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## New Retirement Model – How Does it Work?

*Second in a series of articles*

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What if we were not constrained by laws and regulations that govern what is and isn't a pension plan? How would we design a new type of retirement plan that maintains some of the basic advantages of a defined benefit (DB) pension plan while lowering or, even, eliminating the employer's risk profile? Or, for that matter, how would we design a defined contribution (DC) plan offering true lifetime retirement benefits? Well, simply stated, you have to be willing to give up on some or all of the guarantees provided to employees in DB plans under ERISA and accept some of the uncertainties that are inherent in DC plans.

You might, of course, respond that it's not a "DB" plan unless it defines and GUARANTEES a benefit. You may also not consider it a "DC" plan unless it has individual participant account balances. The plan I would create wouldn't be either a DB or a DC plan as we have come to understand these plans under ERISA. This new retirement plan model, sometimes referred to as a "defined ambition" plan (abbreviated as "DA" plans), has been under serious consideration by actuaries and government officials in the Netherlands and the UK.

### Thinking Outside the Box: What Would This New Breed of Retirement Plan Look Like?

This design would be revolutionary for the U.S. market in many ways. It would reduce the need for our friendly governmental insurance program, the PBGC, to guarantee the plan's benefits. In its purest form, the DA design could entirely eliminate the need for the PBGC. Further, from a corporate

financial statement perspective, there would be no need to recognize assets or liabilities on the corporate balance sheet like we do for overfunded and underfunded defined benefit pension plans, respectively. The expense would simply be the amount to be funded for the year. Just like defined contribution plans that would be the only pension cost entry on corporate financial statements. Check the box that this new retirement plan model would give companies a defined contribution amount for budgeting.

How would this type of plan operate? To start with, it would look just like a DB plan with a stated benefit formula. The benefit formula could be a traditional final pay or career average formula or it could be a cash balance or other hybrid formula. Each year, the employer would be required to fund the normal cost. This normal cost would be determined using a cost method that would cover the accrual of benefits during the year.

What makes this type of plan different from the defined benefit plan is that, by definition, this plan would never be underfunded. Something has to give – so, what is it? In the same way that the participant account in a DC plan may decline in value, the benefits accrued by the participants in a DA plan would also not be guaranteed. One way to accomplish this flexibility is to lower the multiplier in the benefit formula if the actuarial valuation would have shown an actuarial liability greater than the assets of the plan. The multiplier would be lowered so that the "new" actuarial liability based

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◆ on this lower accrued benefit would be exactly equal to the plan assets. Similarly, the plan would also never be overfunded by definition because the multiplier in the benefit formula would be increased if the assets of the plan exceeded the actuarial liability. ◆

A future Viewpoint article will explore both pension and defined contribution plan characteristics that transfer to the “new” DA model.

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