

The Next-Generation Kansas Pension Solution

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House Pensions & Benefits

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Attachment # 3



**The goal of a pension should be to provide
income for life protected for inflation**

Setting the Goal for a Good Retirement

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Goal: Provide standard of living in retirement equal to the standard of living which the state employee has been accustomed during the work life.

Goal Representation: Provide inflation-protected income for life in retirement adequate to help maintain that standard of living.

Objective Function: Maximize the probability of achieving desired target income subject to a minimum income and other risk constraints.

Life Cycle Principle: Strike a balance between the standard of living during the work years and the standard of living in the retirement years.

Criteria for a Better Pension Solution

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- Provide scalable, low-cost investment strategy that focuses on the success of achieving each state employee's desired income goal
- Provide a tailored goal for each state employee that is not "one size fits all", which adjusts to changes in salary and retirement date or employee choice
- Develop a plan that is low-cost, integrated with other retirement-dedicated assets, and transparent to the state employee
- Be effective for state employees who are completely unengaged (never open statements and never customize personal settings)
- Provide meaningful information and choices with easy implementation to state employees who do engage to improve their chances of achieving their income goal
- Allow the State to control their costs including volatility of contributions and eliminate balance sheet risk

These Criteria Are Not Met By Either Cash Balance or Traditional DC Plans

- Accounting standards and actuarial principles under-estimate the cost of cash balance plans.
- Traditional DC plans require participants to make complex financial decisions.
- Neither cash balance nor traditional defined-contribution (DC) plans were designed to provide core retirement benefits.
- Neither cash balance nor traditional DC plans are integrated with other retirement-dedicated assets.
- Both cash balance and traditional DC plans are focused on the wrong goal: wealth instead of income for life.



An Ideal Pension Solution Combines the Best of DB and DC

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LIKE DEFINED BENEFIT

- Focuses on achieving retirement income.
- Manages the estimated risk of failure to achieve retirement goals.
- Does not require employees to select investment strategies and/or individual investments.
- Does not require participants to be engaged.
- Leaves complexity "under the hood."

LIKE DEFINED CONTRIBUTION

- Reduces contribution cost and balance sheet risk for the State.
- Allows customization to individual circumstances.
- Facilitates flexible payout options at retirement.

UNLIKE BOTH DB AND DC

- Creates a deliberately structured portfolio to target each individual's inflation-adjusted income goals.
- Offers meaningful choices to help employees improve their chances of achieving their income goals.

Technology Now Exists to Provide a Better DC Solution

A DC Managed Account Solution:

1. Eliminates the investment confusion often associated with typical DC plans
2. Caters a portfolio to each employees retirement income needs
3. Integrates with the state DB plan and expected Social Security benefits
4. Keeps employees informed about their plan in a meaningful way
5. Can be a standalone or default option for all employees

How Would This Work for Kansas Employees?

