TRANSACTIONS OF SOCIETY OF ACTUARIES
1963 VOL. 15 PT. 2

ELEMENTS OF BENEFIT SECURITY

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The security of benefit expectations under private pension plans is a subject of timely and growing interest. It is the focus of an inquiry of the Pension Research Council of the University of Pennsylvania which has been under way since 1958 and is nearing completion with the imminent publication of the fifth book produced by the study. Certain aspects of the subject were considered by the prestigious Commission on Money and Credit, established under the auspices of the Committee for Economic Development. As a result of these two inquiries, President Kennedy appointed a Cabinet-level committee about eighteen months ago to examine various aspects of the private pension structure, with primary emphasis on its financial soundness and social justification. The Cabinet committee submitted its report in early 1963 to the President, who thereupon referred it to his Advisory Committee on Labor-Management Policy, a blue-ribbon group of twenty-one persons with equal representation from labor, management, and the public. The latter committee is scheduled to submit its evaluation of the Cabinet committee report within the very near future. Some of the recommendations in these two reports, if accepted by the President and enacted into law, would bring about some fundamental changes in the ground rules under which private pension plans operate and, incidentally, would thrust a greater responsibility on the actuarial profession for seeing to the financial soundness of the private pension institution.

The latest manifestation of concern over the security of benefit expectations is the attention which it is receiving at this meeting of the Society of Actuaries.

Each member of this panel has been asked to deal with a specific facet of the broad subject under discussion. My assignment was to identify the elements of benefit security and to suggest in summary form the major obstacles that stand in the way of benefit security today. It was not within the purview of my assignment to propose solutions to the problems which I believe to exist.

There are many specific features of the private pension movement that have a bearing on benefit security, but they can be subsumed under four

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main headings: (1) adequate benefit commitment; (2) competent actuarial guidance; (3) realistic funding program; and (4) effective safeguards for pension-plan assets.

Adequate Benefit Commitment

There can be wide differences of opinion as to what constitutes an adequate benefit commitment. Indeed, some persons argue with sincerity and a certain degree of logic that there should be *no* benefit commitment in a pension plan. These people would settle for a *contribution* commitment. I personally feel that a pension plan should have a *benefit* commitment, and I would offer for your consideration the following capsule description of an *adequate* benefit commitment: an undertaking to provide retirement benefits of definitely determinable amounts under conditions which create legally enforceable rights on behalf of the pension-plan participants and provides reasonable assurance that the plan will accumulate assets sufficient to honor the commitments.

The stipulation that the plan provide benefits of "definitely determinable amounts" was designed to distinguish the commitment from that of a profit-sharing plan and was not intended to rule out plans which provide benefits conditioned on the market value of the underlying assets or changes in the cost of living. The requirement that the commitment lead to legally enforceable rights was intended to exclude the type of undertaking associated with informal or discretionary plans. It is sufficient that the plan create legally enforceable claims against the plan assets as distinct from the assets of the employer. It would not be unreasonable to expect employers to pledge their corporate assets behind the vested benefit accruals of their pension plans, but with some notable exceptions the business community is not as yet prepared to accept this concept. If the realization of benefit expectations is to be tied to the adequacy of plan assets, the definition of an acceptable benefit commitment should have something to say about the prospects that assets will be accumulated at a rate sufficient to honor the accruing claims. This takes one into the area of funding, which will be dealt with in more specific terms at a later point.

Various features of private pension plans impair the adequacy of the benefit commitment. By definition, the commitment is not adequate when the undertaking is stated in terms of contributions to the plan. Admittedly, the contributions must be translated into a schedule of benefits, which may take on a certain air of inviolability; but, unless forced by subsequent labor agreements, the employer is under no legal duty to support the projected level of benefits.

Even when the plan's undertaking is expressed in terms of benefits,

there are usually limitations on the commitment which seriously weaken the security of the benefit expectations. These limitations, well known to pension practitioners, include: (1) the right of the employer to alter, modify, or terminate the plan at any time; (2) the right of the employer to suspend, reduce, or discontinue contributions to the plan at any time and for any reason, irrespective of the funded status of the accrued benefit credits; (3) limitation of the employer's liability, in the event of plan termination, to contributions already made; and (4) restrictions on the activities of pensioners, violation of which may result in forfeiture of further retirement benefits. To make matters worse, these limitations are seldom communicated to the participants in such a manner as to make their implications clear.

Another source of weakness in the benefit commitment is the absence of, or unduly restrictive, provisions for the vesting of benefits other than at retirement or in the event of plan termination. A survey by the Department of Labor of plans filed with the Department pursuant to the Federal Welfare and Pension Plans Disclosure Act revealed that two-thirds of the plans, covering 60 per cent of the participants, make some provision for vesting other than at retirement or plan termination. However, vesting is usually conditioned on a fairly long period of service, typically twenty years, and the attainment of a specified age, such as forty, forty-five, or fifty. Such conditions for vesting may be appropriate for employment termination due to voluntary quits or discharges for cause, but they raise serious questions of public and social policy in an economic environment where an increasing proportion of terminations are attributable to technological changes. Inadequate vesting provisions are of especial concern in connection with wholesale layoffs, plant shutdowns, and other developments that might be characterized as partial plan terminations. The problem is ameliorated when such developments are in fact treated as a partial plan termination, but inequities arise when these severances are regarded as ordinary withdrawals.

Competent Actuarial Guidance

The services of a qualified actuary are highly essential to the successful functioning of a pension plan. He must determine the probability of occurrence of those future events that will call for payments under the plan, estimate the probable amount of such payments, and ascertain the sums of money that must be set aside from time to time to meet such payments. He must make assumptions as to mortality rates, disability rates, rate of return on investments, rate of employee withdrawals, ages at which retirement will occur, and the behavior of wage and salary rates.

The actuary should participate actively in the design of the pension plan, having special cognizance over those plan features that exert a direct influence on costs. His counsel should be sought with respect to eligibility for participation in the plan, benefit formulas, provisions for early retirement, optional annuity forms, employee contributions, and allocation of plan assets upon termination of the plan.

After the plan has been in operation for a period of time, the actuary should examine the experience of the plan to test the validity of his earlier assumptions. If substantial deviations are found, the assumptions may have to be modified. The actuary must also prepare periodic valuations of the liabilities under the plan to determine whether the funding policy being pursued by the employer will prove adequate.

In all these matters the actuary must combine sound professional judgment with valid mathematical techniques.

The principal threat to sound actuarial guidance is the lack of legal recognition of the actuarial profession and the absence of any formal means of enforcing actuarial responsibility. In no state must a license be obtained to practice as an actuary, and the federal and state laws and regulations which make references to the services of actuaries in connection with pension plans do not define the term "actuary" or prescribe any qualifications for such a practitioner. It is understandable that, under such circumstances, a number of persons without the technical qualifications and experience required for the actuarial guidance of a pension plan have set themselves up as consulting actuaries. While the Society of Actuaries and the Conference of Actuaries in Public Practice have made progress toward the enforcement of standards of competence and professional conduct on their memberships, neither has the authority to exclude from the public practice of actuarial science those persons who do not measure up to its standards.

Another factor that has an adverse influence on the quality of actuarial guidance is the intense competition among life insurance companies and banks for the assets generated by pension plans, along with equally vigorous competition among actuarial consultants. All too often, this competition has resulted in the use of cost assumptions far less conservative than would seem to be dictated by the realities of the situation. These practices are not confined to the ranks of consulting actuaries but are reflected in the actions of many life insurers, even in the quoting of rates for the purchase of annuities.

A final factor that deserves mention is the limited role played by actuaries in the design of many plans. Frequently, the basic structure of the plan has already been fashioned before the actuary is called in to

estimate the cost of what others have proposed. This can clearly lead to inadequate consideration of those plan provisions with direct cost implications.

Realistic Funding Program

It is not sufficient that the employer or other pension-plan administrator retain an actuary qualified to offer the advice and perform the computations necessary to the sound construction and functioning of the pension plan. The employer must actually follow the advice provided by the actuary. Most important, he must adopt a financial policy that will lead to the accumulation of plan assets, including paid-up annuities, in conformance with the actuarial cost projections developed by the actuary. There is general agreement that any plan which aspires to any type of funded status other than terminal funding should at all times have assets equal to the cumulative normal costs of the plan; that is, normal costs should be funded on a current basis. If the plan aspires to a fully funded status, the past-service liability and other forms of supplemental liability must eventually be funded in full. There is room for opinion as to the rate at which the supplemental liability should be funded. A *minimum* objective might contemplate the complete funding of the supplemental liability within twenty-five to thirty years after the event which created the liability.

There are some formidable obstacles to the attainment of realistic funding programs for pension plans, even if it is assumed that a sound funding course has been charted by the actuary. The most obvious obstacle is the possible inability of the employer to allocate the required resources to the plan. If fiscal ability is assumed, however, the employer may be unwilling to follow the prescribed course of financial rectitude through good times and bad. The employer's resolve to finance the plan in a proper manner is not strengthened by the typical plan provision relating to the employer's contribution. The contribution commitment is usually vague as to both the *amount* and the *timing* of the contributions. Provisions such as the following are not at all unusual: "The Company will contribute at such times and in such manner as the Board of Directors deems advisable." Even if the plan is fairly specific as to the amount and timing of the employer's contributions, the commitment is all but nullified by the reserved right to suspend or discontinue contributions at any time. In unilateral plans this provision permits the employer to avoid further obligation, despite the fact that his past contributions were not sufficient to meet the benefits credited to date of suspension.

