

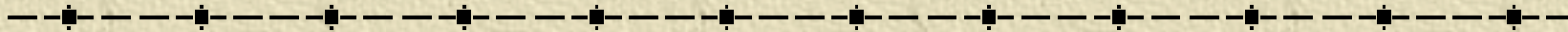


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# SOCIAL SECURITY PRIVATIZATION:

## USING A TARGET BENEFIT APPROACH FOR INDIVIDUAL ACCOUNTS

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# Target Benefit Private Accounts

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Today's discussion:

- Defined Contribution vs. Defined Benefit Plans
- Hybrid Target Benefit Plans
- Target Benefit Approach to Privatized Accounts
- Issues That Will Need to be Resolved
- Questions and Answers



# Target Benefit Private Accounts

## 1A. defined contribution plans

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- Individual Accounts
- Benefit equals accumulation of contributions and fund earnings
- Possible self-investment
- Lump Sum distributions
- Account Statements



# Target Benefit Private Accounts

## 1A. defined contribution plans

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- The employer contribution:
  - Is discretionary, if a profit sharing plan (and allocations are dictated by the plan document)
  - Is mandatory, if a money purchase plan (as dictated by the plan document)



# Target Benefit Private Accounts

## 1A. defined contribution plans

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- The employer contribution:
  - Is voluntary, if a 401(k) plan (as each individual elects his respective salary deferral amount on an annual basis)



# Target Benefit Private Accounts

## 1 A. defined contribution plans

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### Attributes

- Employees like to track their accounts
- Employers like to shift the investment risk to the individual employees



# Target Benefit Private Accounts

## 1B. defined benefit plans

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- Pool of assets
- Benefit equals amount promised in written plan document
- Professional investment
- Annuity distributions
- Accrual Statements



# Target Benefit Private Accounts

## 1B. defined benefit plans

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- The employer contribution:
  - Is mandatory, is determined annually by an enrolled actuary, and represents amortization of PV of expected future liabilities less the current value of plan assets



# Target Benefit Private Accounts

## 1B. defined benefit plans

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### Attributes

- Employees like to know in advance their retirement income
- Employers like rewarding valuable employees with adequate retirement income



# Target Benefit Private Accounts

## 2A. target benefit plans

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### Attributes

- Individual Accounts
- Benefit at retirement equals accumulation of contributions and interest



# Target Benefit Private Accounts

## 2B. target benefit plans

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### Funding

- Plan document defines a targeted retirement annuity and provides actuarial factors
- The annual contribution represents amortization of [PV Target – account]



# Target Benefit Private Accounts

## 2C. target benefit plans

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### investments

- Employees still bear investment risk (employer tries to properly fund target benefit, but there are no guarantees)
- No self direction



# Target Benefit Private Accounts

## 3A. Proposal

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Individual chooses target

- Annual evaluation of retirement goals versus ability to properly fund
- The individual determines his own retirement age



# Target Benefit Private Accounts

## 3B. Proposal

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Annual contribution amount

- Government issues actuarial tables
  - Years to retirement
  - Targeted monthly annuity
  - PV needed currently
  - Amortization factor



# Target Benefit Private Accounts

## 3B. Proposal

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### Annual contribution amount

- Example: individual, who has an account at 12/31/01 of \$70,000, expects to retire in 12 years and wants a monthly retirement income of \$2,400



# Target Benefit Private Accounts

## 3B. Proposal

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Annual contribution amount

- Example: (from table)

“12 years until **age 65**”

<u>Monthly Benefit</u>	<u>PV needed today</u>	<u>amort. factor</u>
2,200	104,960	0.113
<b>2,400</b>	<b>114,501</b>	<b>0.113</b>
2,600	124,044	0.113



# Target Benefit Private Accounts

## 3B. Proposal

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Annual contribution amount

- Example:

PV needed today           \$ 114,501

Account 12/31/01   <70,000>

Balance needed           44,501

Amortization factor   \* 0.113

Annual contribution   \$ 5,029



# Target Benefit Private Accounts

## 3B. Proposal

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Annual contribution amount

- Example: Can the individual afford to contribute \$5,029 for 2002 ?

