

# Retirement 20/20: Envisioning the Future of Retirement

Anne Button, Deloitte Consulting LLP

Tom Sablak, Cassidy Retirement Group, Inc.



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## Retirement 20/20

- What is Retirement 20/20?
- Overview of work to date
- Measurement frameworks
- Next steps



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## What is Retirement 20/20?

- Retirement 20/20 is our initiative to rethink retirement systems
- What's possible?
  - Go beyond the limitation's 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
  - Sixty participants
  - 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



## Four key stakeholders defined

- **Society.** All citizens – today & future (government as agent for taxpayers/society)
  - Societal issues include intergenerational balance and redistribution of wealth.
- **Individuals.** The fundamental retirement unit. The people preparing for and then experiencing retirement.
- **Employer.** User of human capital, who needs to attract, retain, motivate and eventually retire its workforce.
- **Markets**
  - Capital markets in which the accumulation and decumulation of wealth takes place.
    - ◆ Markets ability to hedge retirement risks, e.g. longevity bonds.
  - Financial intermediaries who offer solutions in market
    - ◆ E.g., Insurers, mutual funds



## 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



## 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 stakeholders' knowledge, talent optimally
- Definition of stakeholder roles shapes new designs



## 2007 Conference (cont'd)

- 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
- Role of society is not to change retirement patterns



## Role of markets - conclusions

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



## Role of employers - conclusions

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



## Measurement frameworks

- Something completely different
- Tool to be able to evaluate designs (existing and potential) based on the “first principles” uncovered through Retirement 20/20
- Oversight via Project Oversight Group (aka “POG”)



## Measurement frameworks – why?

- There are a lot of other possibilities out there
- Provides a systematic way to evaluate possibilities using Retirement 20/20 “first principles”
- Allows us to compare and contrast
- Nothing will be perfect – but strengths and weaknesses can be identified



## Framework design

- Looks at how well the program 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 (cont'd)

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



## Framework design (cont'd)

- Considers how well the design works in the “perfect world” and “considering moral hazard”
  - Baseline rating based on perfect world
  - Revised rating based on effect of moral hazard



## Moral hazard: defined

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



## Why moral hazard?

- Still in development
- Struggle between:
  - Theory – how well the design could work
  - Reality – how well the design does work
- Provides an advantage to new/unknown designs
- Highlights the importance of governance structures



## Evaluation criteria

- Evaluate across numerous dimensions:
  - Society (9), individual (11), employer (8), markets (6)
  - General headlines (4): self-adjusting systems, aligning roles with skills, new norms for work and retirement, alignment with markets
- Summary page shows 8 ratings:
  - Composite rating for 4 stakeholders; plus
  - Composite rating for 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 and 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 cases – DB & DC

- Looked at single-employer corporate DB and DC
  - Benchmark
  - Allows for refining the framework design based on things 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.	Red		
Aligns roles with skills	Aligns stakeholders' roles well with skills.	Yellow		
New norms for work and retirement	Could support flexible work arrangements, e.g. phased retirement, return to work, etc.	Red-Yellow		
Alignment with markets	Could use market mechanisms effectively to hedge risks.	Yellow-Green		Rating after moral hazard: ■
Society (composite rating)	Meets society's needs and risks.	Yellow-Green	Individual criteria ratings: ■■■■■■	Ratings after moral hazard: ■■■■■■ Adjusted composite rating: ■
Individuals (composite rating)	Meets individuals' needs and risks.	Yellow-Green	Individual criteria ratings: ■■■■■■	Ratings after moral hazard: ■■■■■■ Adjusted composite rating: ■
Employers (composite rating)	Meets employers' needs and risks.	Red-Yellow	Individual criteria ratings: ■■■■■■	Ratings after moral hazard: ■■■■■■ Adjusted composite rating: ■
Markets (composite rating)	Meets markets' needs and risks.	Yellow	Individual criteria ratings: ■■■■■■	Ratings after moral hazard: ■■■■■■ Adjusted composite rating: ■



