Pensions and Retirement Conference: Sharing Responsibility for Long-Term Security: Closing comments

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Our conference theme was "Sharing Responsibility for Assuring Long-term Financial Security." Retirement systems are facing major challenges, are in a state of change, and more change is on the way. Change in the social contract offers a broader context for this discussion. Benefits – both pensions and health – as well as available work options are an important part of the social contract.

Some of the key points raised in our discussion and some additional resources to help address them are as follows:

The employer role in financial security –- both retirement and health benefits are evolving. In the round table discussions, there was divided opinion about the desirability of the employer moving to the role of facilitator of benefits rather than the bearer of risk and provider of benefits. The ERISA Industry Committee's (ERIC) New Benefit Platform is a proposal from the business community that would call for major changes in the employer role. (http://www.eric.org) Expect the issues raised by ERIC to be a part of the continuing debate about the social contract and employer role. The Society of Actuaries (SOA) in its Retirement 20/20 project is working with a multi-disciplinary group to help develop new models for retirement security in the changing world. (http://retirement2020.soa.org/)

Definition and timing of retirement –- the options for working and retiring are changing and we need new options. Nearly 50% of today's retirees phased out of work in some way, but often on their own, without employer support. People probably need to work longer and we need new options for making this happen. At the same time, employers who want to offer better phased retirement options need clarification of legal requirements, particularly with regard to rehire of retirees. Much of the action today is in rehire of retirees. See the Conference Board Report "Phased Retirement After the Pension Protection Act" for more information. As individuals are changing the way they retire, they need help making plans for their lives. Sally Hass from Weyerhaeuser Company discussed "Healthy, Wealthy, and Wise" which offers an integrated approach to help employees plan their lives.

Risk pooling and sharing –- traditional DB plans place a great deal of risk on the plan sponsor and traditional DC plans place all of the risk on the participant. The evolution of the social contract is to shift much more risk to participants, but results have not been good. An alternative is to maintain plans that include employer risk bearing, but manage them more effectively. New management techniques enable sponsors to integrate thinking about plan design, investments and funding in a way that will reduce plan sponsor risk. Robert Aglira from Mercer and Kenneth Garrett from FMC explained how they had worked together to restructure retirement programs in a a way that would balance the level of risk, cost and the plan sponsor's goals. They provided insight into how to think about trade-offs and alternatives. The SOA Retirement 20/20 project is seeking new models for risk pooling and sharing and includes a paper on Self Adjusting Systems. (http://retirement2020.soa.org/) Self-adjusting features provide a basis for new risk sharing mechanisms that would open up new options, but many of them would require new legislation to be put in place. An example of such a feature is a retirement age indexed to changes in life span. A call for papers on this topic is coming soon from the Society of Actuaries and more papers will be available next year. To learn more about how risk is shifting in society is changing the social contract for Americans, see "The Great Risk Shift" by Jacob Hacker. (http://www.greatriskshift.com/)

Evolving retirement plan DC plan model – we have learned repeatedly from experience in our own plans and from behavioral finance research cited in several of the presentations that individuals do not have the discipline and the skill to save and invest successfully for retirement on their own. The new model is DC Plans that include various "auto" features including auto-enrollment, new default investment options, and auto increases. But these models do not lead us all the way to a secure retirement – we still need to think about benefit adequacy and management of the payout period.

Amount of risk in DC plans – there is controversy about whether target date funds are good default options and whether they place too much risk on participants. Zvi Bodie discussed equity risk and challenged whether the amount of equity risk being borne by participants was appropriate. In the discussion, it was pointed out that what is appropriate in a supplemental DC plan may be undesirable in a primary DC plan. Several speakers discussed the importance of lifetime income, the need to understand longevity risk, and the need for better defaults and options for the payout period. It was pointed out that participants underestimate their life expectancy and often withdraw more than they should. Under these scenarios, DC plan assets will often be exhausted well before the end of life. Mark Iwry presented several policy options to encourage/support life income and Zvi Bodie talked about the need for annuitization of DC assets. To learn more about how individuals have invested their 401(k) distributions in retirement and how they thought about the issues, see the Society of Actuaries focus group report, Spending and Investing in Retirement – Is there a Strategy? The quotes from participants about their own planning are very powerful. (http://www.soa.org/research/pension/research-post-retirement-needs-and-risks.aspx)

Evolving total benefit plan designs – we need to think about how medical benefits integrate into the retirement picture. At present, medical benefits are a key consideration in when to retire and can be a barrier to retirement. Retiree medical is a major cost. Joan Boughton from Fidelty pointed out that medical costs have crowded out pension spending and that we need new models for plan design. There was discussion about the need to integrate pension, capital accumulation and pension benefits in our thinking, and to provide benefits that can be customized so as to better fit needs at different points in the life cycle. Note that if the ERIC proposals were adopted, the role of medical benefits in personal decision making would change drastically as then individuals could buy medical coverage in the open market on a basis comparable to the way employers can secure it.

How much is enough – two ways of thinking about how much is needed in retirement were discussed, traditional replacement ratios and lifetime consumption smoothing. Larry Kotlikoff discussed lifetime consumption smoothing, and why traditional replacement ratios did not take into account many of the variables affecting individual lives. It was pointed out that employers and employees have different needs and perspectives. For a discussion of the two models and how they relate, see the roundtable discussion "Perspectives on Retirement Planning and Consumption" from the October/November 2007 **Actuary** (http://www.soa.org/library/newsletters/the-actuary-magazine/2007/october/toc2007oct.aspx). Zvi Bodie is a panelist and I provided observations and comments.

It is clear that we have already experienced a shift to individual responsibility and major changes in retirement systems. Many DB plans have been frozen or terminated and the DC plans have grown a great deal. At the same time, auto features have been added into DC plans to enhance their ability to provide retirement security. Population demographics are changing and our population is aging. Many people are redefining retirement in their own lives and companies will need their skills longer. These changes add up to a system in evolution. The social contract has changed, but more change is on the way. Underlying this evolution is a big question – what is the proper role of the corporation in society, and what is the proper role of the corporation with regard to providing security for its employees?