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Design Objectives

- address shortcomings in existing plan designs
  - in defined benefit plans
    —concentration of risk on plan sponsor
- in defined contribution plans
  —concentration of risk on individual participant
  —over-reliance on employee funding and self-direction
- in both
  —inflexibility of distribution options

Overview of Design

- individual cash balance account
  —employer funds periodic principal credits
- account deemed invested in retirement portfolio
  —asset allocation adjusts over time to changes in employee's circumstances
  —employer guarantees principal credits and, if it wishes, added subsidies
- portfolio continues during pay-out
  —flexible installments plus longevity annuity
  —funded by continually adapting portfolio

Cash Balance Plan

- species of defined benefit plan
  —where benefit is expressed as hypothetical individual account
  —rather than deferred annuity, as in traditional defined benefit plan
- plan is noncontributory
  —so participation is automatic
  —and no employee contributions are required or accepted
- principal credits added to account
  —usually as percentage of current pay
  —funded by the employer

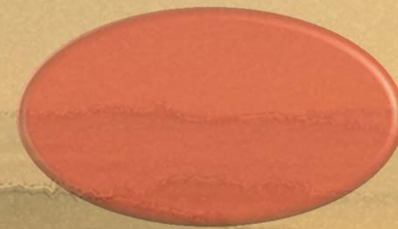
Individual Retirement Portfolio

- unlike conventional cash balance plan
  —where account credited with current bond yield
- instead credited with earnings or losses
  —on hypothetical portfolio of investment assets
  —made possible by "market rate of return" standard in PPA 2006
- asset allocation tailored to individual
  —can't ask 65-year-old to bear same risk as 25-year-old
  —so rate earned will vary among individuals
  —unlike in conventional cash balance plan

Asset Allocation Mechanism

- not based on participant direction
  - instead based on information about or provided
    —by employee, such as current and expected retirement ages, other benefits and assets, risk tolerance, health condition
- assets dynamically reallocated over time
  —based on changes in information about or provided by employee
  - allows employee to participate
    —based on what employee actually knows
    —without requiring investment expertise

Simpler Process



Account

Asset Classes

Employer Contributions & Subsidies

- employer funds principal credits
- employer guarantees principal credits
  —account balance can't fall below sum of principal credits
  —if employer wishes, can provide minimum rate of return > zero
- employer can subsidize benefit distributions
  —distributions generally tied directly to account balance
  —but it's a defined benefit plan, so distributions can be subsidized (i.e., to be worth more than account) for disability, death, plant closing, QJSAs, etc.
- employer assumes longevity risk
  —can spread and diversify risk over plan

Retirement Distributions

- avoid stark all-or-nothing choices—annuity vs. lump sum
  - discourage lump sums
    —by offering mixed or intermediate options or not offering them
- allow portfolio to continue to operate in retirement
  —three pots: bond ladder for early years, longevity annuity for later years, and market exposure for liquidity and inflation protection
- longevity information inputs
  —more than actuarial or underwriting
  —individualized mortality analysis
  —medical research using big data and AI