

# American Academy of Actuaries

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## Social Security Structure

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# Social Security Benefit Structure

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- Defined Benefit Program
- Payroll Tax
- Trust Funds
- Risk Sharing
- Reform Proposals
  - Individual Accounts
  - Defined Contributions
  - Risk Bearing



# Comparison of DB and DC Structure



- Predictable Retirement Income
- Risk Spreading
- Social Adequacy
- Individual Equity
- Investment of Assets
- Passing Assets to Heirs
- Efficiency for Retirement Income



# Comparison of DB and DC Structure



- Transition Considerations
- Intergenerational Equity
- Predictable Financing
- Affordability
- Integration with Private Pension System
- Advance Funding
- Impact on National Savings



# Predictable Retirement Income



- DB Provides Lifetime Formula-based Income
- DC Accumulates Retirement Savings
- Adequacy of Retirement Income for Lifetime
- Account Balance, Investment Return
- Withdrawal or Payout Strategy
- Annuitization
- Gender, Health Status, Interest Rates
- Potential Superior or Inferior Investment Returns



# Risk Spreading



- Investment Risk
- Longevity Risk
- Inflation Risk
- Disability Risk
- DB provides Insurance
- DC does not pool Risks
- DC Benefits based on Account Balance
- DC Benefit: Reasonable and Adequate?



# Social Adequacy and Individual Equity



- Tilted Benefit Formula
- Cross-subsidy Features
- Disadvantaged Socioeconomic Groups
- National Solidarity
- Relationship to Contributions
- Savings and Investment
- Notional Defined Contribution Concept
- Balance between Adequacy and Equity



# Investment of Assets

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- Investment Risk of DB Plan Sponsor
- Social Security PAYGO Funding
- Trust Fund Investments
- Special Issue Treasury Bonds
- Market Rate of Return
- DC Plan: Directing Investment of Assets
- Equity Investment Returns and Risks
- Impact of Annuitization



# Passing Assets to Heirs

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- Retirement Income
- DB Benefits Cease on Death
- Fairness Argument
- Insurance Concept
- Estate Building
- Wealth Accumulation
- DC Benefit Inheritance



# Efficiency for Retirement Income



- Comparative Expense of DB and DC
- DC Fees
- Investment Management, Record Keeping
- Investment Elections, Asset Transfers
- Benefit Distributions, Annuity Purchases
- Leakage of Account Accumulations
- Lump Sums
- Emergency and Pre-Retirement Access



# Transition Considerations



- DB Reform of Existing Parameters
- DC Structural Reform
- Current Contributions Fund Current Benefits
- Relatively Small Buffer Fund
- DC Transition Requires Funding Old Benefits
- Potential Treasury Borrowing
- Intergenerational Equity
- Expense of Transition



# Predictable Financing



- DB Benefit Provisions Determine Funding
- Economic and Demographic Factors
- Trustees' Actuarial Projections
- Stability of Payroll Tax Rate
- Actuarial Balance
- DC Contributions Fixed
- Easily Understood
- Predictable and Affordable



# Integration with Private Pension System



- Retirement Plans shift from DB to DC
- Personal Savings essentially DC Structure
- Social Security DB Structure Controls Risks
- Social Security DC Structure Transfers Risks
- Triple DC Structure Risk Profile
- Combined DB/DC Structure Risk Profile
- Individual Risk Aversion
- Impact of Removing DB Risk Protection



# Advance Funding and Impact on National Savings



- DC Investment favorable Economic Impact
- Easier to Manage Future Social Security Costs
- Adding New Asset Pool?
- Or merely rearranging Existing Asset Pool?
- Government Debt to Finance Transition
- Offset to Gains from Increased Investment
- Affordability and Use of Economic Resources



# Academy Issue Brief Conclusions



- Ten Objective Criteria
- Six Criteria More Favorable to DB Structure
- Three Criteria More Favorable to DC Structure
- One Criterion No Apparent Advantage
- Conclusion: DB Structure is preferable to DC structure for Basic Benefits under Social Security because of ability to tailor benefits to needs and its inherent risk-sharing attributes, and efficiency in delivering a floor of protection needed by workers.



# Academy Issue Brief

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- “Social Security: Evaluating the Structure for Basic Benefits” [American Academy of Actuaries, Sept. 2007]
- Available at: [www.actuary.org/pension](http://www.actuary.org/pension)





# Philosophy of Choice and Risk

- Bob Dylan on Choice: You must pick up one or the other though neither of them are to be what they claim.
- William Shakespeare on Risk: Whether 'tis nobler in the mind to suffer the slings and arrows of outrageous fortune. For who would bear the whips and scorns of time that makes calamity of so long life.

