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US Retirement Market and the Role of the Actuary

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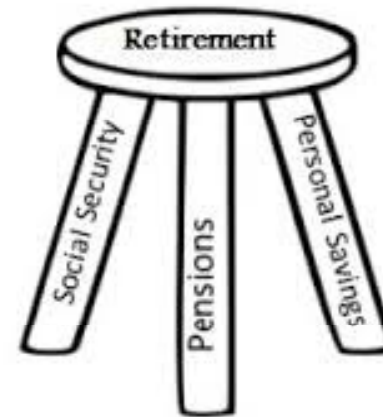
2nd & 3rd February, 2015 Mumbai - India

Introduction

- ▶ Retirement security: a three legged stool
 1. Social Security
 2. Personal savings
 3. Employer pensions (public and private)

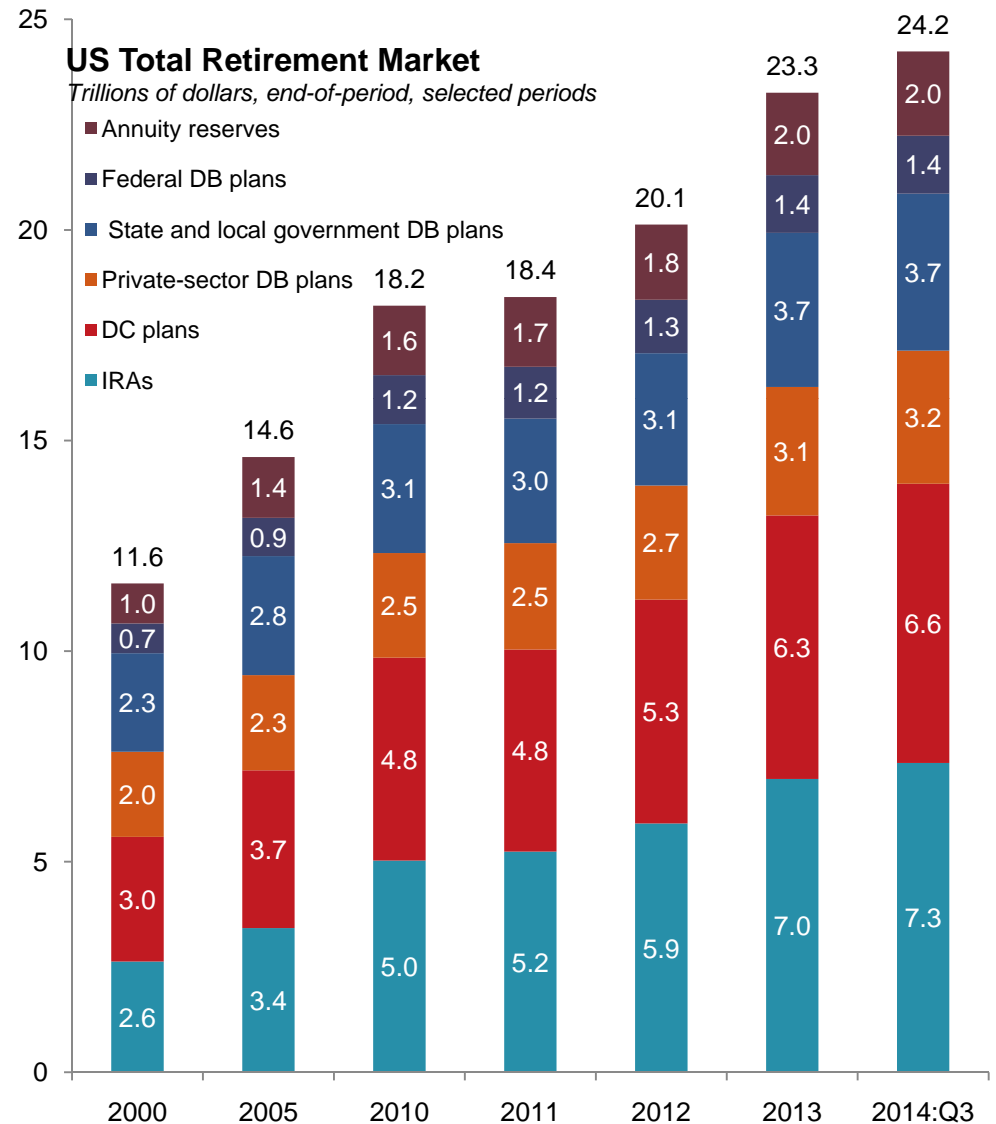
- ▶ De-risking in US defined benefit private pensions

- ▶ Role of the Actuary



Overview of US Retirement Market

- ▶ Total US retirement assets of \$24.2 trillion as of 09/30/2014
- ▶ Liabilities for public and private DB plans exceed assets



Source: Investment Company Institute report "The U.S. Retirement Market, Third Quarter 2014"

