Retirement 20/20

HEADLINES FROM THE CONFERENCE

Resolving Stakeholder Tensions: Aligning Roles with Skills

Sept. 24–25, 2007

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Retirement 20/20

ENVISIONING THE FUTURE

This report presents headlines from our second *Retirement 20/20* conference "Resolving Stakeholder Tensions: Aligning Roles with Skills." The conference focused on the alignment of roles and skills for society, markets and employers and on minimizing competing priorities among the stakeholders. This headlines report covers the key roles for each stakeholder that emerge from the conference. The full describes report in more detail the discussions and thought process of the attendees in developing these stakeholder roles. The full report is available electronically at *www.retirement2020.soa.org*.

Introduction

Retirement 20/20, an initiative sponsored by the Society of Actuaries' Pension Section, aims to bring together experts interested in and impacted by retirement issues in order to design a new retirement system from the ground up. In reaction to the shortcomings of both traditional defined benefit plans and defined contribution plans, Retirement 20/20 seeks to find solutions that meet the economic and demographic needs for the 21st century.

On Sept. 24–25, 2007, the Society of Actuaries held its second annual *Retirement 20/20* conference. The 2007 Conference focused on the alignment of roles and skills for different stakeholders. The conference attendees worked on defining stakeholder roles that work together while minimizing competing priorities between stakeholders. In the end all roles need to be assigned; to the extent one role is removed from one stakeholder, it needs to be transferred to another (i.e., interlocking roles).

Background on *Retirement 20/20* and the First (2006) Conference

The initiative began in late 2005 with the purpose of designing a new retirement system based on the belief that neither defined contribution nor defined benefit plans are the ideal answer, and a better way can be found. The initiative did not start by looking at specific designs or risk sharing ideas, but rather started with the idea of developing core principles.

The 2006 Conference[1] was a discussion of needs, risks and roles for the following stakeholders:

- **Society**. By society, we mean society as a whole (all taxpayers/citizens). This includes both current and future generations since there are intergenerational costs and risk-bearing issues.

- **Individuals**. Individuals are the ultimate users of retirement income and have the need to prepare for retirement and then manage retirement income while negotiating various risks.

- **Markets**. Markets have the dual roles of retirement asset accumulation and de-accumulation and also provide hedging opportunities.

- **Employers**. Employers hire individuals and need to attract, retain, motivate and retire individuals.

The six themes that came out of the 2006 Conference were:

1. Systems should align stakeholders' roles with their skills;
2. Systems should be designed to self-adjust;
3. Systems should consider new norms for work and retirement and the role of the normative retirement age;
4. Systems should be better aligned with markets;
5. Systems should clarify the role of the employer; and
6. Retirement systems will not succeed without improvements in the health and long-term care systems

The seed for the 2007 Conference was found in the first theme of aligning roles with skills. Participants at the 2006 Conference discussed the fact that individuals aren't the best suited for retirement planning or deciding how to invest retirement assets, and an employer's goal in business usually isn't to operate a pension plan. This misalignment of roles with skills creates problems in today's retirement system. Therefore, the proper alignment of stakeholder skills with roles is critical to the success of any new retirement system.

Headlines

Executive Summary

For 2007, we set out to determine the optimal roles for our various stakeholders. Proper role definition is critical for the system's success. The correct role would be one that uses each stakeholder's knowledge and talents optimally. For example, market experts would work in the markets, and employers could focus on their core business. Defining the stakeholder roles is also necessary before beginning to design the features of the new retirement system.

For 2007, we focused on role definition. Particularly:

- Which stakeholder 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?

The stakeholders discussed in 2007 were society, markets and employers. Based on the consensus development of conference participants, the key roles identified for these stakeholders were as follows:

1) Society provides structure to the retirement system through:

- Helping individuals make the right decisions,
- Setting some guidelines about what **ought** to happen, and
- Providing consumer protection.