If YES, then he so elects on a government form and if employed, ***his employer will match contribution***



# Target Benefit Private Accounts

## 3B. Proposal

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Annual contribution amount

- Example: Can the individual afford to contribute \$5,029 for 2002 ?

If NO, then he must pick a lower annuity, a later retirement age, ***or ask the government for help***



# Target Benefit Private Accounts

## 3B. Proposal

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### Annual contribution amount

- Example: I have assumed that the government determines PV at age 65 based on annual annuity factor of 8.0, and that ALL adjustments are based on a 6% interest rate WITHOUT any mortality charge.



# Target Benefit Private Accounts

## 3B. Proposal

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### Annual contribution amount

- Any means testing lies solely with the individual, not the government
- Employed Americans do similar analyses each year for 401(k) and cafeteria plan elections



# Target Benefit Private Accounts

## 3C. Proposal

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Self-directed investment

- ***Proper education is necessary***
- Good investment decisions results in lower contributions
- Bad investment decisions results in higher contrib.



# Target Benefit Private Accounts

## 3D. Proposal

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### Government assistance

- An actual contribution deposited into the individual's account on a year-to-year basis
- Takes the form of a welfare subsidy



# Target Benefit Private Accounts

## 3D. Proposal

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Government assistance is only available for:

- Indigent individuals who cannot make ***statutory*** minimum amount
- Individuals out on family, medical, military or other valid leave



# Target Benefit Private Accounts

## 3D. Proposal

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Government assistance for:

- Individuals who are unemployed
- Individuals who are disabled
- Individuals who work abroad



# Target Benefit Private Accounts

## 3D. Proposal

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Government assistance for:

- Individuals who are within **10** years of retirement, have made a good faith effort to properly fund and invest their account, but the account will be insufficient at retirement



# Target Benefit Private Accounts

## 3D. Proposal

### Government assistance

- The individual must sign a form, under penalty of perjury, requesting the government assistance for the particular year
- The government should validate each request



# Target Benefit Private Accounts

## 3E. Proposal

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### The retirement benefit

- The accumulated account balance should be amortized over the individual's life expectancy based on current government-developed mortality tables



# Target Benefit Private Accounts

## 4. Unresolved Issues

- Please NOTE that this proposal is for a government to establish a social security program comprised ENTIRELY of target benefit funded private accounts – there is no advice for a transition from a DB type system



# Target Benefit Private Accounts

## 4. Unresolved Issues

- is there a minimum annuity that an individual must fund for, or a minimum amount that must be contributed each year?



# Target Benefit Private Accounts

## 4. Unresolved Issues

- is there a maximum amount of contribution that an employer must match for each individual?



# Target Benefit Private Accounts

## 4. Unresolved Issues

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- How will the government regulate the self-directed investments?
  - Education of individuals
  - Regulation of funds
  - Benefit statements
  - Insurance for fraud/theft



# Target Benefit Private Accounts

## 4. Unresolved Issues

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- Can the accounts be used for any reason other than retirement?
  - home purchases / education / medical expenses
  - Other personal uses



# Target Benefit Private Accounts

## 4. Unresolved Issues

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- Although each individual chooses his own retirement age, is there a minimum age (such as 55) or a maximum age (such as 80), especially if the distribution of benefits is taxable?



# Target Benefit Private Accounts

## 4. Unresolved Issues

- What happens if an indigent individual outlives his life expectancy, thus depleting his entire social security account while still alive?



# Target Benefit Private Accounts

## 5. Questions and Answers

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- Is there anything you don't understand about my proposal for target benefit funding of private social security accounts?
- Is there any unresolved issue I failed to discuss?
- Is this proposal viable?



# Target Benefit Private Accounts

Thank You

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