Pension Quick Fix

The letter below, drafted by Larry D. Zimpleman, who chairs the Academy's Pension Committee, was sent to key members of Congress on February 4, 1988. It properly reflects the Academy's objections to the current trend of pension legislation as demonstrated most recently in the Omnibus Budget Reconciliation Act of 1987. This Academy statement was spurred, in part, by a recent Washington Post editorial (see sidebar) that praised the stricter funding standards set forth in the bill.

On January 18, the Washington Post carried an editorial entitled "Pension Fix" lauding the recent pension legislation contained in the Omnibus Budget Reconciliation Act of 1987. A more appropriate title might have been "Pension Quick Fix."

As you know, this legislation began its torturous course as a result of the financial instability of the Pension Benefit Guaranty Corporation (PBGC). The PBGC's problems, in turn, stemmed from an inadequate premium base and from the ability of plan sponsors to run up large deficits (while remaining within the law) and unload those liabilities on the PBGC, turning the PBGC into a kind of welfare institution for corporate America. Most agreed that some changes were needed and that fine tuning the existing law could solve the problem.

Instead, Congress has adopted a vast, intricate, and complex set of requirements that will affect the retirement income and benefit security provided by every private pension plan in America. It will now be more unlikely that new defined benefit plans will be created, which may also affect the long-term health of the PBGC.

We at the American Academy of Actuaries, which includes within our membership more than 85% of the enrolled actuaries qualified under the Employee Retirement Income Security Act (ERISA), have long been concerned and vocal about the trend of pension legislation. As a professional association, we rarely take positions on issues of public policy concern; our goal is to offer our expertise to public policy decision-makers so that they can exercise informed judgment. In the immediate matter, we are suggesting no particular action; rather, we are offering a broader perspective that we hope will be kept in mind when the next, inevitable round of pension legislation takes place.

The recent action by Congress fits a pattern. For the better part of a decade, the voluntary private pension system has been subject to continuous rule changes. The sum total of these almost annual "reforms" has been unnecessary complexity, increased administrative expense, and the loss of focus on what the law and the policy should do: (1) encourage employers to offer pension plans to their employees, and (2) protect the retirement income provided by those plans.

The tremendous growth in pension coverage and benefit levels since the end of World War II has resulted in large part from favorable tax policies providing tax deferrals until benefits are received. By a judicious blend of tax incentives with funding requirements, the health of the pension system improved significantly, so that today more and more employees can look forward to an adequate and secure retirement income. The improvement has also served to reduce the pressure on Social Security and other public programs. But these tax deferrals (most of which are ultimately subject to taxation) are viewed as "tax expenditures" by those who are primarily concerned with short-term budget cycles and budget deficits. As these deficits have grown, the development of pension policy has shifted from congressional labor and employment committees to the tax committees.

February's report on the Washington luncheon and legislative and regulatory briefing contained an error that changed the meaning of the sentence. The statement should have read: Borzi went on to address the Family and Medical Leave Act, predicting that the bill, with a new provision that would exempt "key employees," will receive action on the floor in February or March of 1988.
The Future of the Profession

For forty years I have watched and been a part of the ever-present cycle in the casualty/property insurance business. For the same forty years I have watched and been a part of this ever-changing actuarial profession. I must admit that some of the changes I did not like, but the vast majority—even some of those that I opposed—were good.

The profession has been good for me: I can't complain, the nicest part being the actuaries themselves—even some of the characters. I will also admit that the travel connected with the field has taken me to some excellent places, including all fifty states.

I can still remember when I passed the exams and then objected to Casualty Actuarial Society (CAS) Fellowship by the paper route. This method has since been changed. I recall when some of us new Fellows asked how presidents were selected. I also remember when I wanted an experience requirement. The compromise, seven exams for CAS associate, was a good move. I remember that when in the early 1960s questions were raised about the impractical aspect of the math exams, nothing much changed.

And I remember when the Academy was formed, and it was going to be the “end-all” of all problems. The Academy has accomplished many, many things, but not all problems were solved, and many, many new ones have been added.

Also, I must now admit that when I passed my last exam, I felt that was it—I had arrived. Now I know I only knew where part of the actuarial library was. Now I know why what we call continuing education is so necessary. The program of the Conference of Actuaries in Public Practice has completed its second successful year.

When I first passed my exams, my list of essential functions for an actuary was simple: math-statistics and rate-making, including loss reserving. That was about all. Later I added economics, accounting, and a little law. After much mental evolution and revolution, my list has now expanded to ethics, logic, rate-making, economics, math-statistical procedures, accounting, and a little law. What a change!