Another barrier to the achievement of a satisfactory funded status is

the influence of the Internal Revenue Service. The responsibility of the Internal Revenue Service in the area of pensions is limited to two matters: (1) the prevention of discrimination in favor of stockholders, officers, and highly compensated employees and (2) the protection of the tax revenues of the federal government. The two responsibilities are related, of course. In its zeal to carry out the mandate, the Service has been more concerned with *over*funding than with *under*funding. The most recent evidence of this attitude is found in Revenue Ruling 63-11. The Service feels that it has no responsibility or authority to enforce actuarial soundness, except to the degree necessary to prevent the prohibited discrimination. One is forced to the conclusion that, on balance, the Service has been a negative factor in the pursuit of actuarial soundness.

A final factor that complicates the achievement of that elusive status of "full funding" is the valuation of pension-plan assets. The concept involves a balancing of liabilities and assets. It is not enough that liabilities be computed on a realistic basis; assets must also be valued on a reasonable and consistent basis. The big problem—as yet unresolved—in this area is how to treat unrealized appreciation in the value of equity investments in pension-plan portfolios.

Effective Safeguards for Pension-Plan Assets

Once funds have been set aside for the meeting of pension obligations, they must be administered in such a manner as to ensure their use for the exclusive benefit of the plan participants and their beneficiaries, with minimum risk to the principal consistent with a reasonable rate of return. The Internal Revenue Code and implementing regulations require as a condition for qualification that the legal arrangement for the holding of plan assets be such as to prevent the recapture of contributions by the employer prior to the satisfaction of all liabilities under the plan. Apart from the prohibition against certain types of prohibited investment transactions, however, no standards of investment conduct are imposed.

This is an extremely sensitive area, partly because it is the focus of competition among funding agencies. The employer has a strong interest in maximizing the return on the plan investments, since his costs will be reduced thereby. This motivation could drive him to authorize an investment policy that could impair the benefit security attaching to a fund of assets. Thus, other things being equal, the plan participants should prefer a conservative investment policy. To the extent, however, that a portion of their benefits will be paid from investment income, they have an interest in maximizing the yield on investments. One of the intriguing issues in this area is who should have authority to determine investment

policy—the employer, the plan participants, or some public body representing the interest of the employees. The employer is the residual, if not the only, cost bearer in a pension plan which gives him a strong claim to determine the broad investment policy for the plan. On the other hand, the funds are set aside for the benefit of the participants and their beneficiaries, and it could be argued that they or some representative of theirs should decide the broad distribution of investments. A subsidiary question in this whole area is who should vote the stock, if any, held by a pension-plan trustee or in a separate account with a life insurance company? Specifically, should the employer or the funding agency exercise the voting rights?

There is a conviction on the part of some observers that the existing prohibition against certain investment transactions is largely ineffectual in that (1) its scope is too narrow and (2) the penalty provisions do not operate as a deterrent to engagement in the proscribed transactions. On the latter point, it is argued that only the participants (the innocent parties) suffer any penalty, that being the temporary or permanent loss of the favorable tax treatment accorded a qualified plan.

Other persons see a problem in the incomplete disclosure of the investment portfolio of pension plans under the Federal Welfare and Pension Plans Disclosure Act. These people believe that the interests of plan participants can be properly safeguarded only if all investment transactions are exposed to public scrutiny.

Concluding Remark

This has been a very sketchy treatment of the elements of benefit security and some of the obstacles in the path of such security. Many will not agree with the selection of elements or the manner in which they are formulated. Others will be able to find fault with some of the "problems" cited. These remarks will have served their purpose if they lay the groundwork for a constructive discussion of means of strengthening benefit security of private pension plans—a goal with which we can all agree.

THE ROLE OF THE INSURANCE COMPANY ACTUARY

RAY M. PETERSON:

Introduction

"Whatever is worth doing at all is worth doing well." This admonition, given to his son over two hundred years ago by Philip Dormer Stanhope, Earl of Chesterfield, is an apposite apothegm for this discussion. Another observation of Lord Chesterfield, however, has no place here, viz., "Without some dissimulation, no business can be carried on at all." Indeed, we

are concerned lest pension expectations prove to be illusory and mere pretense.

First, I will set the stage by describing, as I see it, the environment in which the private pension movement in the United States will be operating in the years ahead. Then, having set the stage, I will depict briefly the role of insurance companies in contributing to the future environment of private pensions, and, finally, I will examine how the performance of both insurance company and consulting actuaries may be improved and thus contribute to the enhancement of pension expectations.

Environment of the Business Process

Private pension-plan expectations are established by what I choose to call the "business process" as distinguished from the "political process"—the begetter of governmental programs. Our business enterprises are expected to experience more severe competition in the years ahead, both domestically and internationally. This means, as to pensions, greater concern as to costs and the need for attractive benefits that will draw and retain the increased number of capable employees required to keep a business thriving in this accelerated competitive environment.

The business process has three great virtues: (1) as a discipline of a market economy, the need and desire to *know* probable costs in *advance;* (2) the purpose to accumulate funds during the employees' working lifetime and thus contribute to the stream of savings and consequent capital supply; and (3) the flexibility of choice as to kind and level of benefits, thus permitting accommodation to capacity to pay.

In contrast, the political process is greatly influenced by the disciplines of the ballot box supplemented by the activities of nonelected groups in government who develop programs they want and then wait in the wings for the politically propitious moment to propose them. As to fund accumulations under the political process, they either are inappropriate or, where appropriate, suffer woefully from political mismanagement—witness the present state of the Civil Service Retirement Plan. Then, as to flexibility of choice, a national compulsory program such as the Social Security System provides none, of course, and gives no recognition to capacity to pay.

But with the freedom and flexibility found in the business process, there are responsibilities. In devising programs, responsibility must be taken that they not only serve the business enterprise well but also do not overlook the public interest. Then, as a matter of great importance, there is the responsibility for financing benefits so that performance matches promises. Under plans utilizing a trust fund or a deposit adminis-

tration type of insurance company contract, the employer has the responsibility for fund adequacy. Although the wind-up provisions of most of these plans could, in the end, place the risk of fund inadequacy on employees, I believe that, in the years ahead, most employers will increasingly recognize a moral obligation to meet expectations.

The preservation and enhancement of pension expectations depend upon, first, the continued capacity of the employer to make contributions and, second, fund adequacy. In turn, fund adequacy depends upon three major factors: (1) competent actuarial advice and cost studies; (2) an investment performance that serves well the needs of a pension plan; and (3) the actual making of the required contributions. The responsibility for fund adequacy cannot be successfully met unless advice and guidance from investment experts, lawyers, and actuaries is sought, obtained, and followed. In the very competitive era ahead of us, the business process will justify its existence only if this partnership between those responsible and their advisers functions with complete understanding and a courageous purpose truly to recognize and meet costs without passing burdens on to future managements and stockholders and also functions without unwitting overfunding.

Finally, a part of the environment of the business process will be the watchful and even critical eye of a number of interested observers. These will include the administrators of the Disclosure Act, the Internal Revenue Service, the Securities and Exchange Commission, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, and the accounting profession and pension experts, self-appointed and otherwise. Also, institutional investors who hold stock of companies may be increasingly interested in the cost of liberalized benefits and the methods of cost recognition. The matter of improvement and extension of vesting provisions will be a specific concern of some of these observers. Those who are devoted to the business process cannot afford to ignore these watchful and critical eyes.

Insurance Company Role in the Business Process

In recent years the character of the pension market has been marked by two major changes: first, a wider interest in investing in common stocks and, second, an increasing demand for financing facilities that permit flexibility in plan provisions and in the incidence and level of contributions. These changes can increase the order of responsibility of the employer for adequacy of funds to cover pension expectations.

Pension-writing insurance companies have endured a dismal decade

during which they labored under unfair competitive handicaps that were not due to the intrinsic nature of the insurance institution. Now, by appropriate legislative and regulatory action, we are happy to say that, in the main, the problems of tax discrimination and inability to adjust to changes in investment conditions and the character of the pension market have been solved. In most states insurance companies are now able to compete on the true merits of their services.

Insurance companies, with their actuaries playing an important part, are now responding to the demands of the pension market by offering a wide spectrum of services with varying degrees of employer responsibility as may be selected. But, under all forms of contracts, the insurance company generally takes over full responsibility at retirement by guaranteeing benefits. This guarantee, I submit, does importantly enhance the security of pension expectations. This spectrum of services ranges from the deferred group annuity contract (the facility with maximum insurance company responsibility) to the immediate participation guarantee deposit administration contract form with a separate account for equity investments (the arrangement with maximum employer responsibility). Since the details of this spectrum of services are elsewhere available and also differ among insurance companies, they will be omitted from this discussion. It is appropriate to recognize that the availability of separate accounts and the use of the investment year method of allocating investment income constitute a fully adequate response to the investment demands of the pension market and make the traditionally expert insurance company investment services an attractive means for meeting pension-plan investment needs. Among the advantages of this service is the insulation, as contrasted with a trust fund, from such allegations as have been recently reported in the press with respect to the Retirement Benefits Plan of the McCrory Corporation and the Teamsters' Central States, Southeast, and Southwest Areas Pension Fund.

