



SOCIAL SECURITY PRIVATIZATION:

USING A TARGET BENEFIT APPROACH FOR INDIVIDUAL ACCOUNTS

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Target Benefit Private Accounts



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

- 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

- 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

- 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

1A. defined contribution plans

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

- 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

- 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

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

Attributes

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



Target Benefit Private Accounts

2B. target benefit plans

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

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

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

Annual contribution amount

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



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3B. Proposal

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

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
2,400	114,501	0.113
2,600	124,044	0.113



Target Benefit Private Accounts

3B. Proposal

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

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

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

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

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

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

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

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

Government assistance for:

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



Target Benefit Private Accounts

3D. Proposal

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

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

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- 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

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



Target Benefit Private Accounts

4. Unresolved Issues

- 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

- 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

- 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

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- 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

- 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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