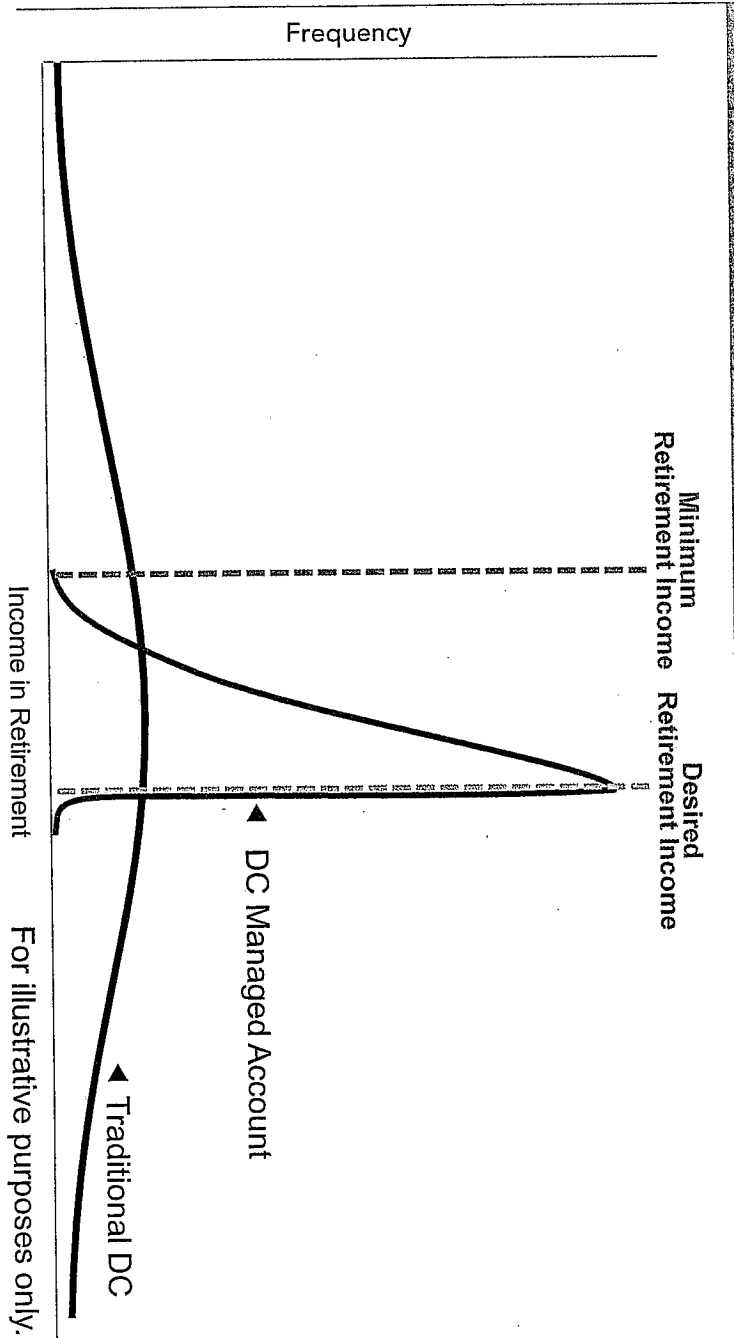
- Each participant has a different financial account profile—no one is “average.”
- A targeted income managed account creates an investment strategy for each participant based on his or her retirement account characteristics.
- Retirement account balance sheet integrates certain (known) sources of retirement income.

CURRENT RETIREMENT ACCOUNT BALANCE SHEET	
Assets	Liabilities
Current DC account balance	Essential income target
Projected future contributions (human capital)	Surplus available for desired income target
Social Security Benefit	
State Defined Benefit	
State Cash Balance Benefit	

Dynamic Portfolio Strategy Focuses on the Goal

- Dynamically manages risk of participants not achieving their goals
- Improves chances of achieving desired income target
- While reducing the risk of ending up too far below it

ILLUSTRATION



Income in Retirement For illustrative purposes only.

