

Are DB and DC adversaries?



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Contents

- Demographic issues – effect of global ageing on the pension market
- Comparison between DB and DC
- What are the options
- Is there a mid-way
- Technology challenges
- Summarizing...

Demographic context – effect of Global aging

"If I had known I would live this long, I would have taken care of myself!"

Declining fertility
Increasing life expectancy

Changing age structure of population

- Globally the numbers of older persons (60 years or over) will more than triple
- Increase in the number of the oldest old (80 years or over) is expected have more than a five-fold increase.

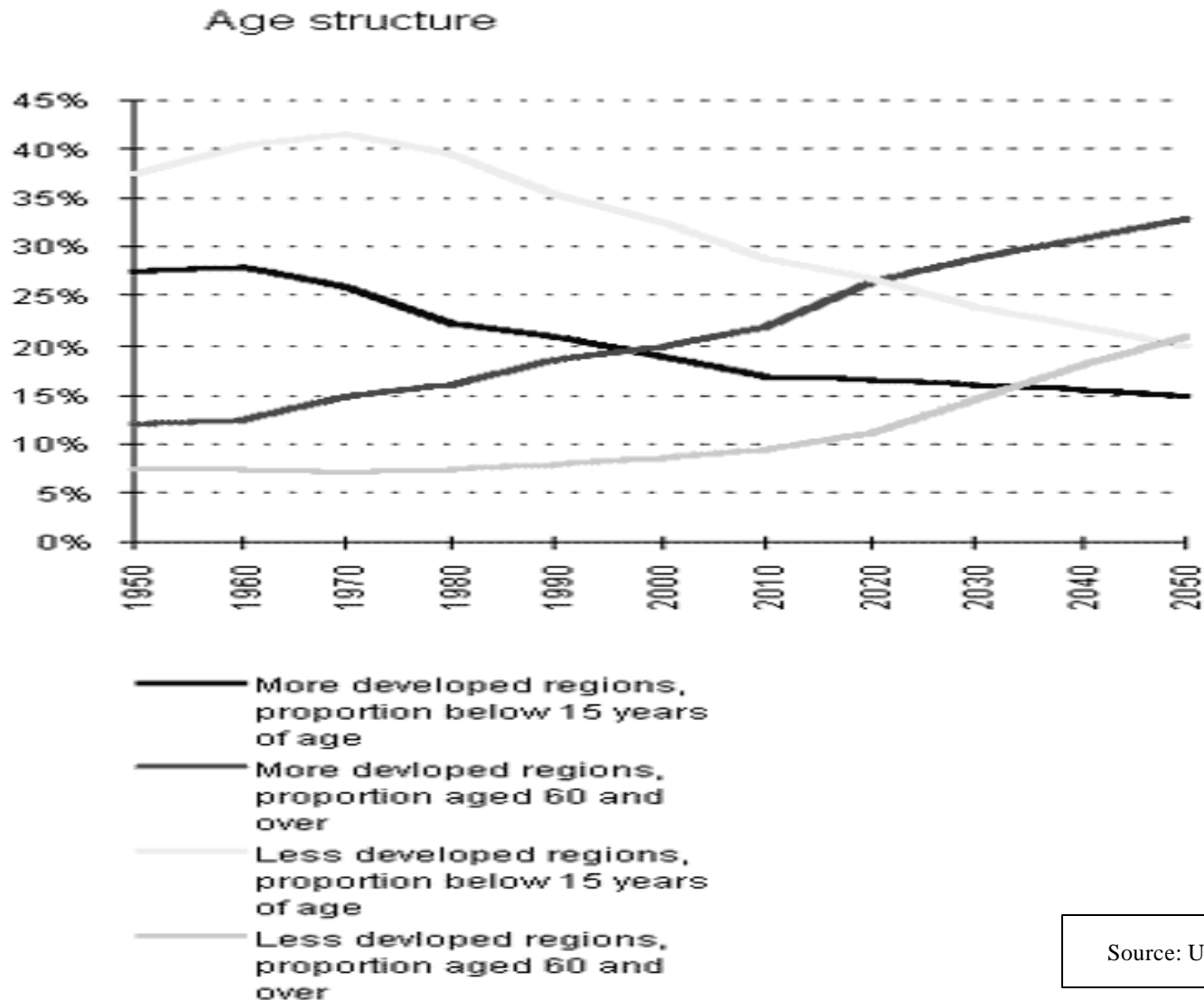
New challenge for the state

- Pensions and other long-term care benefits
- Increase in elderly dependency ratio.

