



SOCIETY OF ACTUARIES

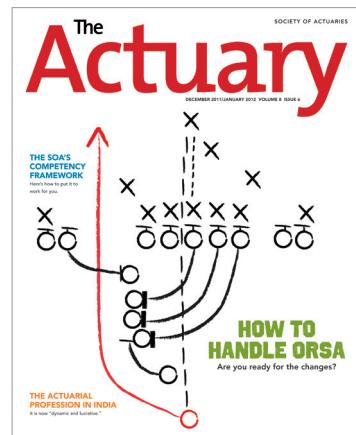
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Letters To The Editor

SOCIAL SECURITY AND LTCI



DEAR EDITOR,

IN THE DECEMBER 2011/JANUARY 2012 ISSUE, *The Actuary* presents SOA President Bradley M. Smith's speech at the SOA Annual Meeting held in October 2011.

Smith articulated five societal problems involving substantial actuarial considerations. I will comment further on one of those, i.e., the problem of Social Security.

Smith used politically proper terminology when he stated as follows:

"... tax revenue in excess of benefit payments accumulated in the Social Security Trust Fund. The federal government borrowed this excess revenue to pay current expenses."

He noted that the actuarial profession needs to support efforts to better educate the tax-paying public and lawmakers about the Social Security funding problem. I believe he meant we should do this more profoundly than by crunching numbers when asked.

I agree wholeheartedly and am writing to suggest some specifics.

Much of our citizenry is badly misinformed about the Social Security Trust Fund. Following are some explanatory efforts I have used in my economics classes:

1) The Social Security Trust Fund is a myth. The propagated value of the Trust Fund, currently in excess of \$2 trillion, is what WOULD be in the Trust Fund IF the government had been putting revenue into the fund and paying expenses out of it. In reality, our government spends (and always has spent) all tax receipts regardless of their nature, and supplements that with borrowing, in order to meet its obligations.

2) Your grandmother opens a college savings account for you and funds it in an actuarially determined way. Each month she kindly shows you the documentation of the account. You feel assured. But one day she says to you that she has taken all money out of the account and used it to pay for an elaborate cruise. She still plans to pay for your college education, but how much assurance do you have now?

3) Bernard Madoff was half correct when, from prison, he labeled the Social Security system a Ponzi scheme. The two basic elements of a Ponzi scheme are that new money pays old, and that old money is not in trust because the operator has already taken it.

Of course, the actuarial profession can do much more than explain the non-existence of the Trust Fund. Actuaries are well-positioned, perhaps uniquely positioned, because of our training in the diverse areas of demographics, projection of contingent financial obligations, discounting, and cash flow comparison.

Actuaries could advise politicians, as well as the public in general, perhaps as follows:

1) The size of the mythical Trust Fund (as well as the year that it "goes broke") should be irrelevant to decision making. Actuaries can critique a statement such as "Social Security is sound for the next 40 years" when it means only that the Trust Fund drops to zero at the end of that time.

2) Calculating the size of the Trust Fund is a waste of time. Similarly, including the amount the government owes the Trust Fund in the official tally of the national debt, while a nice attempt to "own up" to having spent the money, is misleading.

3) Current law precludes payment of any benefits beyond the amount that can be financed by the Trust Fund. Actuaries should argue for the repeal of this law because it imbues a meaningless number, i.e., the size of the Trust Fund, with a tremendous amount of leverage. Wasteful political bickering will result from this law.

4) The funding problem will continue to worsen from the scissors effect of longer lives and lower birth rates. Two defenses we have are productivity and immigration (the demographic benefits of immigration are poorly understood and actuaries could assist tremendously).

Actuaries are well-positioned to go even further. Taxation provides the cash flow to match against the obligation, so actuaries should be involved in tax policy. Here are two thoughts wherein actuaries might concur (or not, if it comes to that) and might proceed from:

1) Social Security and Medicare (also in Smith's list of five societal problems) should be aggregated for purposes of funding-related legislation. The political process will be streamlined if one debate,

instead of two, is the result. Also the payroll tax system would be simplified if these two were unified.

2) A debate could be introduced as to whether the payroll tax system should be combined into the personal and corporate tax systems. The logic of separate payroll taxes is strained when the proceeds are spent rather than used to fund the programs for which they were designed. **A**

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DEAR EDITOR,

CORIN CHAPMAN'S DECEMBER/JANUARY EDITORIAL, presented as a plea for reasonableness in the regulation of long-term care insurance, raises issues that go beyond regulatory policy and beyond the LTC line. These issues could, and should, fill the programs of actuarial meetings for years, and the editorial deserves to be a case study for seminars in many disciplines. Here are some questions that jump out at me:

- If limits on premium increases contribute to less efficient insurers leaving the market, is competition reduced or stimulated?
- Why should insurers be allowed to avoid the cost of significant pricing errors through premium increases? In no other business can underestimated costs be shifted to past purchasers.
- Do insurers bear particular responsibility for pricing and disclosure in an immature market with scant credible experience?
- A very long-term policy dependent on lapse-supported premiums in effect contains an embedded tontine. What ethical hurdles exist? What disclosure to prospects is appropriate?
- What is the optimum investment strategy for LTC? To the extent that LTC insurers could have protected investment returns via derivatives but failed to do so, should regulators allow shortfalls to be borne by policyholders?
- What is the appropriate place of non-forfeiture values (e.g., paid-up insurance) in LTC policies?
- Can risks be equitably shared with insureds through participating LTC policies?

- Should Medicaid's role as a de facto LTC insurer be reduced? Formalized? Expanded? Can the future cost of this commitment be better communicated to the public?

An overarching question, if we are indeed a profession, is: How does the actuary balance professional responsibilities to an insurer employer or client, the insureds, and the public at large?

Frank E. Finkenberg, FSA, retired

DEAR MR. FINKENBERG,

I appreciate your response and agree that perhaps my article raises more questions than provides actual answers. As you point out, the issue basically boils down to responsibility. Within an insurance contract, I believe there are embedded shared risks by both the insurer and the insureds, particularly with longer term products. Shifting all those responsibilities to the insurer or to the insured would make the product either unsustainable or unmarketable. As actuaries, we are forced to take a primary role in building a product that is beneficial for all parties involved, which consequently obliges us to begin debating many of the questions that you have presented. Only by understanding the points of view of all parties involved can we have a rational and reasonable discussion about these complex issues. Therefore, a thank you goes out to those, like yourself, who continue to motivate the conversation as each question raised hopefully generates an answer that builds a stronger and more beneficial insurance industry. **A**

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