Specific goals that society should work toward include:

  - Encourage **lifetime income** (annuitization), at least through a basic social insurance component,
  - Help individuals in the **accumulation** of retirement wealth, and
  - Provide **oversight** to the system through appropriate levels of rules and regulations.

2) Markets provide structure to support the retirement system by:

- Facilitating and allowing for **groups** to approach the markets,
- Providing proper **incentives** for agents (who can facilitate the use of groups),
- Providing **standardization** among products offered, and
- Encouraging **innovation** in hedging and pooling instruments.

3) Employer provides structure to the retirement system through:

- Playing a role as a **facilitator** of individual savings,
- Serving as an unbiased **educator and trusted advisor**, and
- Participating in various **elective employer roles** of purchasing agent, distributor of income and guarantor.

Conference Overview

Roles were considered for three of our stakeholders:

- **Society.** Society in this case is society at large: all citizens and particularly all taxpayers who have to pay the cost of any retirement system designed. In this case, government (including politicians) acts as an agent or representative of taxpayers/society. Taxpayers include current taxpayers and future taxpayers, those who may end up paying for unfunded mandates.
  Society as a whole is often concerned with issues of intergenerational balance (more money spent on retirees means less money to spend on children and infrastructure) and the redistribution of wealth (social insurance systems, such as U.S. Social Security and the Canada Pension Plan/Quebec Pension Plan (CPP/QPP) often pay progressive benefits, where wealthier taxpayers receive less money relative to their earnings or contributions than less wealthy taxpayers).
- **Markets.** Capital markets are where the accumulation and de-accumulation of wealth take place. For purposes of our discussion, markets include financial intermediaries (e.g., insurers and mutual funds) who take the raw product of the capital markets and turn it into solutions for individuals and groups. Markets are a key to the success of the new retirement system. They can reduce the cost of retirement risks by providing the proper hedges (e.g., longevity bonds).
- **Employers.** Employers play a key role in today's retirement system, as the sponsors of defined benefit and defined contribution plans in both the United States and Canada. Employers also have motivations that may drive them to want to sponsor retirement plans—as a tool to help attract, retain, motivate and eventually retire their workforce. The employer discussion tended to focus on private (rather than public) sector employers; in some cases the employer discussion considered differences between the two employers.

What happened to individuals?

Keen observers will note that we identified four stakeholder groups at our 2006 Conference—individuals, employers, markets and society—but the 2007 Conference only focused on three of those. The individual as stakeholder was excluded from the 2007 Conference. What happened? Mostly driven by logistical considerations, we focused on the other three stakeholders. However, even though individuals were not highlighted by a separate panel discussion, they were always part of the conference discussions. The discussions focused on what roles the other stakeholders needed to play to best support individuals.

The conference was organized into three panels. Each panel began with expert speakers, chosen to present diverse views of the issue, who introduced the topic. After the panel introduction, the participants broke into working groups to discuss the issue in more depth. A spokesperson then reported the consensus (or lack thereof) of his group back to the full conference. At the end of the two days, conference participants were given the opportunity to vote for their favorite themes (those that they felt were the most important) from all of those that emerged out of the discussions.

Role of Society

Malcolm Hamilton (Mercer) and Virginia Reno (National Academy of Social Insurance) presented an overview of how and how well the social insurance systems are working in Canada and the United States, began discussion of the proper role of society in providing retirement security, and debated the role society should take with respect to retirement savings. Conference participants then considered these questions, as well as whether society should protect people if they are forced to retire before they plan to and whether society should encourage individuals to work longer.

The primary conclusion of conference participants was that the role of society is to provide structure to the retirement system. This comes about primarily through three main functions:

- Help individuals make the right decisions,
- Set some guidelines about what ought to happen, and
- Provide consumer protection.