1. State of Social Security

Background on Social Security

- ▶ Established in 1930s to provide a basic level of income during retirement
- ▶ Pay-as-you-go (not pre-funded)
- ▶ Benefits are progressive
- ▶ Benefits are guaranteed for life and indexed to cost-of-living

Social Security concerns

- ▶ Cash flow deficit: payroll collections are not fully covering benefit payments
 - After fund depletion, only ~3/4 of scheduled benefits is projected to be covered by payroll taxes
- ▶ Longevity
- ▶ Recessions have decreased taxable earnings

2. State of Personal Savings

- ▶ 36% of US workers have less than \$1,000 in personal retirement savings
- ▶ 60% of workers have less than \$25,000 in personal retirement savings
- ▶ Statistics on personal savings much higher for workers who have either an IRA, defined contribution, or defined benefit plan
- ▶ Cost of living and day-to-day expenses are the top reasons workers do not save (or save more)

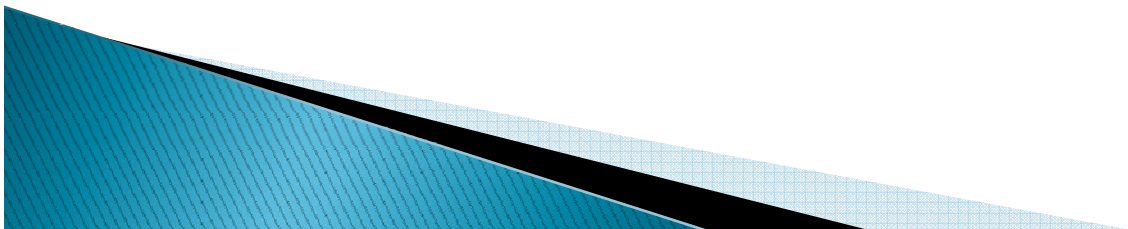
In total, about how much money would you say you (and your spouse) currently have in savings and investments, not including the value of your primary residence (or value of defined benefit plans)? (2014 Workers n=783)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2014 Has Ret. Plan*</u>	<u>2014 No Ret. Plan</u>
Less than \$1,000	29%	30%	28%	36%	11%	73%
\$1,000 - \$9,999	17	18	18	16	17	16
\$10,000 - \$24,999	10	12	11	8	10	5
\$25,000 - \$99,999	20	20	19	18	28	3
\$100,000 - \$249,999	14	11	12	11	16	2
\$250,000 or More	10	10	12	11	17	1

*Has Retirement Plan defined as respondent or spouse having at least one of the following: IRA, DC plan, or DB plan

What Can the Actuary Do?

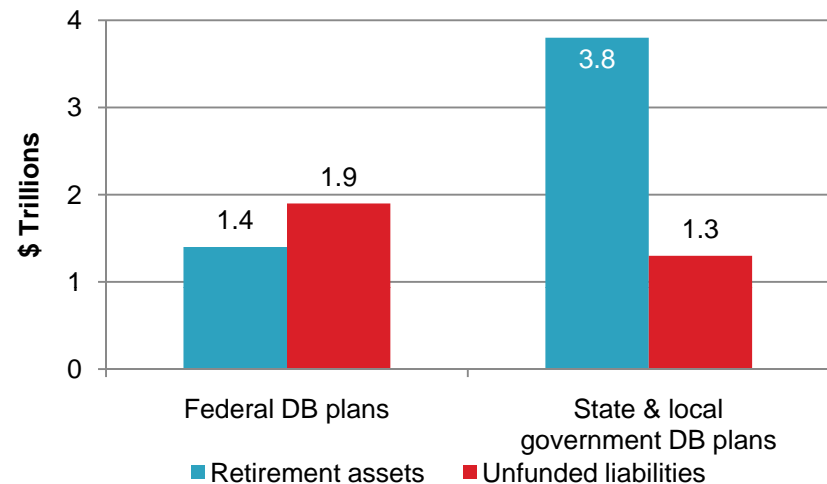
- ▶ Actuarial analyses on the impact of legislative changes to the Social Security system (e.g., increasing the retirement age, decreasing benefits)
- ▶ Refine longevity projections
- ▶ Continue to emphasize financial literacy and the value of lifetime income
- ▶ Product design that provides lifetime income for individuals (e.g., longevity annuities)
- ▶ Promote employer-based plans, especially given statistics on personal savings and connection with other retirement plans



3a. State of Public Pensions

- ▶ As of the end of 3Q 2014, public pensions had over \$3 trillion in unfunded liabilities
- ▶ Longer-term pension benefits often promised in lieu of salary increases
- ▶ Like private pensions, hurt by market volatility
- ▶ Accounting rules allow for optimistic actuarial assumptions
- ▶ Contribution holidays