Performance of the Actuary

We may postulate as a general proposition that the better the actuary does his job, the more is the security of pension expectations enhanced. This entails both actuarial cost studies and plan design. The completion of his task depends not only upon a good technical performance but also upon a good report, the vital highlights of which reach the top decision-makers of a company. Defective communication can be a weak link. The Opinion Research Corporation recently published the results of a study of obstructions to the flow of communication in large corporations and

concluded that this is one of the biggest of all corporate problems. In the pension area it can include an unfortunate reluctance by the lower echelon of a corporation to disagree with the top boss or to tell him that his ideas on plan provisions or funding arrangements are not what they should be.

As to the actuary's role, let it first be said that insurance companies generally, take the position that under a deposit administration type of contract the employer should have completely free choice as to engaging the services of a consulting actuary or utilizing the actuarial services of the insurance company where offered. At the same time, most insurance companies believe that it is entirely appropriate for them to make such services available. Insurance company actuaries have demonstrated that they can meet successfully their responsibilities to policyholders as a whole and to a policyholder in particular.

In this new pension environment the insurance company actuary cannot rest on past laurels, however resplendent. He will have to do more than point out that the guarantee of annuities is the birthright of life insurance companies, that security is a hallowed tradition of such institutions, that the mortality tables used (and misused) for pension valuation purposes are mainly those sired by insurance company actuaries, that the environment in which the insurance company actuary works is one of prudence and pragmatic conservatism, and that about half of the papers on retirement plans in the first thirteen volumes of the *Transactions* were written by insurance company actuaries (*TSA*, XV, 185). No, the insurance company actuary, along with his consulting brother, must be concerned about improving his performance.

In considering possible areas of improvement, the actuary engaged in pension work may well measure his performance by a set of standards which I would expect any actuary—either consulting or insurance company—to accept as proper goals or ideals. I have prepared a list of such standards that I will call the "Seven *C*'s of Competence." These represent standards of performance that we should observe in our own work and should protest if we know of situations in which they are not observed. Here are my seven *C*'s of competence: (1) complete client communication; (2) courage of convictions; (3) compatibility of cost components; (4) conscientious carrier comparisons; (5) candid cost comparisons; (6) collateral cost cautiousness; and (7) constructive citizenship. Let me illustrate briefly what I think these standards involve. When I use the term "pension actuary," I am referring to both insurance company actuaries and consulting actuaries.

1. *Complete client communication.*—The competent pension actuary

will explain fully to employers any limitations on, or implications of, his actuarial cost figures. He will point out the presence of factors likely to result in a rise or fall in future costs relative to the present estimate. He will point out the relationship between the likely level of funding under the proposed actuarial cost method and the liability for the benefits that employees would expect to receive upon plan discontinuance.

2. *Courage of convictions.*—The competent pension actuary will stand by his actuarial judgments in the face of contrary pressures. He will not use questionably low cost figures as a means to avoid adverse client reaction. He will not withhold unpalatable advice under the persuasion of associates with more of a sales than a professional orientation.

3. *Compatibility of cost components.*—The competent pension actuary will be sure that his actuarial assumptions and actuarial cost method are compatible. He will not, for example, ordinarily use withdrawal rates in connection with an accrued benefit cost method; nor will he fail to use a salary scale for a final salary plan funded by the entry-age-normal cost method (new terminology—projected benefit cost method with supplemental liability).

4. *Conscientious carrier comparisons.*—The competent pension actuary, when called upon in the role of an independent adviser, will give unbiased advice as to a choice of funding agency. The insurance company actuary will probably be expected to have some bias and will have to accept that situation even if he is truly unbiased. Since the consulting actuary will usually be expected to be unbiased, it is particularly important that he meet that expectation.

5. *Candid cost comparisons.*—A competent pension actuary will not permit his client to believe that the difference in real cost between two alternative funding agencies is *automatically* revealed by comparing the cost figures quoted by proponents of the two agencies. He will carefully bring out the extent to which a difference in cost figures is, in fact, attributable to (i) a difference in assumptions, not supported by a difference in the performance of the agencies; (ii) a difference in actuarial cost method; or, even, (iii) a difference in the benefits provided. He will use particular care in the complicated situation of a proposed conversion from the use of individual policies to a group coverage or a trust fund arrangement.

6. *Collateral cost cautiousness.*—The competent pension actuary will pay close attention to the actuarial cost implications of such collateral features as annuity and lump-sum options. This includes recognition of (i) the cost implications of options with inadequate adverse selection

safeguards; (ii) the defective plan design aspects of such option provisions; (iii) the adverse selection aspects of "floating" retirement dates and revocation privileges; and (iv) the cost implications of conversion factors that are not based on the requirements of actuarial equivalence, as when a lump-sum settlement exceeds the true value of the annuity being given up.

7. *Constructive citizenship.*—Last but by no means least, the competent pension actuary will want to consider conscientiously the extent to which he is able to perform those services to the general public for which he is specially qualified. He will be interested in the political process that shapes our Social Security system and such programs as the Civil Service Retirement Plan. He will keep informed of the worthwhile actuarial studies of the Division of the Actuary of the Social Security Administration. He will pay attention, in a critical way, to the material produced for public consumption by the "Baltimore Bureaucracy" that administers and "sells" OASDI. He will be interested in the activities of the Civil Service Commission and its actuaries in their unremitting and so far fruitless efforts to put the Civil Service Retirement system on a soundly funded basis.

Although these seven *C*'s of competence may not encompass all of our desired standards of performance as fully as the seven seas of the earth encircle that terrestrial ball, I do hope that you are not all at sea but do see better how our performance can be improved.

Conclusion

As a concluding observation, may I say that it is vital that the public continue to recognize that private pension programs, created and maintained in the environment of the business process, have a major legitimate role in our economic life. These plans will attain a higher level of maturity in the years ahead, and their performance will be severely tested. The full acceptance of their role may well depend upon giving a high order of priority to pension obligations lest we become overwhelmed by the political process.

Insurance companies, by unique services, and their actuaries have an opportunity to contribute much to the realization of the full potential of private pension programs and the achievement of one of labor's chief aims, "a measure of security in old age."[1] Although the actuary engaged in pension work well knows that his activity is even more of an inexact science than some other actuarial pursuits, he is not relieved from the responsibility of substituting "facts for appearances and demonstrations for impressions."

[1] *U.S. News & World Report*, August 12, 1963, p. 72.

THE ROLE OF THE CONSULTING ACTUARY

FRANK L. GRIFFIN, JR.:

In a recent address before the Conference of Actuaries in Public Practice, Society President John Miller made a number of observations on "The Responsibilities of the Actuarial Profession." Among them were:

> The fact that the actuary must make judgments which can only be confirmed over a long period of time may appear to put him in a very enviable position. Actually, the time element involved places a very serious responsibility on the actuary when he is called upon to make decisions or recommendations.
>
> With the trend toward the institutionalization of personal and family savings and security, the responsibilities of the actuary have grown beyond his duty to client or employer. When he serves any institution which is affected with a public interest, he becomes responsible, as a professional man, to its beneficiaries and potential beneficiaries and to the stockholders as well, a responsibility which may at times override other considerations.

I am sure we all subscribe to these sentiments. My interpretation of these responsibilities, and my role here, might be expected to differ somewhat from those who have preceded me—though not in fundamentals. It falls to my lot to co-ordinate certain actuarial and nonactuarial aspects of this question, and this is my natural inclination in any case.

I assume that our remarks may omit from consideration the threat to pension security arising from gross acts of dishonesty and misuse of funds, for which there are the usual legal remedies. But what about misrepresentation of the facts about private pensions, leading to exaggerated expectations and to an unwarranted clamor for reform? The public is often misled by tricks of semantics, and to some extent this is the case here. It is not the actuaries or others familiar with the practical problems in this field who are usually guilty of this; rather it is the man who sees only one aspect of the question—the reformer or the politician who seeks to make capital of it—who is usually to blame.

Walking down the Boardwalk on Sunday, I noticed a billboard with a real split personality, carrying just such a dishonest message:

[*On the left, in large letters*]	[*And, on the right*]
STOP	VOTE "YES"
NEW	ON THE
TAXES	BOND ISSUE

This kind of misrepresentation can get us into a mess of trouble in the operation of the democratic process. The same gullible persons who swallow that line (and there are many who do) will follow the Pied Piper who urges more and more governmental regulation of private pension plans.

I am sure that everyone speaking on this panel believes that, fundamentally, most private pension plans are in pretty fair shape financially—and especially in relation to most governmental plans, whether Social Security or plans for state and municipal employees. On some of the latter, I agree with Professor Parkinson that we have long since passed the point where it is reasonable to assume that additional taxing power is sufficiently unlimited to "bail us out" indefinitely. With this contrast in mind, a subtle innuendo might be pointed out in the original phrase from which our panel topic was taken—"Protecting *Private* Pension Expectations"—which itself may mislead through the unfortunate inference that private plans are in doubtful condition and might somehow be improved if (God forbid!) the government became a partner!