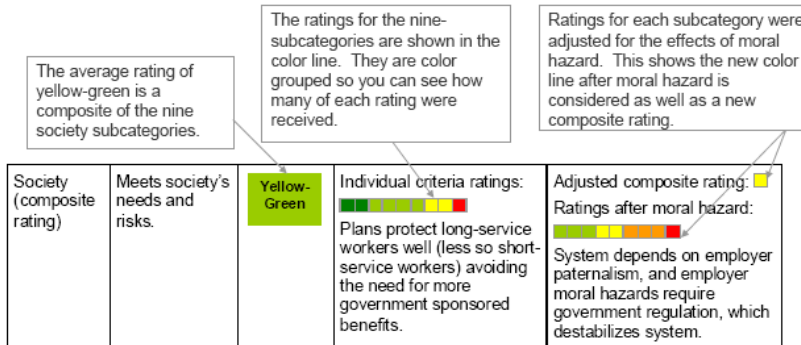
Society's Needs & Risks (Composite rating ■)				
Plan being evaluated: Traditional Final Pay DB US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Moral hazard (& adjusted rating)
Adequate	Protects vulnerable citizens.	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? ■
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. ■
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. ■



Employer Needs & Risks (Composite Rating: <span style="background-color: yellow;">■</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	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. <span style="background-color: red;">■</span>
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. <span style="background-color: yellow;">■</span>
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. <span style="background-color: yellow;">■</span>



## Measurement Frameworks






# Why not just show averages?









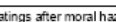

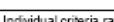
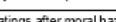

From the DC framework

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.

Individuals (composite rating)	Meets individuals' needs and risks.	Yellow	Individual criteria ratings:  Puts risks to individuals, although plans could offer mechanisms for individuals to hedge their risks better.	Ratings after moral hazard:  Adjusted composite rating: 
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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
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Aligns roles with skills	Aligns stakeholders' roles well with skills.	Yellow		
New norms for work and retirement	Could support flexible work arrangements, e.g. phased retirement, return to work, etc.	Red-Yellow		
Alignment with markets	Could use market mechanisms effectively to hedge risks.	Yellow-Green		Rating after moral hazard: 
Society (composite rating)	Meets society's needs and risks.	Yellow-Green	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Individuals (composite rating)	Meets individuals' needs and risks.	Yellow-Green	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Employers (composite rating)	Meets employers' needs and risks.	Red-Yellow	Individual criteria ratings: 	Ratings after moral hazard:  Adjusted composite rating: 
Markets (composite rating)	Meets markets' needs and risks.	Yellow	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	Red
Aligns role with skills	Yellow
New norms work/retirement	Red-Yellow
Alignment with markets	Yellow-Green
Society (composite rating)	Yellow-Green
Individuals (composite rating)	Yellow-Green
Employers (composite rating)	Red-Yellow
Markets (composite rating)	Yellow

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	Red
Aligns role with skills	Yellow
New norms work/retirement	Red-Yellow
Alignment with markets	Yellow-Green
Society (composite rating)	Yellow-Green
Individuals (composite rating)	Yellow-Green
Employers (composite rating)	Red-Yellow
Markets (composite rating)	Yellow

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



## How did DB & DC Do?

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.



## How did DB & DC Do?

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	Red	Red
Aligns role with skills	Yellow	Yellow
New norms for work and retirement	Red-Yellow	Red-Yellow
Alignment with markets	Yellow-Green	Red-Yellow
Society (composite rating)	Yellow-Green	Yellow
Individuals (composite rating)	Yellow-Green	Yellow
Employers (composite rating)	Red-Yellow	Red
Markets (composite rating)	Yellow	Red-Yellow



## 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 other designs
  - Dutch system
  - TIAA-CREF
  - Ontario Teacher's Fund
  - US multi-employer
  - Church plans
  - New UK structure



## 2008 Conference

- November 2008; two themes:
- Changing signals
  - Signals in Social Security systems
  - Retirement age signals
  - Type and quality of information people receive
- Self-adjusting systems



## Where do we go from here?

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