Industry's preparedness

- Innovative products
- Private pension plans
- Long term care

Global Age Structure



Source: United Nations

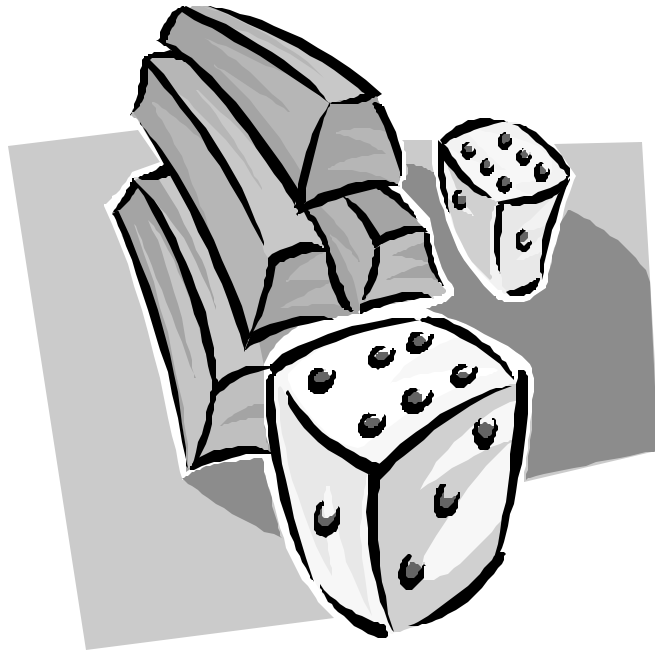
Defined Contribution at a glance

- A specific retirement benefit is not guaranteed.
 - Instead, a specific contribution is made to a retirement account of the employee.
- The account grows depending primarily upon the contribution amount, expenses and investment earnings
- Plan may be contributory (the employee also contributes) or non-contributory.
- The basis for the contribution is flexible- contribution is primarily related to the income or profits of the company.
- Amount of benefit given at retirement for each of the employees will depend upon
 - the amount in the account
 - Age
 - Length of time for the benefit coverage etc.

Defined Benefits at a glance

- The employee is promised a specified benefit on retirement.
- Benefit maybe a flat amount, based on service, salary or a combination of both.
- Cost of the benefit depends upon
 - Age
 - distribution of earnings of the eligible employees
 - other factors (mortality, salary increases, turnover of the company, withdrawal and expenses of the company).
 - Based on all these factors, the contribution requirements for the plan are determined.
- The plan can be either contributory or non-contributory.
- The benefit is more difficult to predict
- More stringent regulations are associated with these plans.

Comparison between DB and DC – the risks for the employee



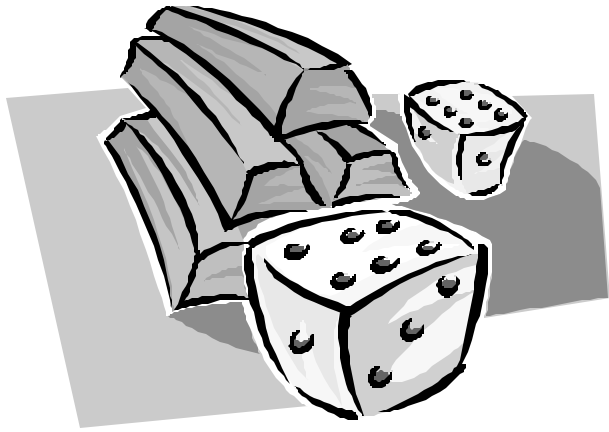
- Investment Risk
- Longevity Risk
- Inflation risk
- Risk of Plan Sponsor's bankruptcy

Comparison between DB and DC – other aspects



- Cost of administering
- Portability of the Pension Plan

More dimensions of risks... for the employer



- Benefit risk
- Contribution risk
- Return on Capital
- Security

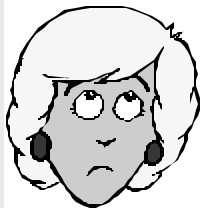
Is conversion to DC the option?