Obviously, such an inference is unfortunate, and I disagree with it. If there is need for more than ordinary effort to protect private pension expectations, we might also remember that frequently the real culprit is "overselling" the expectations rather than inadequate funding. To the extent that this is so, our attention should be turned to the field of communications.

Without agreeing that funding "reform" is needed, I certainly agree that actuaries can play a most important role in keeping pension funding on a sound basis and thus help avoid occasionally insecure pensions and perhaps the even greater calamity of governmental control.

One of the primary functions which should be performed by the consulting actuary is an educational one. Unless an employer recognizes the underlying nature of pension costs applicable to an evolving employee group, he himself will not be able to judge the soundness of one course of action or another. By "soundness," in this case, I do not mean the relatively narrow concept of fiscal soundness of the pension plan itself but rather soundness in relation to the employer's total operation. Actually, there is a possible conflict between (1) actuarial supersoundness (or redundancy) applying to pensions and (2) the long-range welfare of the company and its employees.

The businessman who has not already been indoctrinated in the fundamental concepts of pension funding can be brought to understand much of what he may initially consider to be an occult mystery; for example, the normal rise in pension payouts as the covered group matures, the steeper but shorter rise in "terminal funding" requirements, and, finally, the incidence of "advance funding" requirements by different actuarial methods. An actuary who has not been widely exposed to these problems of indoctrination may be surprised by the frequency with which false notions are held on these matters by otherwise sophisticated businessmen.

We still hear it alleged, occasionally, that, since pension payouts are less than interest on the existing fund, no contributions should be necessary. And so it goes.

The actuary himself is not above being educated, however, in matters which relate the employer's other financial requirements to the funding of the pension plan. Here, if we are to make any sense in the employees' over-all security picture, we must keep an open mind. You cannot protect pension expectations in a vacuum. Any course of action which leads to a stronger company, better able to weather occasional financial reverses and to meet competition, may enhance the security of the employee group as a whole, regardless of its current effect on the level of pension contributions. In the employee security picture, it would be stupid for the employer (or his actuary) to give all his attention to the pension plan, or to the full funding, before it is otherwise timely, of vested benefits for employees who leave the service.

The consulting actuary has a very real responsibility to the public—and this includes both employers and employees—in seeing that the information he furnishes does not mislead those who rely upon it. This in turn means that he should consider all factors pertinent to his projections, employ adequate assumptions, and clearly indicate the effect on current and future contributions of the cost method chosen. If he has done all this, he certainly should be free—and, in fact, may have the duty—to recommend any reasonable system of budgeting contributions which fits other important requirements which the company has made known to him.

Within the framework of adequate assumptions, it is entirely proper to choose that actuarial cost method best suited to the company's long-range objectives. For example, just because the entry-age-normal method is technically the method of the "going concern" does not mean that it should always be followed. Ignoring for the moment the question of proper accounting for pension costs, the incidence of contributions to the pension fund may be extremely important to the company. A method under which relatively small contributions are made in the early years, recognizing that they will increase later, may, by providing a source of larger current capital expenditure, result in a more prosperous company with greater security for the employees.

An element of judgment on the part of both the employer and his actuary obviously is required. This is what makes the educational role of the actuary so important. Most consulting actuaries whom I know are doing a commendable job here as well as in the exercise of judgment and imagination.

It would not be ethical, in my opinion, for an actuary to accede to outside pressures to "shave" his assumptions to a point where the adequacy of the resulting contributions is open to serious question. There is room for honest difference of opinion, of course, especially with respect to those factors most dependent on the future economy, such as yield and salary scale. And it is possible to be too conservative as well as not conservative enough—there are two sides to the coin.

We all know of situations where the actuary has hidden behind ultraconservative assumptions and defended them zealously to avoid change. Many of us can remember the day when some of our most reputable actuaries staunchly defended a 2½ per cent interest assumption—which, remember, was for the long-term future of a pension plan—even though others espoused a more realistic view based on the lessons of history. The moral of this is that actuaries are human even when they play God and that they can learn from those they seek to counsel. One danger of trying to regulate pension funding, perhaps on the mistaken theory that we are protecting the individual employee, is that the more we eliminate judgment the more we put a strait jacket on progressive ideas.

It is apparent that I take strong issue with views on protecting pension expectations which suffer from the wearing of blinders against the larger picture. I feel it is time we gave as much attention to protecting the employer's continued operation expectations. For, unless he can continue to operate successfully, the pension plan has little meaning. A pension plan should not rule a company. It is meaningless to fund a plan so richly that it puts the employees' jobs on the block. Employee security depends first on the company's welfare. To argue otherwise is to say we "don't give a tinker's dam" what happens to a company or its payroll, so long as its employees' accrued pensions are funded when it goes out of business!

By the same token, conferring vested rights (or requiring full funding of vested benefits) does not answer all the basic questions. The money has to come from somewhere—from less liberal eligibility, from a less adequate pension formula, from the exclusion of employees who are the most immediate retirement problem, or else from moneys which might otherwise be invested in the business to strengthen its future.

Vesting is merely one of many benefits which may be included under a pension plan, and terminating employees should be expected to take their chances on the sufficiency of funds just as those employees remaining in service must take their chances on the employer's continued funding of their ultimate benefits. To require that all accrued benefits should be 100 per cent funded at the earliest point of full vesting—either through stringent accounting rules, unwise legislation or regulation, or whatnot—

could increase the cost of a plan to a point where it might not be adopted at all or where the primary pension objectives were so watered down as to be unrealistic.

In our zeal to protect employees in one small area, we should not lose perspective relative to areas of more vital concern. Acting in completely good faith with its employees (and it seems to me that any other assumption is inconsistent with modern employer-employee relationships), a company must consider first the long-range welfare of the entire organization. Must we assume, as present proponents of regulation appear to do, that employer and employee interests are always opposed? I am not so surprised that the "reformers" should do so, but I am certainly surprised that a practical actuary should be willing to swallow the line regarding a permanent conflict between employees and employers. The protection of employee security requires a healthy company.

Mr. Dyer has asked that I touch upon the activities of the American Institute of Certified Public Accountants and of the Society's Committee To Study Pension Accounting, insofar as this may relate to our panel subject. While the purpose of so-called standard accounting charges for pension costs has no direct relation to our subject, it most certainly has an indirect one. The result of early proposals by the research staff of the AICPA would have imposed cost charges (regardless of level of contribution actually made) similar to "level premium" funding, resulting in very high as well as inflexible charges in the early years of a plan. Certainly, if a company contributed on the same basis as those proposed charges, pension reserves would increase more rapidly than under the more usual funding arrangements followed today. I suppose this would suit those who feel that there should be heavier funding to protect pension expectations. On the other hand, it would hamstring many companies and perhaps prevent the adoption of plans at all in some cases. That unfortunate result does not appear to inhibit those "hell-bent for reform." I am happy to report a more favorable climate under the new director of this project.

One of my highly esteemed colleagues once remarked (rather hopefully, it now appears) that it is a long way from the ivy-covered walls to the legislative halls. I am afraid that this is no longer true today, for the academician appears to be more vocal than the practical man who understands the give-and-take of the market place, and he has the ear today of those who make a political career of "reform." To the extent we embrace regulation as the solution to all questions confronting modern man, to the same extent we speed the pell-mell retreat from self-discipline and responsibility which has always been a mainstay of the free society.

This talk of "benefit commitments," included in Dr. McGill's presen-

tation a few moments ago, sounds like Ontario all over again. Apparently, employers are doing such an effective job of financing today's pension commitments that the government feels it has to move in to increase commitments in order to have something more to regulate!

The surest and shortest road to security of pension expectations is the one leading to corporate solvency. Since the employer pays the bills, his ability to afford pension contributions must be protected. Flexible funding arrangements and investments which work hard to produce a good income are essential in many cases. The road to regulation, automatic vesting, and other compulsions can only bring the golden goose to the chopping block. Only if we have completely given up the ideal of a free society can we have the temerity to suggest regulation as an appropriate answer to this question. The answer lies in responsibilities seriously taken by employers, trustees, insurance companies, consultants, and actuaries alike.

Finally, if pension expectations are not to be illusory, the federal government can get into the act by adopting fiscal policies designed to discourage undue inflation.

THE ROLE OF GOVERNMENT

KENNETH R. MACGREGOR:

I understand that my participation in this discussion is intended to shed some light on the subject from the point of view of government supervision and also from the Canadian viewpoint. I emphasize the latter because I naturally would not presume to suggest what course should be followed in the United States.

Extent and Importance of Private Pension Plans

The first question that seems to arise is whether private pension plans are extensive and important enough for governments to be concerned about them.

About 26,000,000 persons in the United States are apparently now covered by private plans, including approximately 6,000,000 persons under insured plans and 20,000,000 persons under uninsured plans. In Canada about 2,000,000 persons are covered by private plans, of which upward of 1,000,000 persons are in plans that are not insured. Looking at the assets of private plans, either in the United States or in Canada, they are approximately one-half as large as the assets of all life insurance companies in each country. The aggregate interests of persons in private plans dwarf the interests of members of fraternal benefit societies. Thus private pension plans are a big and very important business indeed.