One goal of society with regards to the retirement system is that it wants to ensure that today's workers save enough that they aren't a burden on tomorrow's taxpayers. Society, when focusing on the roles of helping individuals make the right decisions and setting guidelines about what ought to happen, could achieve this particular goal by doing the following:

> *"There's an awful lot of work that needs to be done to find ways to alleviate poverty without shifting burdens to future generations [and] without undermining the incentive to save for people with average incomes. To me that's the challenge. Canada's done an OK job, but there's certainly room to do these things better."*
>
> *—CONFERENCE PARTICIPANT*

- **Encourage lifetime income (annuitization).** First, conference participants felt the basic social insurance benefits ought to be structured as lifetime income, and they should maintain their progressive element. Participants discussed whether flat-dollar benefits were better; flat dollar benefits introduce negative incentives for individual behavior and the surrounding bureaucracy around means-testing was thought to outweigh any potential savings. Secondly, as a rule, society should mandate or encourage the annuitization of retirement savings. It could do this by mandating or encouraging the annuitization of a portion of savings (e.g., up to a dollar level or percentage of pay). Note that this could be done through tax mechanisms; annuitization could be tax-favored while not annuitizing could carry tax penalties.

- **Accumulation of retirement wealth.** Conference participants felt that society should take an active role in helping individuals accumulate funds for retirement. This could be done in several ways. One way would be for society (the government) to mandate a minimum level of savings and encourage more savings (e.g., through tax policy). Another way this could be achieved would be to set up a mandatory second-tier program that would exist in addition to the social insurance system (Social Security in the United States, CPP/QPP in Canada). This second-tier system might be thought of as a mandatory pension plan out of which employers or individuals could elect to opt. This idea was revisited and developed more fully in the role of the employer discussions.

- **Oversight.** Society has a responsibility to set the rules and regulations and to provide oversight to the system. This occurs in several ways. First, society provides basic oversight for consumer protection. Secondly, it encourages some degree of standardization to allow consumer comparability. Finally, in providing oversight, the government also needs to "get out of the way" to allow and encourage evolution. The example noted most often was removing barriers to phased retirement and later retirement that could help encourage new patterns of work and retirement in an individual's later life.

Two final observations that arose from the role of society discussion were:

- **Participants felt strongly that society should not set any direction regarding retirement age**. Some people have argued that society ought to be encouraging later retirement, particularly for knowledge workers, as this will help to avert the retirement crisis by keeping people in the workforce longer (paying taxes into the social insurance system without yet collecting benefits). Conference participants felt that society should neither encourage nor discourage earlier or later retirement.

- **Participants felt that society should have an actual retirement policy, not just a tax policy.** Tax policy is certainly one way to influence the behavior of individuals, but conference participants noted again and again the need for oversight, standardization of products and education of participants—three potential goals of society that are unrelated to tax policy.

Role of Markets

Keith Ambachtsheer (KPA Advisory Services) and Zvi Bodie (University of Boston) discussed the imbalance between the markets (and the very sophisticated individuals who work there), and the individuals who need the markets to help them manage their retirement risks. This is partly due to a lack of symmetric information (market makers and financial intermediaries have more information than users of the market, particularly unsophisticated users such as individuals). Panelists considered whether you fix that asymmetry by using buying cooperatives (unsophisticated individuals band together to hire an agent who understands the markets), or by offering guarantees (consumers don't have to understand how the car is put together because it comes with a manufacturer's warranty). In identifying a solution, one must consider that buying collectives may not achieve what is desired if their agents don't have the proper incentives.

> *Behavioral finance certainly emphasizes [that] you want to offer few choices. If you give too many, you muddy the waters. Toyota only offered three good cars in the 70s, meaning they only offered three cars, as opposed to GM [which] had lots of bad cars, but you could get lots of variety in those bad cars.*
>
> —CONFERENCE PARTICIPANT

The animation of the panelists spilled out into the working groups, where participants considered how the markets can best be used to hedge retirement risks. They considered whether the information asymmetry that the panelists discussed could be better handled by focusing on variety or standardization (particularly of products), whether we should focus on designing better solutions for individuals or encouraging increased formation of groups, and how to get all of this done.