U.S. Total Retirement Entitlements



“Kentucky lawmakers demand reforms to teacher pension plan” – USA Today (January 1, 2015)

“New Jersey’s pension system debt hits \$170 billion” – TownHall (12/05/2014)

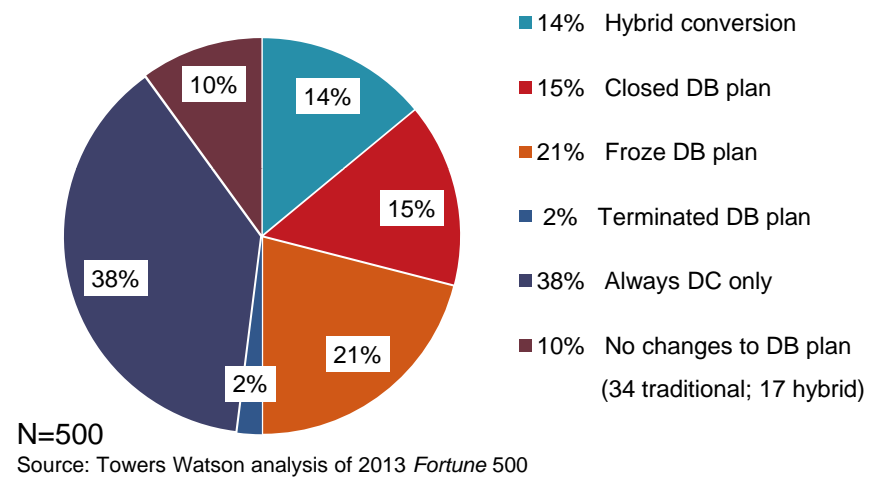
“Hawaii’s billions in unfunded retirement liabilities part of national trend” – Hawaii Reporter (11/20/2014)

“Public Pension Tabs Multiply as States Defer Costs and Hard Choices” – New York Times (February 24, 2014)

3b. State of Private Pensions

- ▶ Market volatility, declining interest rates, increasing longevity, and complicated regulation
- ▶ PBGC liabilities increasing
- ▶ Many defined benefit plans closed to new entrants, or benefits frozen altogether¹
- ▶ Unfunded benefits still remain
 - Aggregate S&P 1500 pension plans funded status declined from 88% to 79% between YE2013 and YE2014²
- ▶ DC plans becoming main employer-sponsored pension vehicle

Most recent changes to retirement programs since 1998



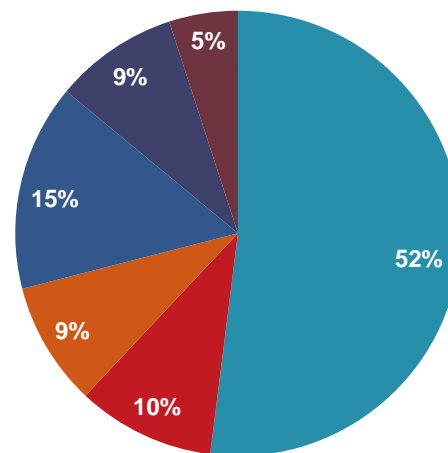
1 Source: Towers Watson, "Retirement in Transition", 2014.

2 Source: Mercer, January 6, 2014.

What Can the DB Plan Actuary Do?

- ▶ Actuaries play a critical role in assisting plan sponsors with de-risking
- ▶ Liability-driven investing (LDI) seeks to invest plan assets to match characteristics of the liability, and mitigate risk of declining rates on funded status
- ▶ Longevity risk is increasingly of interest, especially with recent release of the Society of Actuaries' RP-2014 mortality tables and mortality improvement scale
 - Liabilities increased 3-7%

By 2015, 71% expect to have implemented an LDI strategy



- Yes - We have implemented an LDI strategy prior to 2013
- Yes - We have implemented/will implement an LDI strategy in 2013
- Yes - We are planning to implement an LDI strategy in 2014/considering for 2015
- No - We have considered an LDI strategy but decided against implementing it
- No - We have not considered an LDI approach
- Don't know

Source: "US Pension Risk Management: What Comes Next?" November 2013. Towers Watson. 180 organizations surveyed.

Liability De-Risking

Lump Sum Cash Outs

- ▶ Plan design offers lump sums
- ▶ Lump sums offered to former terminated employees
 - Currently attractive because of disconnect between mandated lump sum mortality and current assumptions
- ▶ Regulatory requirements for minimum funded status; accounting impacts

Retiree Buyouts

- ▶ Several options:
 - Individual retiree annuitization
 - Buy-in
 - Plan termination
- ▶ Notable examples:
 - GM (\$26 BN, 2012)
 - Verizon (\$7.5BN, 2012)
 - Motorola (\$3.1 BN, 2014)
 - All with Prudential

Longevity Swaps

- ▶ Still nascent market in the US
 - Basis risk
 - Costly bespoke transactions