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PANEL DISCUSSION

PRIVATE PENSIONS IN THE UNITED STATES AND CANADA

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MAJOR POLICY ISSUES IN AMERICAN PRIVATE PENSIONS

DAN M. McGILL:

The private pension institution, which was a relatively insignificant social and economic force as recently as 1940, has, within the last quarter-century, become a major phenomenon on the American scene. It is estimated that there are today more than 50,000 pension plans covering 25 million employees, or about half of the nongovernmental, nonagricultural labor force. Annual contributions to these plans are running at roughly $7 billion, with 80 per cent of this amount coming from employers. Assets in the amount of $90 billion are being held to meet the benefit obligations of these plans, with $3 billion being paid annually to roughly 3 million beneficiaries.

It is predicted that, by 1980, 42 million employees will be covered by private pension plans that will control $200 billion in assets and will be paying $9 billion per year in benefits to 10 million retired persons. The covered segment of the labor force is expected to embrace 85 per cent of the group believed to lend itself to coverage under these plans.

It is inevitable—and proper—that an institution of this magnitude should come under critical scrutiny by both public and private bodies. The last few years have witnessed an evaluation of the public policy implications of the institution by a Cabinet-level group of federal officials, an appraisal of pension accounting principles by the American Institute of Certified Public Accountants, a re-examination of actuarial practices and responsibilities in the pension area by the Society of Actuaries, two major inquiries into the security of pension benefits by the Pension Research Council, hearings into various aspects of pensions by congressional committees, and the publication of a number of books critical of certain phases of the institution.

It is not possible within the limits of this paper to deal with all the issues that have come to the fore in recent years or even to deal in comprehensive fashion with the major issues. This paper focuses upon what I regard to be the paramount issues, with sufficient depth of analysis to provide the basis for an enlightened and, I hope, lively panel discussion. The basic objective has been to identify and dissect the principal issues of the day, without necessarily offering solutions, or guidelines to the solution, of the various problems posed.

Relative Roles of Public and Private Pension Programs

Perhaps the most pervasive issue of the day is defining the relative roles of public and private pension programs. No one interested in the growth of the private pension institution can view with complete equanimity the continual expansion of the federal OASDHI program and the prospects for much greater liberalization of the benefit structure unless some boundaries can be established for the public program. There is general agreement with the loose generalization that the federal program of old age insurance should provide a floor of protection, with the benefits of private pension plans being supplemental thereto. There is, of course, no consensus as to what constitutes a "floor of protection." In this paper, certain postulates are offered for the proper scope of OASDHI, the understanding being that everything beyond these limits would lie within the sphere of private pension plans. These postulates pertain to coverage, level of benefits, and financing.

1. *Coverage.*—Coverage under the federal program of old age insurance has from the beginning been based on attachment to the labor force. This is not an inevitable feature of a social insurance program, and in some countries coverage is defined in other more-comprehensive terms, universal coverage being the objective. The coverage concept in this country reflects not only a philosophical preference regarding the manner in which one qualifies for a benefit but also an election with regard to how the benefits are to be financed. Coverage by labor-force attachment goes hand in hand with payroll taxes on employers and workers. Given this concept of coverage and financing, one should conclude that actual participation in the program should be as broad as administrative limitations permit. Ideally, every gainfully employed person should be covered under the program and, with each amendment to the law, the ideal has been more closely approached. At the present time, about 95 per cent of the nongovernmental labor force is covered.

2. *Level of benefits.*—The determination of the proper level of benefits is a most difficult matter to resolve. It involves a judgment as to the

fundamental function of a public old age insurance program, whether it is to provide a subsistence income barely above the poverty line, is to meet a substantial (possibly the dominant) portion of the old age economic needs of persons at all income levels, or is to accomplish something in between these two extremes. Like coverage, this issue is closely linked to financing.

The underlying concept of the system is that benefits payable with respect to a particular individual should be related to his covered earnings, as contrasted to a scheme that would provide flat benefits. The original law reflected a strong attachment to the principle of individual equity, and, consequently, the benefits to which a particular worker would be entitled were to be based on the cumulative covered earnings on which payroll taxes had been paid by the employee and his employer. With the introduction of survivorship benefits in 1939 and with almost every major amendment to the law, the concept of individual equity has been decreasing in relative importance to that of social adequacy. Since 1939 benefits have been based on the worker's average monthly covered earnings, with the benefit formula being weighted in favor of the lower-income individual.

Under the original law, the wage base to which both payroll taxes and benefits were related was $3,000 per year. With this ceiling, in 1938 all the wages of 97 per cent of the covered employees were recognized for benefit purposes, and 93 per cent of the aggregate earnings of covered employees were recognized. The earnings base was raised to $3,600, effective in 1951; to $4,200, effective in 1955; to $4,800, effective in 1959; and, finally, to $6,600, effective in 1966. The $600 boost in the base approved in 1950 fell far short of restoring the relationship between aggregate and covered earnings existing at the inception of the plan, but the increases since 1950 have approximately maintained the relationship existing in 1950. This is demonstrated by the fact that the proportion of total earnings in covered employment embraced within the base was 81.7 per cent in 1951 and is estimated to be 80.4 per cent with the new base of $6,600.[1] A base of about $15,000 would be needed today to restore the original ratio of covered to aggregate earnings.

