Actuarial Valuations for DC Plans

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Contingencies, the flagship publication of the American Academy of Actuaries, published a paper entitled "Actuarial Valuation for DC Plans" in its Jan/Feb 2014 issue. The paper called for the development of a framework for actuarial valuations for DC plans.[1] This framework would be similar to its well-known counterpart for DB plans in many ways.

Since then, the need for a disciplined approach to measuring DC plan outcomes has become much clearer. DC plans have continued their march to becoming the predominant source of retirement income. However, plan participants still have (at best) limited access to regularly updated estimates of the retirement income their plans would fund.

The basics of the methodologies required for outcome valuations of DC plans first appeared in finance textbooks decades ago. Since then, these methodologies have continued to improve. The existing quantitative and qualitative methods can generate robust simulation-free estimates of retirement plan outcomes, even though further improvements would be useful.

This paper reiterates the call to develop a framework for DC plan actuarial valuations. Further developments should include study materials, issue briefs, best practices, and actuarial standards of practice in this area. Work in this direction would provide valuable services to retirement plan participants.

Here is a summary of some of the key points in the abovementioned "Actuarial Valuation for DC Plans" (see the paper for more details).

- Plan participants would benefit from a systematic actuarial approach to measuring plan outcomes.
- Simulation-free stochastic analysis should provide a solid foundation for DC plan actuarial valuations.

[1] Mindlin, D. Actuarial Valuation for DC Plans, *Contingencies*, Jan/Feb 2014, p. 40-47.

- In a typical DB plan valuation, the plan's benefits are given, and a key result of the valuation is the contribution required to fund the benefits. For a DC plan valuation, the situation is just the reverse: The contribution rate is given, and the challenge is to estimate plan benefits.
- A DC plan valuation requires no conceptually novel methodology but can use the well-established methodology that, for decades, has been in the mainstream of the theory and practice of finance in general and DB plan management in particular.
- There are substantial differences between the economic assumptions required for DB and DC plan valuations. All these differences, however, reflect the outdated features of the conventional DB plan valuation model.
- The challenge of evaluating the sufficiency of retirement savings and income is as important as it is long-standing. Reliable information regarding the outcomes of retirement programs provided by an unbiased source should be helpful to DC plan participants and sponsors.

Obviously, a lot of work is required to develop the framework for DC plan actuarial valuations. Initial steps in this development may include a task force, issue briefs, modest size pilot projects, and others. More than anything, this development requires creative actuaries – especially chief-actuaries! – that are ready and willing to innovate.

This author would like to encourage the leadership of the actuarial community to explore this great opportunity to provide a valuable and much-needed service to DC plan participants and sponsors.

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