Why put ethics first? If we don’t have good sound rules and standards for the conduct of our profession, we don’t have a profession. But the question is, where to draw the line? How to write a standard? Ethics is largely a matter of perspective, of viewing things in their true relations. Have you ever been in the position of having to do something that just did not feel right? Or something that you wouldn’t tell your mother? What do the experts in a particular field think of what you’re doing?

Rate-making is generally considered an art, not an exact science, or at least part art and part science. Therefore, there is a range of reasonableness. When this area of reasonableness is breached or crossed over, an ethical problem may be evident. Another ethical problem may develop if persons who are not qualified in an area become involved. Not all misconduct can or will go to a disciplinary hearing. The teaching or presenting of standards of conduct may eliminate much of the problem.

Why is logic second? Isn’t that what most actuaries work with...a series of premises with a logical conclusion? Rate-making and economics in third and fourth places can be debated. But math-statistics in fifth place—never! Heresy! Sure, math-statistics is highly important, but how much do you really use it compared to logic, rate-making, and some form of economics?

The world around us is changing. So should we. We should add ethics, logic, and more economics to our exam structure. We should change the mathematics emphasis to more practical mathematical procedures, rather than the present emphasis on speed in gyrating parameters. The exams should be tailored to fit professional needs. The track system of the Society of Actuaries (SOA) should help, but will it change the mix of those taking exams? Currently about 50% of the practicing pension actuaries have not passed all of the Associate SOA exams.

After the exam process is over, the most important aspect of a profession is the continuing education process. Today all the actuarial organizations have many excellent seminars, sessions that offer credit in recognition programs. Another wonderful thing is happening: actuarial organizations are now cooperating in joint sponsorship of seminars. This will...
Letters to the Editor

The following letter was one of twenty-five received in the Washington office in response to our call for comments on the draft report of the Standards Organizing Committee. It is reprinted here as a letter to the editor because it addresses much broader issues than simply the desirability or not of codified standards of practice. It in no way represents the majority view expressed in the letters received, fifteen of which support the establishment of the Actuarial Standards Board, and five of which express no opinion, but simply raise specific questions.

The Update, the People Magazine of the Academy, a Miserable Failure

It was interesting to receive the standards special subject supplement to The Actuarial Update—interesting because you know as well as I, that you, and the other members of the Academy who are involved with the Actuarial Standards Board, already know exactly what you will do. A simple reading of this supplement will show anyone with even an ounce of intelligence that the "die has been cast," and all decisions have been made.

The fact of the matter is that I, as primarily a pension actuary working in the small plan area, have very little trust in the Academy. You have done nothing for me. In fact, at times you seem to try to work against me and others who work in this area.

The Academy, as a lobbying organization, has failed miserably. Look at all of the terrible legislation that has passed Congress over the last five years. From where I am sitting, the Academy has had zero impact in trying to preserve private pensions in this country. Frankly, if it were not for the American Society of Pension Actuaries, I fear to think what we would have today.

Look at the Academy's newsletter, The Actuarial Update. Each issue brings us a couple of cartoons and jokes, and worst of all, interviews with people who are, for the most part, out of mainstream actuarial work. If you insist on interviewing people, interview people who are in the trenches actually doing the work, not some chairman of one of your endless committees. If I am going to spend my time reading something, I want to learn something useful. Let's face it, most of the interviews and articles are boring and worst of all they are self-serving both to the person being interviewed and to the Academy office itself.

I suggest that you spend 100% of your efforts on lobbying Congress on the need to have a strong private pension system in this country—and, pointing out to them all of the ancillary benefits to the country that are derived therefrom (i.e., investment capital, not having old, retired people starving in the streets, etc.)—and, providing useful, hands-on information to the Academy's members. If I want to read a cartoon, I buy a funny book; or if I want to read a boring interview, I'll buy People magazine.

As you will note, I have not signed my name to this letter. I know that you will comment to yourself about this, and I know all the cliches about people who don't sign their name to letters. However, let's face it. Whether I like it or not, this organization will establish this standards board and discipline process. If I signed my name to a letter like this one, who knows, I could end up being your first client.

—Anonymous

P.S.

