

# *Effective Pension Reform Process: The Importance of Clear Objectives*

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# Dr. Arun Muralidhar - Biography

## ❑ Pension Investments:

- Founder, M<sup>cube</sup> and AEGIS – companies that help asset owners manage beta for alpha and risk management
- Graham-Dodd & Ed Baker (twice) awards; many clients won innovation awards for programs we designed
- Added significant value to client portfolios from beta management, especially in 2008
- Managed World Bank Pension Fund; Managing Director at JP Morgan Investments and FX Concepts
- Founding member of Univ of California DC Plan Advisory Board

## ❑ Author of Books on Effective Management of Portfolios:

- *Innovations in Pension Fund Management (Stanford University Press)*
- *SMART Approach to Portfolio Management (Royal Fern Publishing)*

## ❑ Social Security Reform:

- Co-author, with late Prof. Franco Modigliani, Nobel Prize Winner: *Rethinking Pension Reform (Cambridge University Press)*
  - ✓ Offers a unique solution for the Social Security crisis – developed Guaranteed Return approach
- Consultant to Govt. of Azerbaijan, proposed the Modigliani-Muralidhar reform model

## ❑ DC Plan Reforms (Uncovered Worker Plans):

- Manuscript Completed (2016): *50 States of Grey: An Innovative Solution to the DC Retirement Crisis*
- Advisor to Overture Financial (Consultant to CA Secure Choice Investment Board)
- Advisory Member, Council of Scholars - Georgetown Center for Retirement Initiatives
- Co-author with Prof. Robert Merton (Nobel Prize Winner) of the “*Flex MMM Model*” for uncovered workers
- Expert Advisor to World Economic Forum, Retirement Investment Systems project.