Participants concluded that it is very important, when we think about the retirement system, to consider how we use the markets. Structure became a recurring theme, because it was felt that additional structure would help the markets work better. Participants saw this structure represented in the following four characteristics of a new retirement system:

- **Groups.** Markets work best when groups approach the markets. One participant quoted a study where groups (in the form of institutional pension funds) performed at least 200 basis points better than individuals (in the form of mutual funds) when all other factors were controlled for (the difference was largely, but not completely, attributable to fees). Conference participants felt that large groups were best, that groups could be either for-profit or not-for-profit, and that competition among groups was essential. A for-profit/not-for-profit model could mean that you could have government agencies, as well as insurers and other financial institutions, establish groups that individuals or employers could elect to join. Competition is necessary to ensure that participants experience the best outcomes (groups that have to compete would be more efficient than groups that do not compete).

- **Incentives.** Agents help groups (and individuals) use the markets better, but agents need proper incentives. Agents in this case can include agents working with a large group (such as investment managers, actuaries and administrators) and agents working with individuals on their retirement plans (such as financial planners). One conference participant who works for a public pension plan described the principles they use to run their fund: run it like a business; don't do in-house what they can purchase cheaply; reward employees competitively to maintain talent. The discussion on how to give agents the right incentives to work on behalf of individuals included disclosure of costs/fees of products (both as a dollar amount and a percentage) and a better alignment of agents' compensation with the group members' interests (for example, agents' bonuses increase when group members' benefits increase).

- **Standardization.** Conference participants discussed whether market innovation or standardization was necessary, and came to the conclusion that a degree of market standardization was important going forward. Markets need to offer standardized products so consumers can comparison shop. Today, while specialized features on products such as annuities can be very helpful, it's difficult, if not impossible, for most consumers to determine if the special features add value. The analogy was made to U.S. Medicare Supplement plans, which are standardized into 12 basic designs (made a bit more complicated by the introduction of Part D) to allow price comparison by seniors. One advantage of standardization in the retirement system context would be that middle income consumers who had a relatively small amount to annuitize (say $50,000 to $100,000) would be able to get more for their accumulations, given that standardized products should improve comparability, increase competition and drive down prices. For these consumers, an additional $10 of monthly benefit in the long term would come at a lower price than at present, all other things being equal.

  Conference participants discussed whether there should be standardized products (e.g., standard form for a life annuity with a 10-year guarantee period) or standardized features (e.g., guarantee period option works the same on all annuity forms). Participants clearly felt that standardized products were necessary because standardized features did not clear up enough of the confusion. However, the development of standardized products would not mean that insurers and others could not offer products that were not standardized.

- **Innovation.** We need to encourage market innovation, particularly in the development of instruments that can hedge retirement risks. Markets have more ways to hedge financial risks. However, retirement risks are somewhat different from most financial market risks. Pension plans and annuities have long tails on their obligations. In the United States today, the supply of long bonds is far outstripped by the potential demand (from pension plans and insurers), and what long bonds do exist don't match the duration of pension plans and insurer obligations. In addition, systematic longevity risk (the risk that a cohort of individuals will outlive expectations for that cohort) is not a risk that markets can currently hedge. This can make annuitization, in particular, very expensive. Markets must be encouraged to develop the instruments to meet the needs of tomorrow's retirement system so we can bring the complex future into focus.

One thing was clear from the markets panel discussions: markets need to work better. To some extent, this may happen by changing how we use the markets (using groups and agents), but we also need to make the market work better for the retirement system (some standardization and more innovation). Defined benefit plans sponsored by employers arose in an era before many of today's hedging vehicles were developed. We ought to be able to both better use what the markets are doing today, and also demand more from the markets, as we design better retirement systems.

Role of the Employer

Rounding out the two-day conference was a panel that explored the role of employers in the retirement system. Panelists Elaine Noel-Bentley (Alberta Local Authorities Pension Plan trustee) and Robert Patrician (Communication Workers of America) worked through what role, if any, the employer should have in a retirement system. Their discussion covered points such as whether the employer ought to have a role, whether that role should be mandatory or voluntary, whether the employer role should be to put aside money for employees (capital financing), to provide payroll deductions to the employee's fund of choice (facilitate savings), to act as a trusted agent to determine the best accumulation and de-accumulation vehicles, and whether the employer should ever be the guarantor of the retirement promise (as they are today in defined benefit plans). And finally, critically, if not the employer, who?