Although private plans are very extensive now in both the United

States and Canada, there are nevertheless certain differences in the pension situation in each country that should be kept in mind in considering many aspects of this field. When the OASDI national scheme in the United States originated in 1935, private plans had not developed very far. Hence the molding of private plans around the contributory national scheme involved far less serious problems than would have been the case if the order had been reversed. Also, the fact that employee contributions are not deductible from taxable income for income-tax purposes in the United States has probably had some influence in furthering noncontributory private plans. In Canada the only national plan up to date has been a flat pension at age 70, payable on a means test basis from 1927 out of general taxes and without a means test since 1952 from a share of sales taxes and personal and corporation income taxes. With this simple pension floor, private plans in Canada have been free to develop in their own way and they have generally been on a contributory basis. Further, since employee contributions are deductible for tax purposes in Canada, this has probably accentuated the trend toward contributory private plans. In the light of this background, it is easy to see why the introduction of any additional national scheme in Canada on a contributory basis now would involve serious problems for the operators of existing private plans.

The phenomenal growth of private pension plans has taken place mainly during the last twenty years and especially during the last ten or fifteen years. However, notwithstanding this great growth, there is still a large proportion of employed persons—at least in Canada—that are not covered by any kind of private pension plan yet. A survey made in 1962 by the Dominion Bureau of Statistics in Ottawa showed that, of the total nonagricultural labor force in Canada, only 50 per cent were employed by employers that had pension plans. Further, only two-thirds of the employees of employers that had pension plans were covered by such plans. Consequently, all covered employees constituted little more than one-third of the nonagricultural labor force in Canada. This appears to be one weakness of the private plan system, but progress toward broader coverage is steadily being made.

The problem of covering persons not now covered by a private plan is presumably not within the scope of this discussion. Nevertheless, I might mention that the latter problem is currently receiving lively attention in Canada by both the federal government through its proposed but yet-to-be-enacted Canada Pension Plan on a contributory basis and by some of the provinces—notably, Ontario through its recently enacted act to provide for the extension, improvement, and solvency of private pen-

sion plans and for the portability of pension benefits, and Quebec through its recently announced intention to enact a contributory pension plan in that province, the details of which have not yet been revealed. However, quite apart from any further extension of coverage, it seems clear that in both the United States and Canada the safeguarding of the interests and expectations of the multitude of persons already covered by private pension plans is a matter of the utmost public importance.

The Case for Supervision

"Security of Private Pension Expectations" might be considered from two main standpoints: (1) security in the sense that it relates to the solvency of the fund or plan and (2) security to the extent that it can be retained or made portable in the event of change or termination of employment. My remarks will deal primarily with the solvency aspect and to a lesser extent with the portability aspect. When I refer to "solvency" in connection with an uninsured plan, I mean adequacy of assets along with prospective contributions to cover prospective benefits. Technically, most uninsured plans cannot become insolvent, since liabilities are usually stated to be limited to the available assets.

For more than a century, life insurance companies have been providing protection on this continent for insured persons and their dependents. Certainty of payment has always been regarded as essential. At first, certainty was taken for granted but experience showed the desirability, if not the necessity, of providing some form of government supervision to ensure solvency. The early history of fraternal benefit societies, more particularly the throes and woes that societies on the assessment basis went through, demonstrated an even greater need. A somewhat similar situation obtained in the field of fire and casualty insurance. Long before insurance companies and fraternal societies had attained anything like the present financial importance of private pension funds, governments in both the United States and Canada had enacted legislation that gave direction to a general policy of safeguarding the solvency of these institutions and the interests of those placing confidence in them; and that general policy has been expanded and developed to keep pace with changing circumstances ever since. I feel that the record has justified government supervision of insurance companies and fraternal benefit societies in Canada, and I assume that the same conclusion has been reached about supervision in the United States. In the circumstances, there would seem to be a strong case for including private pension plans too. Absence of such supervision seems to me to be a fundamental weakness of the private plan system now, and it would be a pity if nothing is done in this direction until some pension funds get into serious trouble.

At present, a large and steadily increasing proportion of employees look with confidence to private pension plans either alone or in combination with state pension plans as their main provision for old age. In many cases the financial stake of an individual in his prospective pension is greater than in other forms of insurance and property he may have. Other forms of insurance are also likely to be spread among several insurers, but his pension is generally in one place. I would never minimize the seriousness of failure of any insurance organization to carry out its obligations in full, but, even if that happens, it does not usually occur just at the time when the earning power of the insured person has disappeared. It seems to me that certainty of payment of a pension that an employee is relying upon is something that should be assured beyond every possible doubt. There is probably no part of the whole field of insurance where a higher degree of responsibility should obtain than in the private pension field. However, in my opinion, the private pension field presently lacks the discipline and safeguards that pervade the regulated field of insurance. Regardless of how one may appraise the value of government supervision, I think the existence of any police force has a profound influence in keeping us straight and would have a beneficial effect in the pension field too.

There is no problem of solvency as respects private pension plans underwritten by insurance companies except those based upon deposit administration contracts and the newer kinds of contracts involving segregated funds. Even here, there is no special problem as far as the solvency of the insurer is concerned, but I believe that there is cause for concern if any of these contracts are inadequately financed. If employees do not receive the pensions that are held out to them under a plan administered by an insurer, it is difficult to see how the insurer will escape criticism. It seems to me to be in the best interests of all concerned for the insurer to follow closely the actuarial condition of every plan of this type and to do everything reasonably possible to ensure that such plans are adequately financed, notwithstanding the limited liabilities assumed by the insurer. I think that insurers could and should do more in this respect than is being done at present.

The area for real concern is the field of uninsured private pension plans. It seems anomalous that, where an employer chooses to have a pension plan for his employees underwritten by an insurance company, the solvency of the plan will be protected by an elaborate system of government supervision but that, where the plan is financed by a private fund, there will be practically no supervision at all. The interests of the employees are the same in each case, and they usually have no choice in the method of underwriting the plan.

It may be contended by some persons that, since few difficulties have arisen yet and since most plans are trusteed and have actuarial guidance, further supervision is unnecessary.

In this connection it should be remembered that most uninsured pension funds have not been operating very long. The great majority are relatively young and immature as pension funds go. Because of their nature, there has been quite insufficient time for many difficulties to arise, but this does not mean that many serious problems will not yet arise. The relatively few funds that go back many years have, more often than not, shown very large deficits. Further, we all know the unusual hazards of the annuity business, and experience has demonstrated the difficulty of predicting the trends in each main factor. All the resources of technical skill and experience available to insurance companies have not enabled them to escape losses on annuity business, so it is most unlikely that uninsured funds will fare better or even as well. When to this fact is added the possibility of large additional liabilities being suddenly thrown on a fund as a result of increases in wage or salary levels, the need for supervigilance is evident.

As for trustees, it should be remembered that their position is usually that of an agent or mandatory who does as directed and whose responsibility does not extend to questions concerning the adequacy of the assets but only to their safekeeping.

Concerning existing actuarial guidance, I think that this is the greatest single strength of private pension plans if the actuary is properly qualified. His valuations and recommendations are the keystone of security. On this point, I recall the axiom laid down by the late eminent British actuary H. W. Manly that "no one is able to form a fund on safe lines until he knows how to value one." However, our experience in supervision, including the supervision of pension plans under the Income Tax Act and fraternal benefit societies under the Insurance Act, convinces me that the actuary cannot always accomplish desirable objectives by himself and that a government department or agency is often in a more advantageous position to criticize or take the initiative.

Some persons, too, may feel that, if any additional safeguards are necessary, legislation of the disclosure type goes far enough. I refer to legislation like the Welfare and Pension Plans Disclosure Act passed by Congress in 1958 and somewhat similar legislation by a half-dozen or more states as well as regulations made by the Province of Ontario under its Labour Relations Act. These are valuable as far as they go in providing some information about the existence and extent of pension funds and also in affording employees an opportunitv to become better acquainted

with the terms of the plans under which they are covered and the finances relating to them. But policing left to the employees themselves is not likely to do much to guarantee the adequacy of the reserves for future benefits and the sufficiency of the assets. Investigation by some authorized public body is much more likely to have broader effect. A system involving some form of sanction or penalty is invariably more effective still.

Summing up, I think that the main weakness of the private pension system at present is the absence of any authorized person in a position to tie things together, to criticize any aspect of a fund or plan, or to exert pressure to remedy any apparent defect regardless of whether it relates to the assets or liabilities or the manner in which the plan is being financed. There are invariably a good many cooks preparing the pension broth—employers, employees, trustees, actuaries, etc.—but what is needed is a chef or someone to taste the broth from time to time to assure satisfaction when it is finally served.

Experience and Recent Developments in Canada

Now it may be thought that my comments are based more on notions gathered in the supervision of companies than on knowledge about the supervision of pension plans. However, in Canada the Federal Department of Insurance has had very close contacts over many years with a broad cross-section of pension plans throughout the country. Apart from making actuarial valuations regularly of various government pension schemes covering employees of the Public Service, Armed Services, R.C.M. Police, etc., responsibilities under the Income Tax Act in connection with pension plans since 1942 have provided a good insight into the operations and development of private plans during their main period of growth. May I simply say that our experience in the latter connection long since convinced me that some form of supervision is most desirable. I shall not weary you with details of this experience, but, since our work under the Income Tax Act is linked with subsequent pension developments in Canada, perhaps I might refer to it briefly. I do so also because our experience illustrates how supervision may succeed or fail.