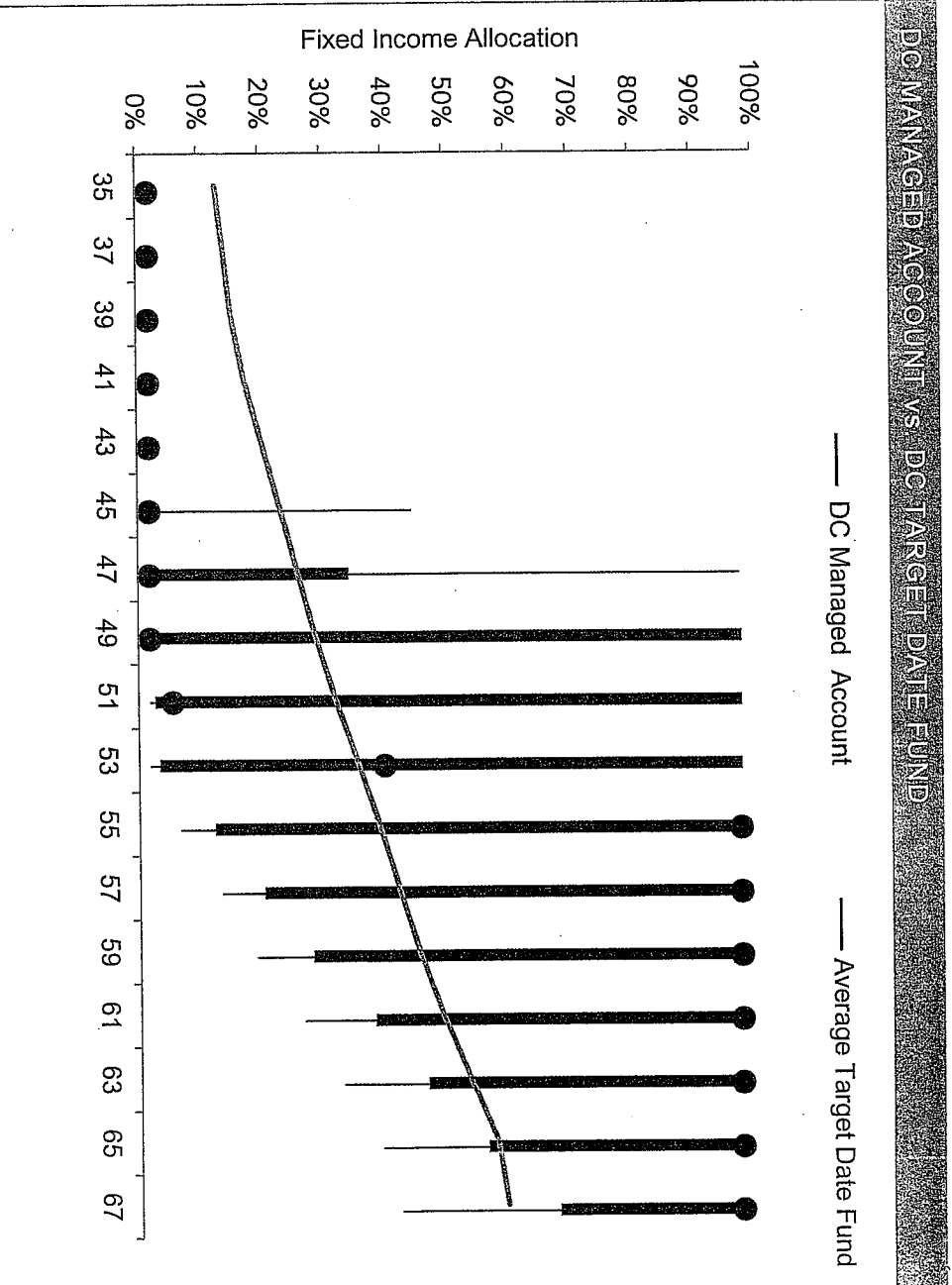
Dynamic Asset Allocation vs. DC Target Date Fund

Customizing the portfolio to each individuals needs vs. one size fits all

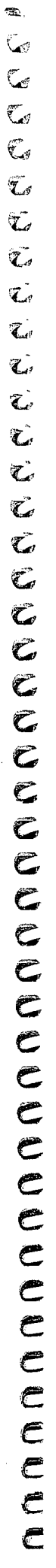
Hypothetical illustration:

- 35 year old
- \$50k salary
- 8.75% total contribution
- \$27.8k Minimum Income goal
- \$47.3k Desired Income goal