The Social Security Administration has applied various tests to determine the adequacy of benefit levels under the old age insurance program. One of the original tests was in terms of the percentage of old age insurance recipients who were also drawing old age assistance benefits. Since the latter are based on a means test, concurrent receipt of both types of

[1] Robert J. Myers, "Amendments to the Social Security Act in 1962–65," *TSA*, XVII (1965), 483.

benefits would suggest that the insurance benefits plus the other resources of the individual were not adequate to meet his demonstrated needs. Some overlapping of benefit entitlement is to be expected, but many students have regarded 10 per cent to be the maximum acceptable percentage. That figure has been exceeded on occasion, but recent experience indicates that the proportion of OASDI beneficiaries aged 65 and over who are receiving OAA has stabilized at about 6–7 per cent and may be expected to remain at that level in the future.

Another criterion that has received some emphasis is that the average primary benefit under the old age insurance program, toward which the worker makes a direct monetary contribution, should be as large as, and preferably greater than, the comparable amount provided under the noncontributory old age assistance program to a person not receiving OASDI. At the end of 1965, the average monthly OAA payment for recipients not receiving OASDI was roughly \$93,[2] while the average monthly benefit under OASDI for a worker who had retired at or after age 65 was about \$90. The latter figure, of course, ignores the ancillary benefits that may be associated with the worker's old age benefit.

A criterion currently being considered for the establishment of minimum benefit standards is one that would seek to provide a steadily covered worker and his wife a combined old age benefit about 10 per cent higher than that which would be payable if the man had worked regularly in covered employment at the present federal minimum wage.[3] The thought is that such a couple should receive benefits somewhat above the poverty line. Under this criterion, single individuals and those who have not worked regularly under the system would receive benefits below the poverty line, and such benefits would have to be supplemented by personal savings, private pension benefits, and possibly public assistance.

If one can assume that at some point in time the general benefit structure of the social security program, including the minimum and maximum payments, is in proper alignment and the correct proportion of aggregate covered earnings is embraced within the taxable earnings base, future adjustments in benefit levels may be based on changes in the cost of living or in the level of wages. The cost-of-living method of adjustment is especially adaptable to flat benefit systems but may be used with systems providing earnings-related benefits. The adjustment may be made on an ad hoc basis or in conformity with changes in some specified cost-

[2] This figure includes vendor medical payments; the average cash payment was about \$80.

[3] Robert M. Ball, "Policy Issues in Social Security," *Social Security Bulletin*, XXIX (June, 1966), 6.

of-living index, possibly one structured to reflect the needs of the aged population. A number of European countries provide for automatic adjustment in benefit levels to reflect changes in the cost of living,[4] and in the United States the Civil Service Retirement System and the military retirement system embody automatic cost-of-living adjustment factors.[5] Ad hoc cost-of-living increases have characterized the American old age insurance program.

The benefits of the American program could be automatically adjusted to cost-of-living changes without an increase in the projected schedule of payroll taxes.[6] Not only do wage levels tend to rise faster than price levels, but the lower weighting assigned to the higher portion of average monthly earnings produces a gain to the system as the level of earnings rises. As indicated below, however, it would be necessary from time to time to adjust the earnings base to which the benefit formula and tax rates apply. Apart from the inflationary impact on the economy, it is difficult to quarrel with the concept of keeping benefit levels in line with price-level changes, if the benefits were at the proper level to begin with and if the minimum and maximum benefits reflect sound principles.

Adjustment of benefit levels to keep pace with wage levels would, under present conditions, produce larger benefit increases than adjustment on the basis of price changes because of the elemental fact that for many years wages have been increasing at a more rapid rate than prices. Earnings in covered employment reflect productivity gains in the economy as well as the forces of inflation. Thus, adjustment of OASDI benefits on the basis of a wage index would mean that beneficiaries would not only be protected against erosion of the purchasing power of their benefits but would also be permitted to share through the social security system in the increased abundance of a generally rising standard of living. Whether the latter feature is a proper objective of a social insurance program is a debatable matter. Many people feel that, as the general standard of living improves and discretionary income expands, individuals should be expected to meet a growing portion of their old age economic requirements out of personal savings and other private arrangements.

[4] For a description of the foreign social insurance systems that have such features, see Daniel S. Gerig, "Automatic Cost-of-Living Adjustments of Pensions in Foreign Countries," *Social Security Bulletin*, XXIII (March, 1960), 13–19.

[5] For details, see John P. Jones, "Amendments to the Civil Service Retirement Act," *Social Security Bulletin*, XXVI (February, 1963), 12–16, and Marice C. Hart, "Cost-of-Living Increases in Military Retired Pay," *Social Security Bulletin*, XXVII (February, 1964), 13–14.

[6] Robert M. Ball, *op. cit.*, p. 6.

Bronson argues that it is a question of whether the national, compulsory program is designed to meet "needs" or "wants."[7] The question of whether social security benefits are to be adjusted on the basis of cost-of-living or wage-level indices is perhaps the most critical issue in the area of cash benefits.