In 1942 the Income Tax Act was amended so as to require the Superintendent of Insurance to advise the Minister of National Revenue concerning the reasonableness of any "special payment" made by an employer in respect of "past services" of employees. "Past services" was interpreted to include not only service prior to the introduction of the plan but also deficits arising from inadequate contributions in the past. In order to qualify as an expense for tax purposes, the special payment had to be recommended by a "qualified actuary" as necessary to ensure that all

obligations of the fund or plan might be discharged in full. This was interpreted to mean that the actuary had to be a Fellow of a recognized actuarial body, and the special payment had to be necessary but not necessarily sufficient. Responsibility for approving the pension plan itself rested with the Minister of National Revenue, but there was nothing in the legislation to serve as a guide for this purpose.

From the outset, we regarded our responsibilities seriously. It was well known that there was ample opportunity for much good to be done, and it seemed only right that tax exemption should be granted with care, especially since exemptions in favor of a particular plan indirectly involve the tax burden shared by all taxpayers. Viewed from this angle, taxpayers as a whole may be said to be contributing to or subsidizing pension plans for which tax exemption is granted. It therefore seemed essential that pension plans should be well conceived and soundly financed and not be simply devices for avoiding or reducing income taxes otherwise payable. Furthermore, any action on the part of the government in approving a plan permitting exemption of contributions by the employer or employees could hardly be interpreted otherwise than as an indication that in the view of the government it was a fair, sound plan for which the government implicity assumed some responsibility.

When we began our work under the Income Tax Act, almost every conceivable situation was revealed. In some cases, although the fund had been trusteed, it had been borrowed back by the employer for current purposes on the strength of promissory notes. In another case it was proposed to invest the entire fund in the employer's plant through a purchase and leaseback deal. Deficits were the rule rather than the exception, and many of them were relatively enormous even in organizations of great repute. In many cases no orderly plan had been established to liquidate the deficit, payments apparently being made mainly at such times and in such amounts as might be convenient or advantageous for tax purposes. Vesting of accrued pension rights in the employee in the event of termination of service at any time was practically nonexistent; in fact, the terms of some plans and the attitude of the employer as revealed in discussion almost seemed to indicate a desire to keep employees in a state bordering on virtual economic servitude through the instrumentality of such plans. Coverage under a plan might be restricted to the president alone, perhaps dressed up with the qualification that he must be a male between the ages of 25 and 65. I could go on, but time forbids.

Notwithstanding the absence of legislative direction, we worked out with the income-tax officials a set of rules and practices governing the approval of plans designed to ensure security of pension expectations

through proper funding, investment restrictions, moderate vesting requirements, avoidance of discrimination, etc., which were published by the Department of National Revenue in 1946 for the information and guidance of all concerned. These rules were generally accepted and in my opinion had a very beneficial effect upon pension practices in Canada. Among other things, the vesting requirements were the forerunner of the broad views now prevailing on this feature.

The system worked well until about 1952, after which it steadily weakened. Finally, the rules were practically withdrawn altogether in 1959; since then, plans have been accepted rather freely for "registration" rather than "approval," and contributions by employers and employees have been allowed as long as they do not exceed the statutory limits. From the standpoint of good pension fund administration, this course has been rather demoralizing, and it may well be asked how it came about, especially when the need for supervision seemed to be generally recognized throughout the country and a Royal Commission on the Taxation of Annuities had strongly recommended supervision in 1945.

It has been said that the system was gradually abandoned for constitutional reasons, but in my opinion the reasons were practical and political, not constitutional. I am unaware of any constitutional questions having been raised; on the contrary, the views of constitutional experts invariably supported the authority of Parliament to specify conditions governing exemptions from federal income taxes. In this connection, it might be pointed out that at the very time when the rules relating to group pension plans were being relaxed (1957), new provisions were written into the Income Tax Act and are still in effect relating to the deductibility of premiums paid for individual pension policies (so-called Registered Retirement Savings Plans); such provisions include many conditions governing the arrangement of the pension or annuity, its form and time of payment, its "locked-in" status, etc., and no constitutional questions have been raised about these plans either.

The main reasons why this system of supervision broke down were (1) the absence of specific conditions in the act (which could have been remedied) and (2) the fact that authority for approving plans rested with the taxation officials who, in the nature of things, regarded general supervision of pension plans as a very troublesome unwanted child, when they were primarily concerned only in seeing that claims for exemptions were not excessive. Impasses arose when taxation officials would approve a plan, but the Department of Insurance was unwilling to recommend recognition of payments for "past services" where financing of the plan was inadequate or there was some other objectionable feature considered

to be of importance. To these troubles, others were added through the government yielding to requests from particular employers to permit so-called "terminal funding" (which was authorized by an amendment to the act in 1952, thereby undermining all of the rules that had been built up for proper funding) and subsequently to permit wider investment latitude, more particularly as respects common stocks and investments relating to the employer's own business.

In the light of our experience, I believe that supervision through the Income Tax Act is the most efficient practical course open in Canada even though it admittedly cannot embrace plans of tax-exempt bodies and that the former system could have been put on a workable basis. However, it seems unlikely that the former system will be restored now. Instead, the course actually followed created a vacuum which the Province of Ontario was the first to take steps to fill by the appointment of a Committee on Portable Pensions early in 1960.

The main purpose in setting up this committee was to study the problems of pension coverage and security in Ontario and to draft suitable legislation. The committee reported twice in 1961, their second report being accompanied by a draft bill. After public hearings in 1962, a revised bill was finally enacted as the Pension Benefits Act in April, 1963. The chief aims were declared to be "to make future pension arrangements more certain, more just and more widespread." To this end, the act contains provisions relating to portability, supervision, and broader coverage.

Briefly, this Ontario act will be administered by a pension commission and will further the provision of pensions through private plans. It will require all employers having fifteen or more employees in Ontario to maintain or establish a minimum pension plan, either insured or uninsured, by January 1, 1965, for all employees over age 30, based on remuneration up to $400 per month and any of the three usual types of benefit formulas. The minimum monthly pension is one-half of 1 per cent of monthly remuneration for each year of service, payable not later than age 70, or approximately equivalent amounts on other bases. To the extent of this compulsory coverage, pensions must be portable, and contributions cannot be withdrawn in cash. Pension benefits, if any, in excess of the minimum must be portable after age 45 and ten years of service, and contributions for such benefits are locked in at the same time. The act also provides for reports by a Fellow of one of three specified actuarial bodies, for financial statements, regulation of investments, standards of solvency, and supervision of the terms of pension plans in very considerable detail. In general, the act applies only to services rendered after 1964 and is therefore not retroactive. It should be noted that employers without plans

will be required to set up at least minimum plans and that portability requirements apply not only to the minimum benefits but to all benefits. One doubtful point is the penalty or sanction that may be imposed if the standards of solvency are not met.

Undoubtedly, Ontario in its pursuit of pension security hoped or expected that other provinces would enact similar legislation so that there would be substantial, if not complete, uniformity across the country. Although none has followed suit yet, interest has been indicated by a few. However, Quebec has recently announced that it will enact a province-wide scheme of its own on some kind of funded basis, and recent developments in the federal field have created considerable confusion and uncertainty concerning the outcome of it all.

In conclusion, I should like to touch very briefly upon these developments at the federal level.

The federal government has had the constitutional power since 1951 to operate a nation-wide scheme of old age pensions, and the existing flat-rate pension scheme is based upon that authority. However, this flat pension, which began at $40 monthly in 1952, has been raised from time to time since then to $46, $55, $65, and just this month to $75 per month. Although much can be said in its favor, it is susceptible to change through political pressure, and it does not take into account different costs of living in different parts of the country. With the precedents of contributory, earnings-related schemes in the United States and Great Britain having broad application, and having regard for the limited application of private plans up to date in Canada, it is perhaps not surprising that all political parties in Canada have expressed themselves in favor of adding a contributory, earnings-related scheme to the existing flat pension scheme. Such a scheme formed one of the election planks of the Liberal platform in both 1962 and 1963, and, following election in April of this year (being the same month as the Ontario act was passed), the federal government moved swiftly to bring out a nation-wide, pay-as-you-go scheme, called the Canada Pension Plan, applicable to practically all employees aged 18 or over on a compulsory basis and to the self-employed on a voluntary basis. This scheme would be based on remuneration up to $4,000 per annum and would provide earnings-related pensions for participants and for aged survivors of participants, the maximum pension being $100 per month beginning at age 70 on top of the universal flat pension of $75 per month, or reduced amounts beginning at ages down to 65. Earnings for both contribution and pension purposes would also be adjusted from time to time in accordance with an index of average earnings throughout the country.

Although the elements of the plan have been announced, a bill has not yet been introduced in Parliament. At present, it is the object of wide study and considerable criticism and opposition. Critics claim that the existing flat pension scheme is enough for the government to provide, that the proposed plan would seriously interfere with private plans, that the benefit level would be too high, that persons retiring in the early years would be subsidized unduly, that the ultimate cost for young entrants would be more than under a private, funded plan, and that capital accumulation would be diminished. The Province of Quebec has refused to be covered by the national plan, and, if Ontario were to take the same position, the plan would undoubtedly be abandoned. The $64 question is how the Canada Pension Plan, the Ontario Pension Benefits Act, and the proposed Quebec plan on a different basis still can all be reconciled to operate together. Canadians are currently experiencing a rather severe case of pension indigestion through a plethora of plans for pension security.