## ❑ Academic:

- Adjunct Prof. of Finance, George Washington University School of Business

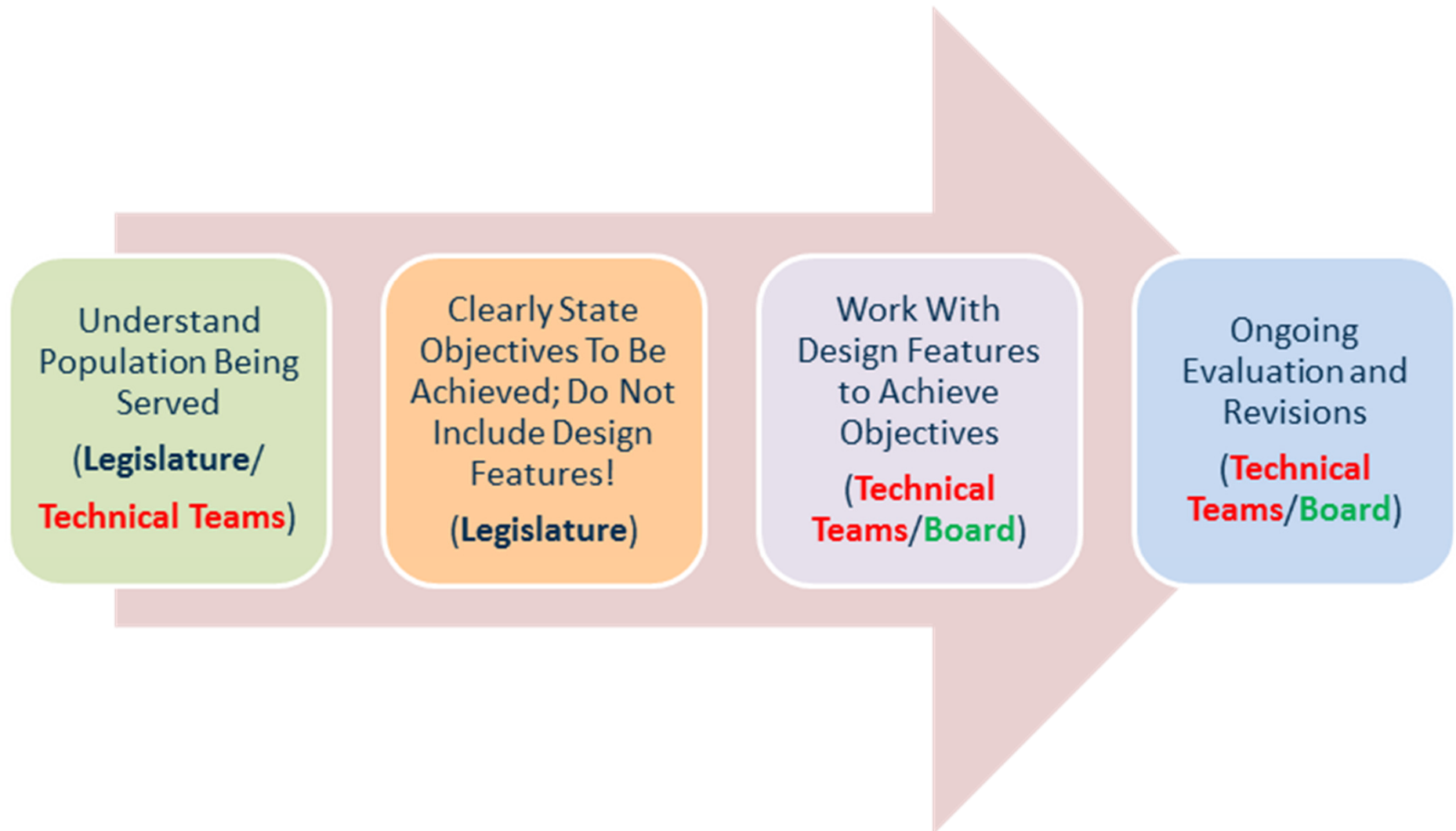
# Disclaimer

- ❑ These are the personal views of the presenter and do not represent the views of any of the organizations he is affiliated with.
- ❑ Nothing contained in this presentation is meant to serve as investment advice and investors are urged to seek appropriate counsel prior to making any decisions.

# Agenda –Process More Critical Than a Particular Model

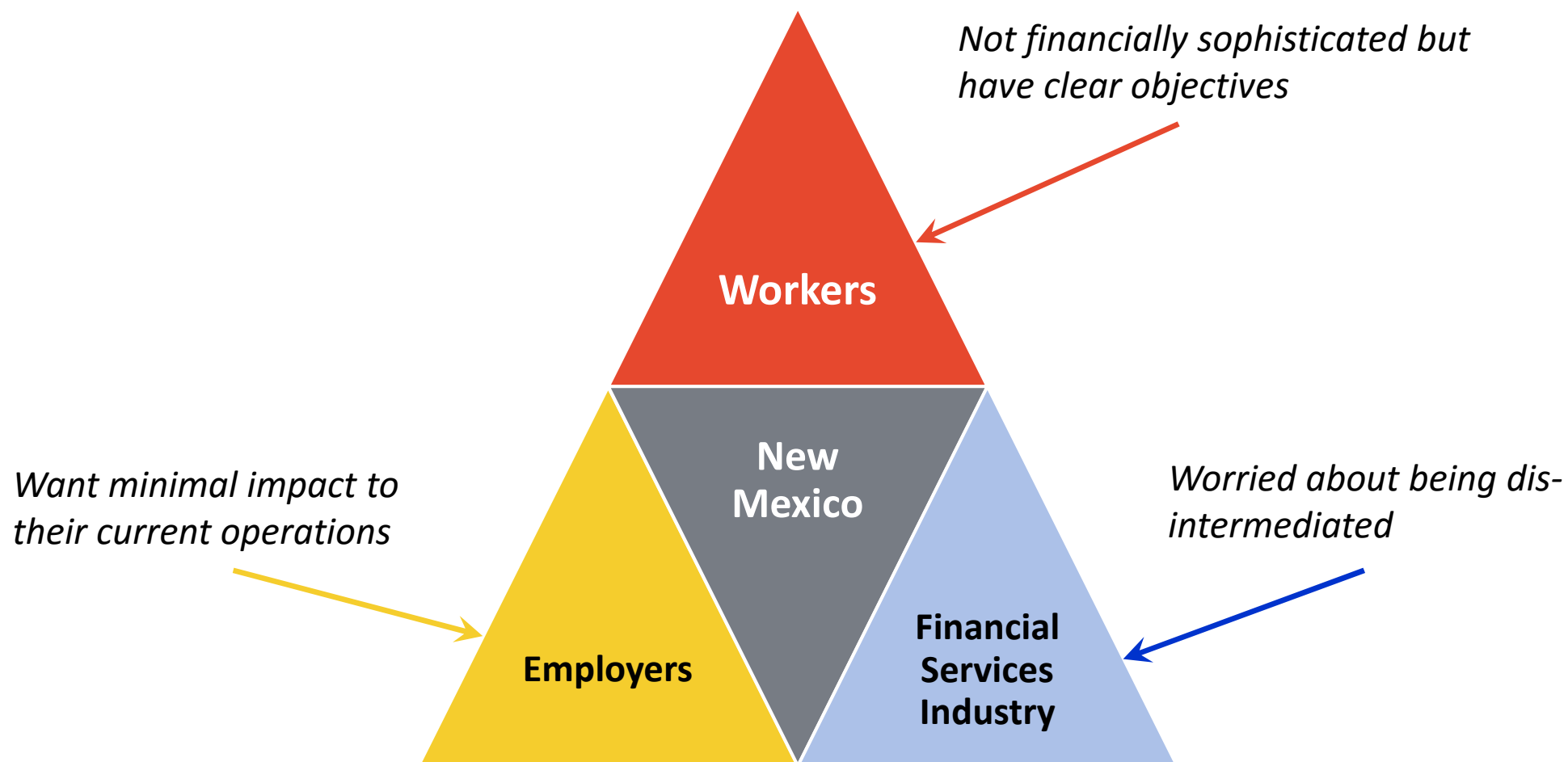
- ❑ **Good Reform Process** – How to Sequence Reforms
- ❑ **Stakeholders** – With Particular Focus on Participants (CA experience)
- ❑ **Example of Objectives** – Make it “SUPER ACCESSIBLE”
- ❑ **Design Features** – Keep Separate from Objectives in Legislation

