I am a Principal and Consulting Actuary of Actuarial Consulting Group, Inc. (ACG). ACG has offices in NY and IL. My Partner, Carol R. Sears, and myself have written an article which addresses what we consider to be a critical piece of national retirement policy that is not currently being addressed properly. It is our goal to encourage a national discussion and debate on the important issues outlined in our article. This article has recently been published in the Spring 2005 issue of the Journal of Pension Benefits.

Carol and I have each served as President of the American Society of Pension Professionals and Actuaries. As recognized experts in the retirement industry, we have each separately been called upon to testify before the House Ways and Means Committee, the Department of Treasury and Department of Labor on various national retirement issues, as well as being called upon to testify as experts in Federal court cases. Attached is a copy of our curriculum vitae which will provide additional information on our backgrounds.

We hope that you will find that the ideas we presented in our article are important in addressing our country's national retirement policy and that you will agree that the concepts are worthy of being included as part of the agenda for the 2006 SAVER Summit. If it would be of help, we would be happy to discuss our ideas with you in more depth.

Thank you for your time and consideration.

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Averting the Retirement Income Crisis

By Carol R. Sears and Scott D. Miller

Catastrophic financial protection cannot be met in an employer-sponsored program under today's tax laws. A new essential benefits program is urgently needed to insure the risk of a person outliving other retirement savings. Actuaries and other pension professionals need to use their combined intellect and experience to build the best forward-thinking retirement program system that truly protects our changing elderly population. This article starts that conversation and offers our first ideas.

A Perspective

Just as we do for health, life, and disability, we need to treat longevity as an insurable event. What does this mean? Insurance is, in its most basic form, a pool of money accumulated to pay benefits only to the premium payers who suffer the fundamental risk (e.g., sickness, death, disability). Generally, people choose to insure life contingent risks that would throw their lifestyle into financial crisis. Financial outflows that can be predicted or sustained by current financial income and savings do not need to be insured. Ideally, savings should cover all predictable expenses. The unpredictable and catastrophic expenses are what need to be insured.

Purchasing individual insurance policies is generally more expensive and less efficient than buying policies as a group. Employer-sponsored benefit programs have worked well as vehicles to offer this pooled insurance coverage for our working population by offering group health, life, and disability insurance. A worker's true level of compensation is usually considered to be a combination of wages, contributions to retirement and other savings programs, and other employer paid benefit expenses (such as insurance). Although workers expect that they will receive each dollar of an employer's contributions to benefit programs such as 401(k) plans, through deposits into their accounts, workers accept that dollars spent on insurance programs are returned only to the people who have the applicable benefit claim. For example even though the employer may pay $10,000 in health insurance premiums for an employee, if that employee...
only has $2,000 of medical expenses, that is all he or she will receive: The remaining $8,000 stays in the insurance pool to pay the insured benefits of others. In contrast to wages and savings programs, insurance program expenses are not person-specific. The average worker knows not to expect a dollar-for-dollar credit for employer-paid premiums.

**What to Do**

One of the purposes of this article is to introduce the concept that an urgent need for catastrophic financial protection has emerged that cannot be met by an employer-sponsored program under today's tax laws. A new essential benefits program should be created to insure the risk that a person could outlive other retirement savings. This program would pay a stream of gradually increasing life contingent annuity benefits. In addition, as discussed later in this article, the program may optionally cover permitted breaks from the workforce before retirement. Protecting the risk of outliving income resources in old age is emerging in everyone's awareness as equal in importance to covering other traditional catastrophic life-contingent risks such as medical care and death.

It is time to redefine “retirement,” and to educate the US people about the need to insure major or catastrophic risks while saving for other predictable and affordable income needs. It is also time to teach the US public about financial mathematics: Why and how to save enough, and the interrelationship of different benefit programs. In mathematical terms, benefit programs are supposed to be exclusive subsets of the universe of major life contingent risks: Their elements of intersection should be minimal. Because no one person or family experiences all forms of risks, no one enjoys all forms of benefits. But everyone receives the benefits they need because of the risks that they experience. Comparison to thy neighbor is not possible. Some receive more than their proportionate “share” of the health care insurance risk pool because they are sicker than predicted. Others receive more than their proportionate “share” of the life insurance risk pool because they die earlier than expected. And still others survive and receive more that their proportionate “share” of the life insurance risk pool.

Our concept is similar to the growing trend in healthcare. Healthcare programs are well on their way to adjusting to the concept of saving for the predictable in tandem with insuring the unpredictable and catastrophic. Health savings accounts (HSAs), for day-to-day and predictable medical costs, used in connection with high-deductible health plans, for catastrophic medical costs, can work for individuals who have the proper attitudes. Retirement programs should follow this lead by utilizing 401(k) or other account balance accumulation type plans as the savings accounts for expected or desired retirement expenses, while a new employer-sponsored program protects income against unpredictable events (such as living too long) that cause current savings programs to be inadequate.