Upon completion of the formal panel presentations, the Moderator opened the informal discussion period by first giving the panel members the opportunity of making additional comments or asking questions of other panel members. Following these additional comments by the panelists, questions and comments were invited from the floor.

MR. PETERSON: I do not want to create the impression that we are all wearing halos up here. These standards that I have mentioned before this sea of faces arose from some specific situations that had come to our attention. I have a rogues' gallery here of actual situations where I feel that there has been something short of the best actuarial guidance on the part of both life insurance company actuaries and consulting actuaries, and if I may, with the Moderator's permission and without identifying anybody, just mention a few situations that we have encountered.

I shall first mention a case where several life insurance companies quoted—and, incidentally, this comes up under the heading of "compatibility of cost components." Four insurance companies presented normal cost figures for a "final salary" plan. One insurance company used a salary scale; the other three failed to do so. Of course, my company made the proper calculation. The other three companies' normal cost figure was just about 40 per cent of our figure. After explaining the significance of the figure, we got the business.

There are two other cases that I would like to mention briefly. One case is a conversion of an individual policy plan to a trust-fund arrange-

ment. A highly reputable consulting firm sought to tell the employer that he could cut his costs 51 per cent by shifting to a trust-fund arrangement. This is an illustration of serious violation of the principles of "complete client communication" and "conscientious carrier comparisons."

The other illustration has to do with the principle of "candid cost comparisons." This is a case where, by shifting from a projected benefit actuarial cost method to an accrued benefit cost method, it was represented to the employer that he could cut his normal costs to 40 per cent of what we had been recommending he contribute, and here again this work was done by a firm of consulting actuaries that has a high reputation.

I do believe there is real room for improvement, and we should take off our halos or not put them on.

MR. GRIFFIN: Since Mr. Peterson got up here without asking a question, perhaps I can do the same. My comment is directed to our good friend, Kenneth MacGregor.

While I am not sure just how it is in Canada, in this country every move of government into the regulation of matters of vital concern to business is like the proverbial camel putting its head in the tent. I am sure that the Canadians have begun to wonder, too, now that Ontario has taken over virtually the whole tent.

In this country, so-called disclosure acts, which originally had publicity for their avowed purposes, are gradually being twisted into complex regulation. There are some who feel that a monster has been created. The Federal Disclosure Act, for example, requires tons of paper to be filed every year—paper seldom seen except by consultants who are trying to find out what their competitors are doing. This all started as an effort to impede the operations of a handful of swindlers, who still stand unconvicted.

Mr. MacGregor said something a while ago to the effect that he deplored the existence of so many cooks and different recipes. I would like to suggest that having more cooks adds a little spice to life. It leads to diverse tasty dishes, even if occasionally one turns up unsalted. For better or worse, I happen to believe in individuality, not in a conforming ant-hill society run by a few favored Keynesian superants.

MR. MACGREGOR: I should merely like to say that supervision, like many other things, can be carried on in all sorts of ways and to various degrees.

As far as supervision of insurance companies in Canada is concerned, we have had legislation to that end for nearly a century, and I do not

think that the companies have ever been burdened with undue detail as a consequence. I know how irksome detailed requirements and red tape can be; and I realize that legislation, rules, and regulations can grow to the point where they may impede business and be unnecessarily costly. However, we have done our best in Canada to keep away from that pattern.

I would envisage a somewhat similar system for the supervision of pension plans. Our practice is to supervise, not to dictate, and to place great responsibility upon the actuary to ensure the maintenance of adequate reserves. Nevertheless, in doing so, we insist that actuaries reporting under our various acts be fully qualified.

MR. WILLIAM F. MARPLES: I am going to start by offering some thoughts on Mr. Peterson's first point, and I hope that we shall be able to communicate completely within these walls at least.

I find some difficulties occasionally with the words used by insurance companies to describe the guarantees they offer in connection with pension benefits. I want you to consider carefully what a guarantee means. Consider for a minute a washing machine. When you buy a washing machine with a guarantee for twelve months, you understand that the guarantee means that, if the machine goes wrong, for the price you have paid, the performance will be put right. Thus it appears that there are two aspects of any guarantee—that is, price and performance.

Now, in relating this to the insurance company guarantee on a matured pension benefit, there is no doubt whatsoever that the insurance company can carry out its guarantee. Hence, if the pension has been purchased from an insurance company, then the performance will be completed, that is, the pension will be paid to the pensioner for the rest of his life.

But the point where the communication with the client is incomplete relates to the fact that the *price* that the client pays for the pension is not fixed at the time that the pension is purchased. Through the process of determining dividends, what amount to additions to the price are charged back to the client if the excess of longevity requires it. Of course, the reverse also holds, namely, that if all the pensioners should die very quickly, then the client would get back the excess of the purchase price. My difficulties do not lie in the system but in the fact that the insurance companies do not use words which communicate that system completely to the client.

My next point requires that I have the courage of my convictions. I am with Frank Griffin. I do not believe in the multiplicity of regulation of pension plans. There is a growing feeling that the more regulations you

have, the better for all. I do not believe that. I think that, if we could build up our professional status adequately, we could be better off than with a multiplicity of regulations.

There are two things further I would like to say. First of all, I would urge you to realize that the original cost estimate basically controls a pension-plan situation. Once an employer has developed a pension system based on the actuary's original cost estimates, then the cost will begin to flow from that pension system and will have little or no correlation with the initial costs by the actuary's original bases of calculation. The employer's costs develop from circumstances of his employment—the longevity of his employees and the rates of remuneration, the scale of benefits, and so forth. So, once the employer has adopted his benefit system, he has assumed responsibility for the emerging costs. From that point on, the actuary's function is to spread the costs over the years. The original cost estimate thus plays a very vital part in the development of the situation and the actuary bears a serious professional responsibility in introducing the original cost estimate.

Finally, I would draw your attention to the fact that in the last few years an entirely new breed of pension plan has arisen, and I refer to the multiemployer union pension plans established as the result of collective bargaining.

In these pension plans the problem is to establish a level of contributions and to calculate a level of benefits appropriate thereto.

If the actuarial cost method employed is the entry-age-normal method, the criterion of successful operation turns on the speed of amortization of the accrued liability. However, since the calculations invariably involve questions of balance between immediate and deferred receipt of benefits, the amortization procedure will not be permitted to go too far. In fact, completion of the originally scheduled amortization would impose an injustice upon current employees, and in consequence it is my belief that in these plans the amortization period will be found to oscillate between, say, 40 years to 25 years and back to the original 40 years. I quote these periods as figures selected for illustration purposes only, without thought of their application to specific cases. The first period from 40 years down to 25 years is hopefully a period of less than 15 years in which the amortization has been accelerated by actuarial gains emerging from deferred retirement and high interest yield. These gains are then applied as the result of the swing back to the original amortization period to produce a benefit increment paid immediately to employees retiring and possibly to existing pensioners. There is a real difference between the actuarial aspects of these plans and those of the regular single-employer plans. The

funding operations of these plans are worth study in depth, since the principles involved are less those of accumulation of assets for pension security than those involving the equitable distribution of benefits within the capacity of the expected contribution income.

MR. HENRY E. BLAGDEN: I thought I might, first of all, reply to Mr. Marples in the matter of insurance company guarantees. The insurance companies are prepared to give complete guarantees. We have found, however, that in a good many cases consultants depreciate our guarantees. They indicate very little need for guarantees. They are more interested in performance. So insurance companies have developed various contracts which de-emphasize guarantees and emphasize more performance. In other words, the guarantees, rather than being quantitative, become qualitative under such contracts.

Now, if I may, I would like to address myself to some of the comments by the members of the panel. I first had in mind getting up because I was afraid that Mr. Peterson's literary masterpiece would have you so bemused by his alliteration that you would not get the message. In his subsequent remarks, he pointed it up.

We have all had experiences of irresponsible statements being made by consulting actuaries as to the savings that can be effected by changing the method of funding a pension plan. Lately, however, I am conscious of a more serious problem. It concerns the cents-per-hour type of case to which Mr. Marples made reference.

Here very often the employers—and I am thinking particularly, of course, of multiemployer plans—negotiate, say, ten cents per hour, and then the question is what will the ten cents per hour provide in the form of benefits? Sometimes they—the trustees that is—will get a consulting actuary who will tell them. Other times they will put it out to bid, so to speak, and different insurance companies will be asked to say what they think can be provided by the ten cents per hour, and they do not all think alike. Sometimes I think my compettitors—of course, I am never guilty—are irresponsible in their statements or estimates of what the ten cents per hour will provide, and quite often they get the business. We do not like this.

Now, what is the solution to this problem? Mr. Dyer referred to one, and you may remember that he finishes up with having a consulting actuary appointed eventually. I think it would be desirable to have a consulting actuary appointed in the first place—an independent consulting actuary.

Now, I have often thought that we should require an independent

consulting actuary even where insurance companies are involved. The problem, however, is that insurance company sales organizations dislike the idea. They say that you introduce a consulting actuary, and you immediately introduce competition, and, unfortunately, one is forced to agree with them. Once or twice in recent years I have read speeches made by consulting actuaries before bankers' organizations, and the tenor of their talk is quite comparable to the kind of talk you might expect me to give to our sales organization. He is patting them on the back. He is telling them how much better they are than insurance companies, and "Brothers, don't give up the ship."