If you are inclined to dismiss what I have said here, take a look at the composition of the Interim Actuarial Standards Board. They're probably all fine people. However, you have three retirees, one college dean, one president of an insurance company, one vice president of a huge insurance company, etc. With the possible exception of Ms. Lautzenheiser (who, incidentally I do not know), where are the actuaries who are actually out there doing actuarial work, signing Schedule Bs, actually running valuations, dealing with the Internal Revenue Service and the Pension Benefit Guaranty Corporation on plan audits, dealing with the incredible demands of clients, etc.? Where are the ones actively writing members of Congress and who are asking their clients to do likewise to try to preserve the private pension system?

Editor's reply: It is regrettable that you find The Actuarial Update of such little use. Based on our mail, our interviews, whether they be with actuaries or others commenting on issues of relevance to the actuarial profession, are probably the single most popular feature we print. Likewise, considering the number of cartoons submitted by our readers, they too, are popular.

The American Academy of Actuaries is a professional association of actuaries involved in all aspects of actuarial work. It is not correctly characterized as a lobbying organization, as you have

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LETTERS TO THE EDITOR
(continued from page 2)
done, or an industry association. Therefore, it cannot have failed miserably in a role it has never adopted.

The Academy, rather, views its role in the government relations area as providing information and actuarial analysts to public policy decision-makers, so that their decisions can be made with informed judgment. Because we are not simply partisan players in public policy debates, our views are sought out by members of Congress and regulatory officials. We are viewed by them as an objective source of data. For example, last summer when Senator Pryor (D-AR) was developing a bill to encourage small businesses to expand retirement benefits to all employees, his staff contacted the Academy to learn more about the problems inherent in smaller pension plans. More broadly, the Academy has repeatedly and vocally pressed the Congress to articulate a national retirement income policy.

The die most certainly has not been cast apropos of the actuarial standards movement. As stated in the special subject supplement, the ASB can only be created by an affirmative bylaw vote of the Academy's membership. The standards board will become reality only if it is the will of the members. You suggest that the composition of the Interim Actuarial Standards Board (IASB) indicates a lack of "actuaries who are actually out there doing actuarial work" involved in the standards-setting process. You are incorrect. Standards are written by operating committees, not the IASB. These committees are full of actuaries "doing actuarial work."

Checklist of Academy Statements
January 1988

Copies available from the Washington office. Please request statements by date of release.


TO: Internal Revenue Service, January 29, 1988. RE: Mortality tables. BACKGROUND: These comments were offered to the IRS in response to a temporary and proposed regulation on the mortality table used to determine exclusion for deferred payments of life insurance proceeds. Δ

Survey of Loss Reserve Opinions for 1987

The following states require an actuary or qualified loss reserve specialist to provide an opinion on loss reserves on the 1987 Fire and Casualty Blank:

<table>
<thead>
<tr>
<th>STATE</th>
<th>ENACTED:</th>
<th>REQUIRED OF:</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>Department Order 7/28/81</td>
<td>Domestic companies only.</td>
</tr>
<tr>
<td>Delaware</td>
<td>Regulation 50, 5/30/87</td>
<td>All companies licensed in Delaware and all risk retention groups.</td>
</tr>
<tr>
<td>Florida</td>
<td>Department Order 5/18/85</td>
<td>All companies licensed in Florida.</td>
</tr>
<tr>
<td>Hawaii</td>
<td>Hawaii Revised Statute 431-106</td>
<td>All companies licensed in Hawaii.</td>
</tr>
<tr>
<td>Illinois</td>
<td>Illinois Revised Statute Chapter 73, Paragraph 748, Effective 9/17/85 and Department Order 9/30/80</td>
<td>Domestic companies only.</td>
</tr>
<tr>
<td>Kansas</td>
<td>Department Order, 7/31/80</td>
<td>Domestic companies only.</td>
</tr>
<tr>
<td>Maryland</td>
<td>Department Order</td>
<td>Domestic companies only.</td>
</tr>
<tr>
<td>Nebraska</td>
<td>Department Bulletin 6/5/85</td>
<td>Domestic companies only.</td>
</tr>
<tr>
<td>New Jersey</td>
<td>NJAC 11:1-21, Effective 12/31/85</td>
<td>All companies licensed in New Jersey.</td>
</tr>
<tr>
<td>New York</td>
<td>Department Order 11/24/80</td>
<td>All domestic companies and foreign companies whose state of domicile requires.</td>
</tr>
<tr>
<td>North Carolina</td>
<td>NCGS 58-21 and Department Bulletin 58-25.1</td>
<td>All companies licensed in North Carolina.</td>
</tr>
<tr>
<td>Ohio</td>
<td>Ohio Revised Statute 3929.30</td>
<td>All companies writing medical malpractice.</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Department Policy</td>
<td>Foreign insurers if state of domicile requires.</td>
</tr>
<tr>
<td>Texas</td>
<td>Board Order 11/6/87</td>
<td>All companies licensed in Texas.</td>
</tr>
<tr>
<td>Washington</td>
<td>Department Bulletin, 85-4, 7/9/85</td>
<td>All domestic companies.</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>By instruction issued annually pursuant to Wisconsin Statute 601.42</td>
<td>All domestic companies and foreign insurers if state of domicile requires.</td>
</tr>
</tbody>
</table>