**Why Now?**

Think back to our actuarial environment when Social Security was introduced in the mid-1930s. It was then, about 70 years ago, that the concept of working full-time until complete work cessation at age 65 started. In the last 70 years, longevity has significantly increased, and individuals generally remain vital and healthy for a much longer time. Studies have shown that most families are dual-income and an ever-increasing percentage of US workers work beyond age 65. A recent AARP survey of 1,200 baby boomers found that more than 80 percent expect to work at least partly in their retirement years. This post-customary-retirement-age work gradually decreases as the individual ages. Cessation of all work-based income does not occur until perhaps the early 70s or later for a fast-growing percentage of the retirement-age population. The three-legged stool of retirement income (personal savings, Social Security, and income from employer-sponsored retirement programs) has become a four-legged stool (with the addition of continued part-time employment income).

Current post-retirement accrual, existing funding requirements, and FASB (Financial Accounting Standards Board) accounting rules make it nearly impossible for an employer to afford to sponsor a traditional defined benefit program. Our Social Security program is suffering similarly. Recently announced legislative initiatives only exacerbate the funding problems. This predicament is particularly vexing, just when the future workforce is not large enough to replace the workforce that has been made up of baby boomers. Keeping employees who have had advanced training, continue to have a desire to work, and can offer their valuable experience becomes crucial. Employers need to find a way to entice dedicated, skilled workers to continue to work past customary age-65 retirement. Just as importantly, retirees need to continue to be as productive as possible. Studies have shown that continuing to work promotes health and
personal satisfaction. Also, because longevity for many 65-year olds will soon exceed 40 more years, not very many people will be able to afford to completely retire and just live off of accumulated savings.

Thus, retirement in today’s culture has already ceased to be something that occurs on a single day and has become a gradually increasing event. However, we must not forget, that because careers and work may continue for more than 50 total years in the new working world, it is important to build career-enhancing and family life care needs income into the “retirement” programs of the future. Let’s recognize and embrace this culture change and design a program in such a way that it can be both affordable and provide benefits at the time of “crisis,” whether that be for short periods of work cessation during one’s career or during the periods of later-age work slow-down and final cessation. We would encourage that providing work/life balance income during advanced education/training or approved philanthropic ventures (that could both be valuable to the employer) or periods when there is a need to take care of sick or elderly family members, be accepted as a form of temporary retirement and be an important part of our proposed retirement program of the future.

Using What Is Available Today

Learning from our industry’s good and bad retirement plan experiences, while supporting the actual emerging income needs of our nation’s retirees, we suggest that:

1. Employers continue to sponsor Section 401(k) programs. Saving via personal and employer contributions into investments that are professionally and prudently managed is the largest component in the retirement program of the future. In other words, 401(k) programs should be considered as the HSA of tomorrow’s retirement system.

2. Where possible, employers should be encouraged to adopt and sponsor traditional and hybrid defined benefit programs. Employers should continue to be able to sponsor benefit programs that grow with their business and suit their unique business objectives.

Twofold Retirement Program of Tomorrow

No one type of program will do the job. All employers should be strongly encouraged to sponsor the following new plan, the Retirement Income Security Plan (RISP), in addition to whatever 401(k)

or defined benefit plan fits their unique business goals. The RISP is intended to provide reasonable, affordable, and essential income needs only protection that is missing today and will be tomorrow’s social crisis without such plans. Without such plans, expect a future social crisis. Savings plans should be the biggest component of the twofold program of tomorrow.

Statistics clearly indicate that even simple retirement savings coverage for US workers is currently woefully inadequate. Important changes that will support the twofold program of tomorrow are happening in this arena already. A forum called Conversation on Coverage, convened by the Pension Rights Center, was sponsored by an array of financial institutions, retiree organizations, business groups, and labor unions. This forum followed a year-long public policy process in which 45 experts developed pragmatic proposals and common ground concepts to expand retirement savings. One subgroup focused on the question: “How do we increase coverage and retirement savings through new institutions and structures?” [See www.pensioncoverage.net for an in-depth look at this group’s recommendations.] It is possible to make 401(k) plans easy and affordable and to accomplish nearly universal coverage using ideas such as those proposed by this group.