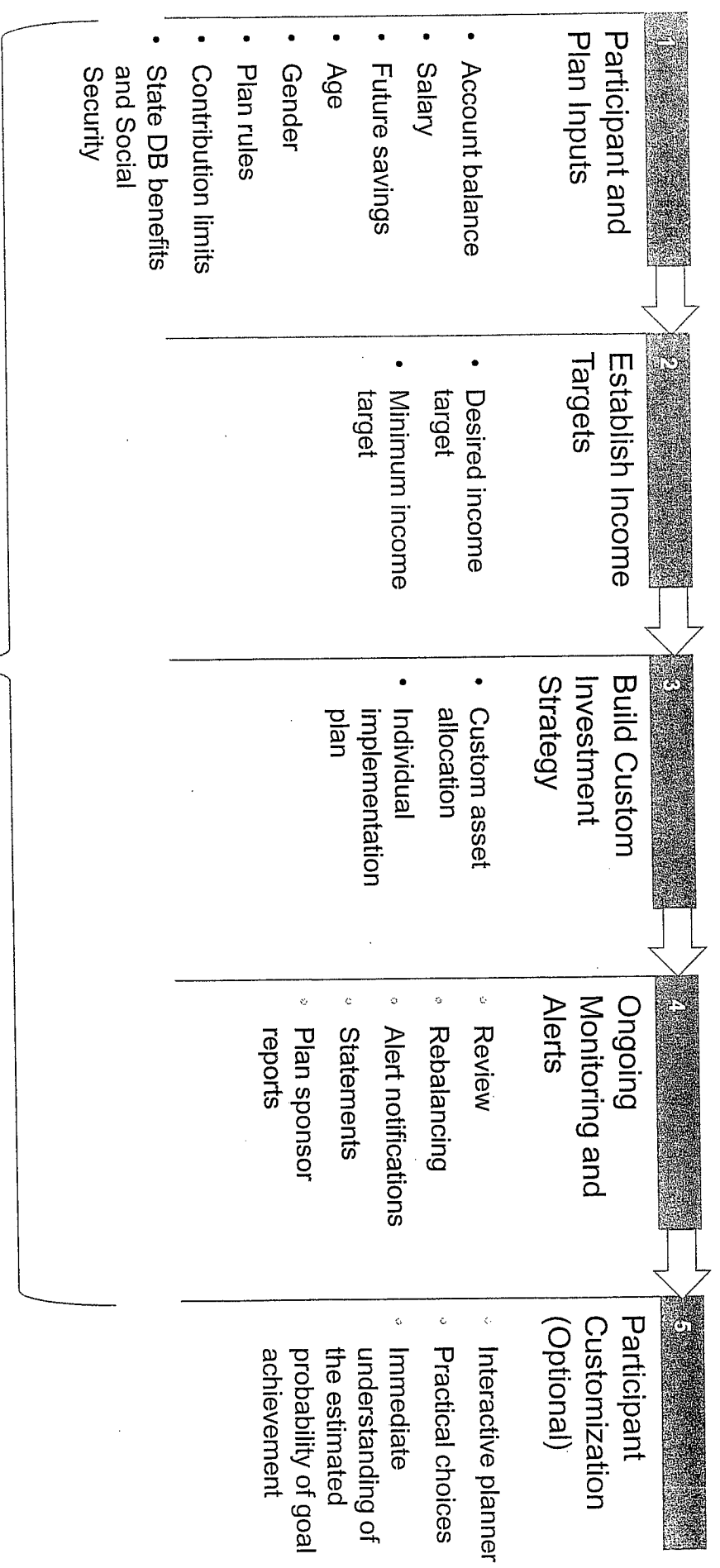
This "box" chart shows simulated fixed income allocations for different ages. For every age, the circle mark is the median, the edges for the respective "boxes" are the 25th and 75th percentiles, and the whiskers extend to the 15th and 85th percentiles.



The projections or other information of the estimated probability of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. The DC Target Date Fund 'Average Glide Path' is calculated by an average of fund categories (International Equity, Domestic Equity, Long-term Bond, and Short-term Bond) of the three largest TDF providers in the US by assets: Fidelity Investments, Vanguard Group, and T. Rowe Price Group. They account for an approximate combined 72% of assets in the US market of \$378 billion as of 12/31/2011. The income targets include DC assets and expected Social Security benefits.



Participant Enrollment Workflow



Steps 1 – 4 occur without requiring participant involvement

Example of a Planning Tool for Employees

Welcome
My Account
Edit Account
Help Center

Customize Your Managed Retirement Account

You may increase the estimated probability of achieving your desired income by making some meaningful choices. Contribute more today, adjust your income targets or work longer.

Current Income \$6,250 per month (before taxes)

Desired Income Target ⓘ
\$2,870 per month (before taxes)

Essential Income Target ⓘ
\$2,000 per month (before taxes)

Pre-tax Contributions ⓘ
3% of your pay Change to \$

ADD CONTRIBUTION

Retirement Age ⓘ
67 years

\$2,870

\$2,000

3%

Example

80%

Estimated probability of reaching your Desired Income Target of \$2,870 a month.

The probability of achieving your essential income target of \$2,000 a month is estimated at 96%.

- Working until age 67
- Your contributions of \$188 per month
- Employer contributions of \$94 per month
- Includes other retirement income of \$1,982

Reset to original settings

Important: Estimated probabilities are hypothetical in nature, do not reflect actual investment results and are not guaranteed.