The working groups debated these questions at length and agreed that employers ought to have a role in a retirement system, but that role could look very different from the role they play today. Today, their role in the retirement system is really based on a binary choice: they sponsor a plan (defined benefit or defined contribution) or they don't. There are some circumstances where they can offer access to a plan (e.g., universities and TIAA-CREF) and some circumstances where they participate in industry-wide plans (e.g., multi-employer plans), but these are limited.

When thinking about the role of the employer, the working groups developed the following possibilities:

- **Facilitator.** Participants felt that employers should continue to play the role they do well today in terms of facilitating employee savings. Payroll deductions are a powerful tool to help employees prepare painlessly for retirement.

> *I think we have to challenge ourselves. What is so fundamentally sacrosanct [with] the employer being the entity that sponsors the pension plan? In the United States, that's a creation of wage price controls of World War II.*
>
> *—CONFERENCE PARTICIPANT*

- **Educator and trusted advisor.** The working groups also focused on the role of the employer as educator and trusted advisor. We know that employees trust their employer to give them unbiased information about retirement accumulations. In addition, the employer can truly be an unbiased agent—the employer realizes no monetary gain from the choice the employee makes, and in fact may be biased to ensure that the employee plans well, which would assist the employer in easing the employee out of employment were this to become necessary or desirable later on.

- **Elective employer roles.** Other possible employer roles include purchasing agent, distributor of income and guarantor. As a purchasing agent, the employer might select groups for employees to participate in or investment funds that meet specific retirement targets and provide superior performance at a reasonable fee level. Many employers play the purchasing agent role today with defined contribution plans and other employee benefits. As a distributor of income, the employer would help employees to structure the transition from accumulation of wealth to creation of lifetime income. Employers wouldn't necessarily guarantee the lifetime income, but they would help structure the choices, such as by setting up preferred arrangements with insurers and other third parties. Finally, the employer could act as guarantor, a role it has played historically in defined benefit plans, whereby the owners of the business (taxpayers for public plans) guarantee some or all of the retirement risks faced by employees. One way this might differ from the traditional defined benefit sponsor role would be that

> *Employers are where it all starts. That's where your compensation comes from, so they are always going to have a role in this. You can't just say, "well, you have nothing to do with it," unless you're going to just go with [a] totally general revenue-financed type of program.*
>
> *—CONFERENCE PARTICIPANT*

the employer might choose to guarantee part of the risk (e.g., longevity risk) but might pass other risks back to the employee, or hedge them in the markets.

Ironically, by opening up a debate on the appropriate role of the employer, we can consider mandating second-tier coverage[2] as one feature of the new retirement system. Second-tier coverage in the United States and Canada has been, to date, employer-sponsored pension plans. One criticism of the current private employer retirement system is that it has never covered the majority of workers. Small employers in particular are unable to play a role, because the cost and risk of sponsoring a pension plan are simply too much for them to bear.

If there were plan sponsors other than employers, and if the employer's role could be simply to ensure that a payroll deduction makes it from the employer to the plan of choice, then you could mandate participation in the system. We already mandate participation in the social insurance system (with some exceptions) and the employer's role in its financing and administration (to remit contributions on behalf of itself and its employees). There could be opt-out options for employers (permitting an employer to sponsor its own plan) and/or for employees (permitting employees to elect to contribute to a plan of their choice).

End Notes

1 A copy of the 2006 Conference report can be found at *www.retirement2020.soa.org*.

2 First tier coverage is social insurance. Second tier coverage is in addition to social insurance, e.g. defined benefit pension plans. Second tier coverage typically defers income and pools risk, while first tier coverage may also redistribute income (between generations and within generations).

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To find a copy of the full conference report and
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