In a nutshell, extremely simple multiple employer plans with low start-up fees and a transfer of fiduciary liability to financial experts, instead of the employer, would be the springboard employers who do not currently sponsor a 401(k) plan need to get their own 401(k) plan started. We believe (building on the concepts developed in the Conversation on Coverage) that once the plan is started and has enough of its own assets to afford to pay reasonable fees, it should eventually transfer into a single employer plan. At that point, the plan can be designed to fit the unique philosophy of the sponsoring business. Legislators need to define fiduciary responsibility and appropriate types of investment choices clearly. The investment industry should develop funds and other investment options that are state-of-the-art with easily discernable fees, and willing to accept start-up fiduciary liability.

Such improvements in the 401(k) plan world should expand coverage to nearly 100 percent. Savings plans can provide most of the income needs of our retirees if handled well.

Savings, although hugely important, is not crisis protection. Adequate savings, accompanied by an
RISP, can provide maintenance of living standards with peace of mind.

**What Do RISPs Look Like?**

RISPs are not intended to replace current qualified retirement plans, but rather to be companion, catastrophic-coverage-only plans. Some features we suggest:

1. The normal form of benefit should be joint and 50 percent to the surviving spouse, if married, or single life if not.
2. The projected benefit formula would be similar to traditional safe harbor defined benefit plans.
3. The RISP would intentionally pay in increasing increments, such as 25 percent from age 65 through 68, 50 percent from age 69 through age 71, 75 percent from age 72 through age 74, 100 percent thereafter.
4. No other optional benefits, even if actuarially equivalent, should be offered. Allowing smooth benefit payments or lump sums would undermine the purpose of these plans and interfere with new proposed funding rules applicable to RISPs.
5. The RISP is intended to co-exist with a 401(k) plan or traditional or hybrid defined benefit plan. It is not intended to be the sole source of retirement income. It is only intended to insure against the risk of loss of income resources caused by longevity.
6. Retirement benefits would commence at the stated commencement age regardless of the employment status of the participant. No postretirement accruals would occur after benefit commencement. Benefits would, however, be increased at each benefit tier (e.g., when the benefit level increases from 25 percent to 50 percent) according to some economic index, such as average wage base for Social Security purposes, that occurred in the interim. Employer contributions and accruals, if any, would continue post benefit commencement in the companion 401(k) or other plan if the individual were still employed there.
7. Mid-career benefit payouts could be included in the RISP:
   - These payouts might occur for such work-cessation occasions as an approved work-related academic or training sabbatical, pressing family care need, or approved philanthropic venture.
   - These mid-career payouts might be permitted once every “x” number of years, or perhaps only a certain number of times prior to retirement benefit commencement. The participant would need to be unemployed during these mid-career payout periods.
   - Because technology and business change to keep up with new innovations has become important to the success of businesses, funding for benefits in a RISP to allow employees to have income while being trained further or to volunteer in an environment that will enhance their skills might be valuable to the employer as well as the employee participant.
   - Death benefits would not be provided in these plans.
   - Smooth and nonvolatile funding and accounting requirements are essential to the sponsoring employer. Each benefit increment would accrue separately from the others and would have its own target full funding age. That is the first 25 percent (in our example) would fully accrue at age 65, the 50 percent would fully accrue at age 69, the 75 percent would fully accrue at age 72, and the 100 percent would fully accrue at age 75. The mid-career work/life balance benefits would be funded actuarially as ancillary benefits.
   - FASB rules for these types of programs should be structured to reflect how the benefits are being accrued and funded and that they are being paid as life contingent annuities only. Ideally, accounting disclosures and actual funding would match. A new set of concise funding and deduction rules that apply specifically to RISPs will be needed, but are beyond the scope of this article.
   - Drawing from the simple design multiple employer plan concept to improve retirement plan coverage developed by the Conversation on Coverage, financial institutions or groups could sponsor multiple-employer RISPs for small or start-up plans. In this way, corporate trustee services, enrolled actuary services, and investment fees could be shared until an employer chooses to sponsor its own single employer plan. Corporate trustees would serve as the fiduciary as well.

**Why?**

The final question is why an employer would sponsor such an insurance type benefits program with a companion 401(k) or similar savings plan program? If the US population is to enter their later years of life with financial security and peace of mind, employers must take on the responsibility of adding
this type of guaranteed longevity income benefit to their benefits program. The three Rs of wage and benefit programs never change—recruit, retain, and reward—and our proposed type of program helps to support this. As employees begin to understand that survival beyond one’s means is a distinct probability, they will be attracted to employers that offer benefits programs that provide this type of benefit. Retention and appreciation would occur. With new smoother funding and FASB rules, these types of plans would be much more affordable and much less volatile than today’s qualified defined benefit programs that are quickly becoming extinct.

It is time to redefine retirement. Let our industry lead in this area, and let us build a better, but more secure, US retirement program.