Quarterly Statements Keep Participants Informed

ABC Company 401(k) Retirement Plan
 195 South Sample Avenue
 Albany, NY 54321

Period: October 01, 2012 through December 31, 2012

John K. Sample
 623 Maple St.
 Our Towne, US 12345

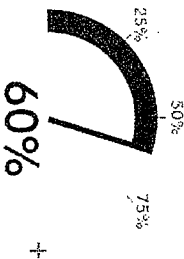
ABC Company 401(k) Plan

Your Contribution Details		
Contributions by Source	This Period	Total Balance
Roth	\$100.52	\$305.88
ER Prior Vesting	\$0.00	\$17.03
Total Contributions	\$100.52	\$322.91

Your Account Balance	
Beginning Balance	\$165.73
Contributions (+)	\$100.52
Investments gain or loss (+/-)	\$5.80
Withdrawals (-)	\$0.00
Fees/Expenses (-)	(\$0.14)
Other	\$0.00
Ending Balance	\$322.91
Vested Balance	\$322.91
Account Rate of Return for Period	1.03%
Year to Date Rate of Return	1.23%

The probability of achieving your Desired Income Target of \$2,450 a month is estimated to be 60%.

Your retirement income outlook is based on your managed retirement account profile and plan settings as of December 31, 2012.



- Working until age 67
- Your contributions of \$100 per pay period
- Employer contributions of \$50 per pay period
- Includes other retirement income of \$1,213

Helpful Tip
 You may be able to increase the estimated probability of achieving your Desired Income target at your retirement age by changing your current settings. You can increase the amount you contribute, plan to retire later or adjust your income goals.

To make changes to your managed retirement account, log in to the online planning tool at www.recordkeeper.com



**Evaluating the Cost of a Guarantee
within a Cash Balance Plan**



Indicated Cost of Current Guarantee For Employee Contributions¹

Cost of 5.25% guarantee, plus 6.00% annuity conversion guarantee

Starting Age in Plan	Income Cash-Balance Guarantees	Income Cash-Balance No Guarantees ²	Additional Income Benefit from Guarantee, \$	Income Benefit from Guarantee, Percentage of Total Cash-Balance Income	Equivalent Increase in the Employer Contribution Rate in No-Guarantee Plan
Age 30	\$9,256	\$6,635	\$2,621	28%	1.7%
Age 40	\$5,368	\$3,856	\$1,512	28%	1.7%
Age 50	\$2,363	\$1,636	\$727	31%	1.9%
Age 30	\$8,204	\$5,900	\$2,304	28%	1.7%
Age 40	\$4,773	\$3,429	\$1,344	28%	1.7%
Age 50	\$2,101	\$1,454	\$647	31%	1.8%
Age 30	\$10,586	\$7,613	\$2,973	28%	1.7%
Age 40	\$6,159	\$4,425	\$1,734	28%	1.7%
Age 50	\$2,711	\$1,876	\$835	31%	1.9%

For illustrative purposes only.

- Incomes are based off the 25th percentile. Assumes guaranteed nominal accumulation rate of 5.25%. Nominal salary growth at 4%. Employee contributions only, set at 6%. Retirement age is 60.
- Five-year nominal US Treasury bonds with monthly rebalancing. Accumulation is based on cash balance proposed contributions

Cash Balance Plan: Indicated Cost Saving from Reducing Guarantees

Estimated cost reduction measured in terms of equivalent annual contribution reduction by the State

Starting Age in Plan	5% Guarantee		4% Guarantee	
	Contribution Increase Relative to 5.25% Guarantee ¹	Contribution Increase Relative to 6% Annuity Conversion ²	Contribution Increase Relative to 5.25% Guarantee ¹	Contribution Increase Relative to 6% Annuity Conversion ²
Age 30	0.24%	1.09%	0.70%	1.54%
Age 40	0.16%	0.75%	0.69%	1.53%
Age 50	0.08%	0.41%	0.69%	1.51%

For illustrative purposes only.
 1. Assumes no change to 6% annuity conversion.
 2. Assumes no change to 5.25% guarantee



Thank You