Do DC plans give “more bang for the buck”

An employer can introduce a DC plan for new employees by

- Closing the DB scheme for new entrants and/or
- Closing the DB scheme for future service accruals

Are the concerns addressed?



- Portability – how mobile is the labour force
 - Different employers have different needs
- Investment risks – they are passed on to the employees
 - DC plans require substantial investments in education to make their participants aware of their choices
- Longevity risk – the risk of outliving the benefit continues..
 - Increasing life expectancy makes DC plans more uncertain
 - Mitigated to an extent by purchasing annuities from Insurance companies

Issues that need to be addressed..



- Choice – does the employee have an option to retain DB benefits?
- Accrued benefits – how are the benefits accrued up to date effected?
 - Do they remain or do they get transferred?
 - Is there a choice?
- Costs – who bears the costs and how do they effect the kitty?
- Benefits for Life events – how are the following benefits effected
 - Death
 - Termination
 - ill-health retirement
 - Disability
- Investment options – what are the options available?
 - Any help available

Is there a mid-way?



- Retirement nest requires the advantages of both DB and DC plans
- Hybrid Plans
 - DC plans with a DB flavor – Target benefit plans
 - DB plans with a DC flavor – Cash Balance plans
- Innovative DB schemes that are more open
 - A lower level of defined benefit based on career average
 - Supplemented by a DC component that helps reduce the employer's exposure to volatility of costs
 - Shared costs

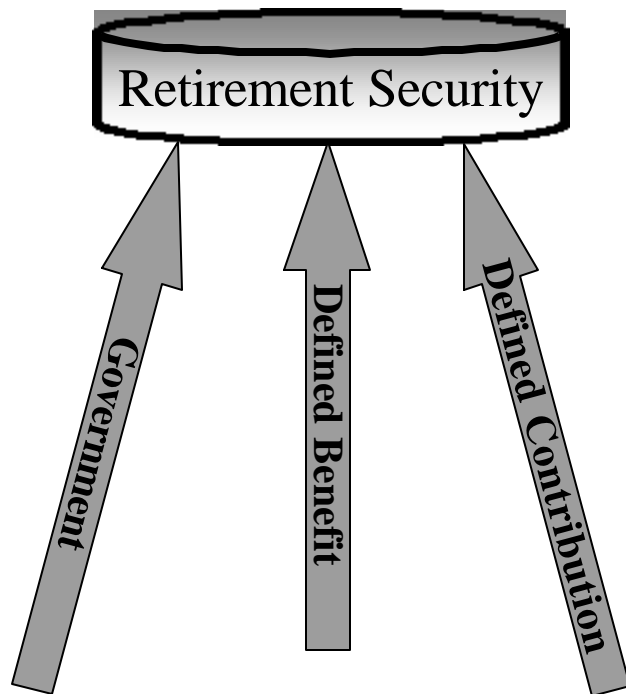
Certain regulatory challenges...

- Should not be age discriminatory
 - Certain hybrid plans tend to favor younger employees as against older employees
- Disclosure norms
- Illustration of benefits
- Actuarial aspects
 - Conversion to a hybrid plan – how will the initial account balance be set up
 - Adjustment factors for delayed or early benefit payments
 - Graded funding rate by ages (for Cash Balance or DC plans) - Allocation depending upon age and service
- Some protection by the state in the form of guarantee for employees in a DB plan
 - In return for consideration paid by the employers

Technology Issues and Challenges

- Good record keeping is the key to administering a pension plan successfully
 - More informed decisions for the fund – assumptions more close to experience
 - Better service to members of the scheme
- Clean data – accurate, up-to-date and complete
 - Consistency checks required
 - More automation reduces costs of on-going administration – less paper work
- Data from legacy systems – biggest challenge
- Record keeping and interface with HR systems
- Integration with other systems in the organization

In a nut shell....



- 3 legged stool for the retirement nest
- DB vs. DC debate assumes that it is a binary mode
 - Only one of the two alternatives is possible.
- One is not superior over the other
- Each has intrinsic positive and negative features
 - Together they complement each other by offsetting each others weaknesses

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Thank you

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