In addition, Minnesota has announced a requirement effective for 1988 annual statements.
PENSION QUICK FIX
(continued from page 1)

The procedural aspects of the process are also a major concern. While broader policy objectives are discussed in public forums, all too often the critical details are decided upon behind closed doors. Drafting of lengthy and complex proposals is handed over to staffers, often after the committees come to a vote on the proposals. Letting staff “fill in the details” in pension legislation has resulted in surprising, novel approaches never previously subject to public scrutiny and debate. This procedural deficiency is compounded when pension legislation is buried in a mass of unrelated tax matters, denial the opportunity to focus on the policy considerations involved.

The most recent legislative package is designed to achieve laudable goals, most particularly ensuring that defined benefit plan sponsors deliver on the benefits they promise, and that the PBGC remains financially sound for those instances in which promises cannot be kept. However, in a nutshell, the new legislation forces plan sponsors to look at the short-term financial status of their plans when making long-term commitments. For example, it places a “cap” on the funding level of a defined benefit plan, even though most of these plans are graduated so as to be highest for the companies whose plans are worst off.

No one is in favor of an underfunded pension system, but not everyone thinks all the new provisions are good ideas. Labor fears they go too far, will deter companies from offering pension benefits and may jeopardize precisely the weaker companies that Congress should be helping instead. Some business interests also are complaining. Failing companies say they can’t afford the costs, and healthy ones say they shouldn’t have to pay them. Why, they ask, should a business that has faithfully funded its own pension plan be taxed because another, perhaps a competitor, has not?

But these are mostly distributional and marginal objections. The fact is that too many companies, including some major ones, have promised more than they can pay.

The following editorial appeared in The Washington Post

Pension Fix

In 1974 Congress toughened the funding requirements for private pension plans. The rules had been lax, and too many plans were turning up without the funds to pay all the benefits they owed. The legislation also created an insurance pool to cover cases—bankruptcies—when the funding rules still would not provide enough protection. The premiums were low; the Pension Benefit Guaranty Corporation wasn’t expected to have that much to do.

Now Congress has moved to fix this. The reconciliation bill passed just before the Christmas recess further tightens the funding standards while raising premiums substantially (atop some smaller increases voted before). The funding requirements and premiums both are graduated so as to be highest for the companies whose plans are worst off.

No one is in favor of an underfunded pension system, but not everyone thinks all the new provisions are good ideas. Labor fears they go too far, will deter companies from offering pension benefits and may jeopardize precisely the weaker companies that Congress should be helping instead. Some business interests also are complaining. Failing companies say they can’t afford the costs, and healthy ones say they shouldn’t have to pay them. Why, they ask, should a business that has faithfully funded its own pension plan be taxed because another, perhaps a competitor, has not?

But these are mostly distributional and marginal objections. The fact is that too many companies, including some major ones, have promised more than they can pay.

Fewer promises and higher payments are both solutions. Neither is pleasant, but Congress was right to insist on them, and seems to have apportioned the burdens about as well as a fallible body can.

The bill was less successful in dealing with another set of questions—the circumstances under which a company should be allowed to drop a plan of PBGC and the rights of PBGC thereafter. The pensioners became pawns in these situations. A bankrupt company says that if the PBGC doesn’t take over its plan, it will have no choice but to cut benefits. The best solution would be to put the pension agency nearer the head of the line in bankruptcy proceedings. But banks and others typically involved in such affairs resist this, and Congress didn’t reach the issue. It reduced the PBGC’s exposure, but only marginally.

A third issue was dropped entirely—what to do when a plan, because the market performs well or for some other reason, turns out to be overfunded. Companies can now retrieve the extra funds; labor doesn’t want them to be able to. Congress is apparently divided. Some labor sympathizers say the money belongs to the workers. The companies say only the promised benefits belong to the workers, that they run the risk of financing these benefits and should also be entitled to the rewards. Why else assume the risk?

Our own sense is that the companies are right, though perhaps they should not be allowed to extract extra money from a fund as quickly as now. But in general this is good legislation. Pensions are costly; the costs need to be recognized. The system is stronger by virtue of the provisions in this bill.

