	<b>Yellow-Green</b>
Individuals (composite rating)	<b>Yellow-Green</b>
Employers (composite rating)	<b>Red-Yellow</b>
Markets (composite rating)	<b>Yellow</b>

DB plans **fail** in their ability to self-adjust (in general) and align themselves to new norms for work/retirement.

# What does this tell us?

Ratings before moral hazard	DC Rating
Self-adjusting	Yellow-Green
Aligns role with skills	Red-Yellow
New norms work/retirement	Yellow-Green
Alignment with markets	Yellow
Society (composite rating)	Yellow
Individuals (composite rating)	Yellow
Employers (composite rating)	Yellow
Markets (composite rating)	Yellow

DC plans do **reasonably well** in adapting to changing conditions, and meet two critical needs of the 21<sup>st</sup> century.



# What does this tell us?

Ratings before moral hazard	DC Rating
Self-adjusting	Yellow-Green
Aligns role with skills	Red-Yellow
New norms work/retirement	Yellow-Green
Alignment with markets	Yellow
Society (composite rating)	Yellow
Individuals (composite rating)	Yellow
Employers (composite rating)	Yellow
Markets (composite rating)	Yellow

But DC plans **fail** in aligning roles to skills. The plan works as well as the individual makes it work.



# What about moral hazard?

DB Plan, before & after Moral Hazard	Before	After
Self-adjusting	<b>Red</b>	<b>Red</b>
Aligns role with skills	<b>Yellow</b>	<b>Yellow</b>
New norms for work and retirement	<b>Red-Yellow</b>	<b>Red-Yellow</b>
Alignment with markets	<b>Yellow-Green</b>	<b>Red-Yellow</b>
Society (composite rating)	<b>Yellow-Green</b>	<b>Yellow</b>
Individuals (composite rating)	<b>Yellow-Green</b>	<b>Yellow</b>
Employers (composite rating)	<b>Red-Yellow</b>	<b>Red</b>
Markets (composite rating)	<b>Yellow</b>	<b>Red-Yellow</b>

# What about moral hazard?

DC Plan, before & after Moral Hazard	Before	After
Self-adjusting	Yellow-Green	Yellow
Aligns role with skills	Red-Yellow	Red-Yellow
New norms for work and retirement	Yellow-Green	Yellow-Green
Alignment with markets	Yellow	Red-Yellow
Society (composite rating)	Yellow	Red-Yellow
Individuals (composite rating)	Yellow	Red-Yellow
Employers (composite rating)	Yellow	Yellow
Markets (composite rating)	Yellow	Red-Yellow

# Measurement Frameworks

- Now looking at new designs
  - Dutch system
  - TIAA-CREF
  - Ontario Teacher's Fund
  - US Multi-employer
  - Church Plans
  - New UK Structure



# Where do we go from here?

- Retirement 20/20 is a process: your participation is vital
- [www.retirement2020.soa.org](http://www.retirement2020.soa.org)
- For more information
  - Emily Kessler, 847/706-3530, [ekessler@soa.org](mailto:ekessler@soa.org)
  - Andy Peterson, 847/706-3591, [apeterson@soa.org](mailto:apeterson@soa.org).