# Effective Process for Reform



*Effective Process = Good and Timely Pension Design*

# Stakeholders: Four Main Groups



*Need a Simple, Safe Investment Solution*

# Objectives: Participants (Using the CA Survey)

## ❑ **Core Objectives (80%):**

- Clear ownership rights with account in their name
- Ability to bequeath balance to heirs
- Low cost investment options
- Access to information electronically
- Portability
- Ability to convert all or part of retirement savings into a monthly income stream

## ❑ **Secondary Objectives:**

- Choice in decisions (74%)
- Access to funds pre-retirement (appx. 30% would opt-out without this feature)

*Need a Simple, Low-Cost, Liquid and “Safe Choice”*

# Additional Feedback from Participants (Using the CA Survey)

## ❑ Who Did They Trust the Most to Manage Their Money:

- Professional advisors (55 %)
- Financial companies (46 %)
- Employer (45 %)
- Insurance companies (40 %)
- Federal and state government (37 % each)

## ❑ Ability to Save:

- 86% confident they could save for retirement. 4 % could not save anything
  - Appx. 30% not saving anything, + another 25 % saving 1 - 4 % of household income.
- The major issues that prevented them from saving included:
  - Insufficient income (81 %)/Pay-off debts (78 %)
  - Unexpected expenses (69 %)
  - Helping out family/unsure about how to invest/put it off (each about 65 %)
  - Unsure about how much to save (55 %)