Now, I have heard people at times refer to the problem of Diogenes and his lamp. Diogenes was not looking for an independent consulting actuary, but many of us in the insurance business are doing so, and perhaps Mr. Dyer or other members of the panel can tell us how to find one.

MR. DAVID LANGER: I would like to suggest that, where there are five or ten or fifteen insurance companies submitting bids to a client and there is not a consulting actuary on the scene to help evaluate them, the first company to speak to the client assist him in setting up a uniform proposal request which he can submit to all the competing companies.

It is questionable for D.A. and I.P.G. contracts whether it is desirable for all the companies to submit plan specifications and cost estimates based on such plan. If each of ten companies submits a different plan together with actuarial data based on differing actuarial funding methods and assumptions, a client (or actuary) would probably have a lot of difficulty trying to make a meaningful evaluation. Plan and cost items could wait until *after* a company is chosen. Presumably, each company could competently assist the client in designing a desirable plan and make any necessary calculations using the funding methods most suitable to the client's needs.

It would appear that the client would find it more useful if he could have data relating to each company's past investment performance and expense ratio, the guarantees it is willing to make, the flexibility of its contracts, its provision for making dividends, and the training and experience of its personnel.

As a service to the client, the company representatives could provide the client with the names of two or more independent consultants whom the client could call on for help in choosing a company. To eliminate the competitive element, a prior agreement could be reached with the consultants that they would completely withdraw after an insurance company had been designated and, further, would not discuss self-funding with the client.

MR. GILBERT W. FITZHUGH: I shall risk seeming to put on a halo. We have heard a lot of talk here today about employers who might go bankrupt from living up to their pension promises and the relative merits of insured and noninsured pension plans, but I have not heard as much as I would like to hear about the rights of the beneficiaries or the proposed beneficiaries of the plans. We heard it said that what good is a pension promise from an employer if, in order to live up to his pension promise, he goes out of business?

It seems to me that, if we are to be responsible advisers to employers, we must recognize the fact that if funding his pension plan on a sound basis would put him out of business, he is no more likely to stay in business with the same pension plan inadequately funded. He is just going to put off the evil day. Sooner or later, he is very likely to both go out of business and have his employees not get the pension. If he cannot fund it soundly, he should not put it in.

Let us not put our heads in the sand and say, "Put in the pension plan and worry about financing it later." If he cannot finance the proposed plan soundly, let him put in a half a plan. But do not put in a plan that would break him if properly financed, because, if he is going to go broke, he is not going to go broke any less quickly because somebody has told him to worry about financing it later.

We heard that we should not have a lot of federal regulation of pension plans, and I yield to no one in my distaste for government regulation of any kind, but again let us look at the beneficiary. It was said that a few pension plans going broke will not be as bad as government regulation. Well, I do not happen to think that government regulation is a fate worse than death. I think that, if we do not have some kind of order in this field, we are going to have more and worse government regulation than if we had a reasonable amount of it now.

For the life of me, I cannot see why it should be permitted under the Taft-Hartley Act for two people to constitute themselves as trustees, one an employer and one a union man—two people who never had two dimes to rub together before in their lives—and then permit them to get together and hire anyone who happens to call himself an actuary. And there is no reason why anyone at all cannot call himself an actuary under the present laws and then manage a pension plan involving tens of millions of dollars with absolutely no supervision of any kind. It just does not make any sense. Sooner or later some of these plans are likely to get into difficulties, and the entire pension field, not to mention the insurance field, is going to get a black eye.

I think we should stop worrying about our own selfish interests as insurance companies and actuaries, whether we are regulated or whether we are not regulated, and get some responsibility into this field to the public and to the people who are paying all our salaries. I am sorry if I put on a halo, but that is the way I feel about it.

MR. MEYER MELNIKOFF: I certainly agree with Mr. Fitzhugh about the need for some form of pension plan regulation, but I would like to go back to the title of this discussion, "The Security of Private Pension Expectations." Dr. Vannevar Bush, while president of the Carnegie Institute of Washington, introduced a variable pension plan, with an excellent, brief discussion of the fact that in a free economy there are risks in all types of long-term planning, including retirement planning. We should be careful lest we espouse regulation that ties our hands so tightly as to prevent us from fulfilling its primary objective.

In a society where the Federal Civil Service Retirement Plan has been amended by Congress so that retirement benefits will be linked to the cost-of-living index, I do not think it would be prudent to assume that the pension expectations of individuals can necessarily be expressed in terms of a guaranteed future income of a fixed number of dollars. Most people look forward to their pension expectations in terms of preserving their standard of living. We should not freeze the concepts of the security of pension expectations in terms merely of a dollar value accounting balance sheet.

MR. G. ASHLEY COOPER: I have just two points to bring out.

First, I would like to add another *C* to Mr. Peterson's list, and the one that occurred to me was the word "confidence." What I mean is that the consulting actuary, in his dealings with employers, must get the employer's confidence. I believe there is only one way to do that, and that is to think like an employer instead of like an employee. Only if we think from the employer's point of view, in his terms as being his plan, will we obtain his confidence and be able to guide him in the way we wish.

The second point is in connection with disagreements under Taft-Hartley plans. I might add that I am currently involved in such a problem, and a real problem, along with Mr. Peterson. There is a mechanism specifically provided for in the Taft-Hartley Act for the resolution of problems and that is for arbitration. Of course, that raises the next problem as to who should be the arbiter. Maybe the Society could do something to help in this area by having a list or panel of distinguished actuaries who would serve as arbiters when actuarial problems arise.

MR. CHARLES B. H. WATSON: I would like to make just two points. I agree completely with Mr. Fitzhugh that one of the most important considerations in this matter is that we must remember that the beneficiaries of the pension plan are entitled to expect that they are going to receive their benefits as far as possible. Granted that means that the employer must remain solvent, but it also means, to my mind, that it is unfair and is a deception if the employer puts in an elaborate pension plan —a generous pension plan—which he anticipates he will not be able to afford over the foreseeable future. It is a mistake, I believe, for actuaries to lend themselves to this sort of deception.

I also believe that it is a mistake for actuaries to regard themselves as being solely on the side of the employer, as the previous speaker seems to imply. You are in there to help him solve his problems. That is correct; but you are also in there with, I believe, a responsibility toward the interests of all parties concerned, and among those parties are the employees who are going to expect that they will receive specifically defined benefits. I think that we should always keep the interests of those people in our minds when we are dealing with employers who wish to install pension plans.

MR. PETERSON: May I speak briefly to Henry Blagden's reference to my high-minded literary effort? For my standards of performance, I originally had some different terms that were not exactly complimentary. At the suggestion of the Moderator, I put them into a very high-minded pattern. These were the original terms for these seven standards, which I called the "seven sorry sins." They were "short-changing," "kneeling," "incompatible-marrying," "prejudice," "obfuscation," "laziness," and "apathy." You will note that they form the acronym "Skipola."

MR. RICHARD DASKAIS: The wording of this topic in the program implies that it is unquestionably desirable to preserve and improve pension security. I am sure that everyone agrees that, if all other things remain constant, it is desirable. However, all other things do not remain constant. If we strive to preserve and improve pension security, we are at the same time inhibiting the establishment of pension plans (whether funded "soundly" or not) and the liberalization of their benefits.

I do not think that the consulting actuary has any right to take it upon himself to decide that pension security should be improved under the pension plans with which he works. This must be left to the actuary's client. The function of the actuary is to inform his client of the various possible future results of various courses of action.

We must keep in mind that in the United States private pensions supplement basic subsistence social insurance benefits. These private pensions generally are part of an employment contract, express or implied. I believe the employer and the employee should be free to enter into whatever contracts they wish which may either provide pensions which are absolutely secure or hold out the possibility of pension payments which may never materialize. The responsibility of the actuary is to inform his client as fully as possible of the circumstances which might prevent the pensions from materializing.

It is fortunate that we are dealing with supplemental pensions under most private plans. Under the Ontario legislation which becomes operative in 1965, part of the basic subsistence pension is to be provided under mandatory private plans; this appears to have resulted in the application of a large number of restrictive requirements to supplemental plans. If we wish to preserve the freedom of employers and employees to make pension contracts, we should recognize a legitimate difference in the level of security of the subsistence plan, on one hand, and the supplemental plan, on the other.

We must recognize that we may have a bias toward absolutely secure pensions because our basic training is so heavily concentrated in the field of contractually guaranteed dollar benefits. The fact that actuaries are employed is not a valid reason for requiring pension benefits to be as secure as if they were contractually guaranteed. I do not believe the actuary can do a professional job for his client if he imposes his ideas of pension security on his client.

Since much of the criticism of the lack of dollar guarantees is based on the assumption that employees are not generally sophisticated enough in the field of pensions to become fully informed, I think it is a responsibility of the actuary to tell his client of the practical problem of informing employees covered by a pension plan of the security of their pensions.

Although this discussion has been from the standpoint of the consulting actuary, the principles apply equally to a government or insurance company actuary. However, the government or insurance company actuary may play a larger role in making the policy of his employer, but, when he does so, he is acting as an executive and not as a professional actuary.