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Congressional Conferees Begin Debate on Medicare Catastrophic Coverage

by Christine Nickerson

House-Senate conferences will begin meeting soon to reconcile differing versions of legislation aimed at protecting 32 million Medicare beneficiaries from catastrophic medical expenses.

Observers of Congress predict that the conference will take some time. In addition to resolving the differences in the two bills, many of the conferees who will write the final version of the legislation will also be serving on a conference committee working on the trade bill—with priority given to that legislation.

On July 22, 1987, the House passed its catastrophic health insurance bill, (H.R. 2470); the Senate amended and passed the bill on October 27. On the surface, the bills appear very similar. Both versions would cap the yearly out-of-pocket expenses that Medicare beneficiaries must pay for covered services. Both would extend slightly the current coverage for nursing-home and home-health care, and both would, for the first time, add broad Medicare coverage for outpatient prescription drugs. Additionally, both versions would require beneficiaries to cover the cost of providing new benefits by increasing the monthly Part B premium (currently $24.80), which includes coverage of physician and other outpatient care, and imposing a new supplemental premium assessed on a sliding scale according to income.

Beneath these surface similarities, however, some major policy and philosophical differences are buried in pages of legislative detail. Additionally, the Administration has endorsed the Senate version of H.R. 2470 and threatened a presidential veto of the House version of the budget bill, (H.R. 2470); the Senate amended and passed the bill on October 27. On the surface, the bills appear very similar. Both versions would cap the yearly out-of-pocket expenses that Medicare beneficiaries must pay for covered services. Both would extend slightly the current coverage for nursing-home and home-health care, and both would, for the first time, add broad Medicare coverage for outpatient prescription drugs. Additionally, both versions would require beneficiaries to cover the cost of providing new benefits by increasing the monthly Part B premium (currently $24.80), which includes coverage of physician and other outpatient care, and imposing a new supplemental premium assessed on a sliding scale according to income.

Beneath these surface similarities, however, some major policy and philosophical differences are buried in pages of legislative detail. Additionally, the Administration has endorsed the Senate version of H.R. 2470 and threatened a presidential veto of the House version of the budget bill. Both versions contain provisions that would split the financing 55% supplemental premium, which would be paid only by beneficiaries with incomes high enough to owe federal income tax. Under the House version, 80% of the needed funds would be raised by the supplemental premium. This would minimize increases in the flat premium paid by all Part B enrollees, but would require those with mid-level income to pay more than they would under the Senate plan, which would split the financing 55% supplemental premium and 45% flat premium.

Another issue that must be resolved is how best to protect beneficiaries with very low incomes. The House bill would require that states pay all premiums, deductibles, and co-payments for beneficiaries with incomes too high to qualify for Medicaid, but still below the federal poverty line. Proponents of the provision say that states would save enough money to pay for the extension because the all-federal Medicare program would begin to pick up costs now covered by the federal-state Medicaid program. The Senate version merely requires that states use any savings to help beneficiaries with low incomes.

Both versions contain provisions that would prevent the impoverishment of a person whose spouse needs Medicaid to pay for the elderly care, with funding coming from general revenues rather than from premiums.

The last major issue is the new prescription drug benefit. The Senate's version would phase in over five years, while the House bill would begin all at once in 1989. Conferees must also decide how much the program would pay for certain drugs and how the costs would be controlled.

Conferees will also consider a provision dropped from budget reconciliation last year that would provide incentives for states to establish health insurance risk pools for the uninsured. When they dropped the provision, which was in the House version of the budget bill, budget conferees stipulated that it would be taken up in the conference on the catastrophic health care legislation.

GUEST PRESIDENT

(continued from page 2)

lead both to better seminars and greater cooperation within the profession.

The future of the actuarial profession depends on the caliber of the youth who enter the profession. We must re-analyze our main recruiting tool (or barrier), the exams, asking ourselves: Are we getting the type of person we need? Our future also depends on the continuing education we provide practitioners of actuarial science. Are our seminars covering the right subjects and attracting an ever-growing body of attendees? Are we including ethics and logic in our meetings programs as essentials to the future of the actuary?

The future of the actuarial profession depends on how we cooperate with each other on the exams and the seminars. Whatever happens here will show us the way to a possible new structure, if necessary. New structuring in and of itself will do nothing to strengthen the profession. Cooperation on exams and seminars will be a better leader of the way.

Muerteries is president of the Conference of Actuaries in Public Practice.