*Need a Simple, Low-Cost, Liquid and “Safe Choice”*



# Objectives: New Mexico, Employers and Financial Firms

## ❑ States:

- Want to do something to help citizens for retirement
- No additional liability

## ❑ Companies:

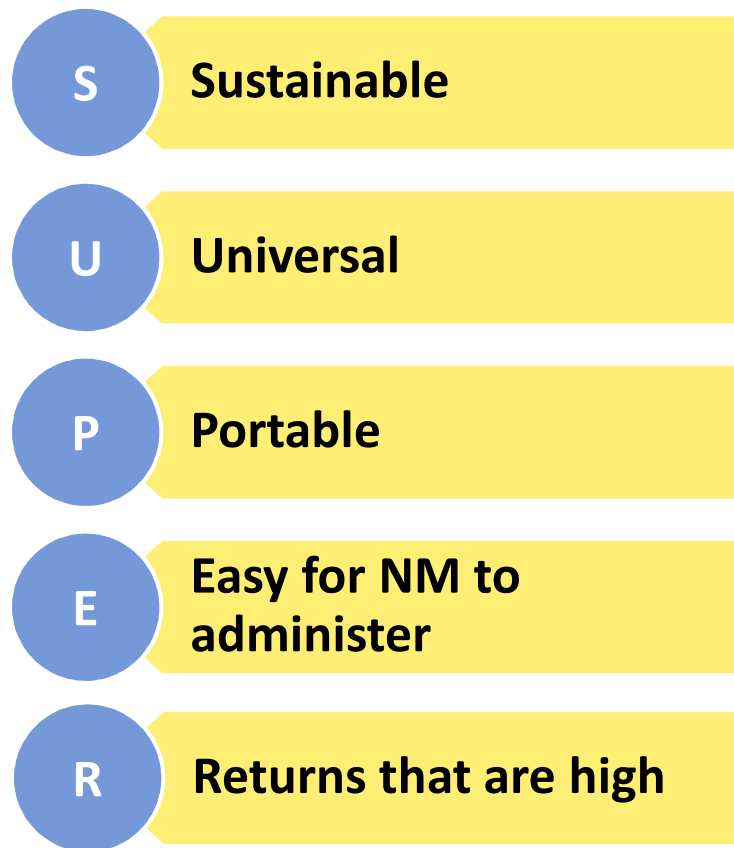
- Ease of implementation – typically small and may not even have a payroll provider
- Absolved of all legal liability

## ❑ Financial Service Firms:

- Do not want government to dis-intermediate them from this business

*Can States Articulate a Virtuous Blend of Competing Objectives?*

# Objectives Summarized: Make It “SUPER ACCESSIBLE”



*Will Need to Ensure that Objectives Consistent with DoL Regulations*

# Objectives Summarized: Make It “SUPER ACCESSIBLE”

- A** Adequate pension
- C** Choice (of replacement rate)
- C** Certainty of outcome
- E** Easy for employers
- S** Smoothing of consumption
- S** Simple reporting

- I** Insulated from political risk
- B** Be inclusive of private sector
- L** Low costs
- E** Easy to regulate

# Examples of Objectives Implied by Current Reforms in Just 2 States + the MMM Approach

Type of Plan	Sustainable	Insulated from Political Risk	Universal (If Yes, Mandatory or Voluntary)	Certainty of Outcome (If Yes, Real or Nominal)	Annuitization /Income Focused (Life or Term)	High Benefit to Contribution Ratio	Portable	Easy	Ease (and Level) of Regulation	Adequacy of Pension
CA	Yes	Yes	Mandatory with Opt-Out	No	No	Fees Capped	Yes (at least within CA)	Uncertain	TBD	Uncertain
CT	Not With Captive Insurance	Yes	Mandatory with Opt-Out	No	Life Desired	Fees Capped	Yes (at least within CT)	Uncertain	TBD	Uncertain
Merton-Modigliani-Muralidhar	Yes	Yes	Mandatory with Opt-Out	Real (High Degree of Certainty)	Term Easy; can hedge Life	Yes (but Depends on Vendor Fees)	Yes	Relatively	Will Be Needed	Likely

***Start with Objectives First and Be Clear About What is Best for NM***

# Design Features (Not to be Confused with Objectives)

- ❑ **Design Features in Reform Legislation (Better Left to Technical Team)**
  - Investment Management: Who manages the portfolio
  - Asset Management: Single portfolio = “Pooled IRA”
  - Investment Outcome: Guaranteed returns on contributions
  - Terminal Outcome: Benefits must be in the form of an annuity
- ❑ **Effective Sequencing Requires Objectives and Design be Kept Separate**
- ❑ **Effective Design and Innovation Can Allow For Superior Outcomes**
  - ✓ Can have choice and manage as a single portfolio (as opposed to single return)
  - ✓ Possible to guarantee cash flows (as opposed to returns)
  - ✓ Choice could be of level of retirement cash flows (as opposed to portfolio)
  - ✓ In a well-designed system, can offer either retirement income or lump-sum

*Have to Design a System Based on Objectives – Must be Simple*

# Summary – Feasible to Create “Individual DB”

- ❑ Important to have good reform process = ensures reform success
- ❑ Understand all stakeholder objectives
- ❑ Example of Objectives: SUPER ACCESSIBLE
- ❑ Understand participant and market limitations
- ❑ Can easily design an effective system that works best for New Mexico