Several European countries provide for some type of automatic adjustment of social security benefits on the basis of changes in wage levels. In some countries the adjustment relates only to changes that occur after the individual retires, while in other countries the wage record is adjusted at retirement to reflect changes that took place during his period of employment, with adjustments also being made throughout retirement. In West Germany, the preretirement adjustment is automatic, but the post-retirement adjustment is based on an annual review by the legislature. In practice, adjustments in the German plan have been made annually, and benefit increases are running far ahead of increases in the cost of living.[8] Robert J. Myers, chief actuary of the Social Security Administration, has developed the statistical data and methodology for adapting the earnings base under the American OASDI program to wage-level changes, without taking a position for or against the incorporation of such a feature in the program.[9]

Whether benefit levels are adjusted on the basis of price or wage trends, it eventually becomes necessary to expand the base of covered earnings to which the benefit formula will be applied and on which payroll taxes will be levied. To the extent that the base does not keep pace with rising earnings, a smaller and smaller proportion of workers get benefits related to their full earnings, and the system moves in the direction of a flat benefit scheme. If all individuals had average earnings at least equal to the maximum earnings base, the system would, in effect, produce flat primary benefits. The base also has to be expanded to produce the

[7] Review by Dorrance C. Bronson of the Report of the 1965 Advisory Council on Social Security, *TSA*, XVII (1965), 106.

[8] See A. R. N. Ratcliff, "The Financial Outlook for the German State Pension Scheme," *Journal of the Institute of Actuaries*, XC, Part IV (1964), 351.

[9] Robert J. Myers, "A Method of Automatically Adjusting the Maximum Earnings Base under OASDI," *Journal of Risk and Insurance*, XXXI, No. 3 (September, 1964), 329–40. Actually, the concept of adjusting OASDI benefits on the basis of wage-level changes has already been introduced into the program in connection with the workmen's compensation offset to disability benefits. The combined benefits are limited to 80 per cent of the individual's average monthly wage or the average of his covered earnings in the highest consecutive five-year period, whichever is larger. The latter figure is adjusted triennially for benefit purposes to reflect increases in the general level of earnings.

payroll taxes needed to finance the increased benefits, unless the tax rates are to be increased or resort is to be had to general revenue financing. The extent to which the base should be expanded is essentially a matter of judgment, reflecting one's philosophy regarding the level of benefits that should be provided through the OASDI program (that is, the basic function of the system), as well as how the benefits should be financed.

3. *Financing.*—Congress has, since 1950, consistently adhered to the principle that the cost of OASDI benefits should be borne entirely from payroll taxes levied at an equal rate on the employer and the employee, with self-employed persons contributing at a rate approximately 1½ times that of the employee rate.[10] This approach has been used because of the convenience of payroll taxes and the direct relationship (in the aggregate) between taxes paid and benefits received. In other words, this system is based upon the theory of taxing according to value received rather than ability to pay. As a result, the financing basis has been characterized by some as regressive, meaning that the burden falls more heavily upon the lower-income individual than the higher-income person. This is clearly not the case, however, since the benefit formula favors the lower-income individuals. The workers, and their employers, who pay taxes on the higher ranges of creditable earnings receive less-than-proportionate benefit rights. This was recognized by the Advisory Council on Social Security Financing in its 1959 report.[11]

The social security programs of most European countries are supported in part out of general revenues. Tripartite financing of the old age insurance segment of the American social security program was considered and rejected at the time of the original legislation, although it was recognized that a governmental subsidy to the program might have to be introduced eventually.[12] Social security legislation during the 1940's authorized appropriations out of general revenue, but none was ever made. This authorization was repealed in 1950, and the principle of self-support through the payroll tax was affirmed.

The issue has been forcefully revived in recent months, not only because of congressional resort to general revenue financing of one-half the

[10] The tax on the earnings of self-employed persons is to be frozen at 7 per cent beginning in 1973, at which time and thereafter it will be less than 75 per cent of the combined employer-employee tax rate.

[11] P. 12.

[12] With respect to this latter point, see Edwin E. Witte, *Development of the Social Security Act* (Madison: University of Wisconsin Press, 1962), pp. 147–51; see also Arthur J. Altmeyer, *The Formative Years of Social Security* (Madison: University of Wisconsin Press, 1966), p. 29.

cost of the supplementary medical insurance program, the full cost of hospital insurance benefits for the transitional coverage of noninsured persons over age 65, and the full cost of the transitional coverage for cash benefits of noninsured persons over 72 (not to mention the administration's recommendation that part of the cost of a proposed new program of benefits for extended unemployment be financed from general revenues), but also because a governmental subsidy seems to be the most politically feasible method of financing substantial increases in OASDHI benefits.

One alternative is to broaden the base of taxable earnings, but, in the absence of a boost in the schedule of tax rates, only a modest increase in the level of benefits could be financed by this approach.[13] The Fogarty bill (H.R. 16253, introduced on July 14, 1966), which reflects the thinking in some official and nonofficial quarters about social security benefit levels and financing, would increase the old age, survivors, and disability benefits by 50 per cent and, in effect, would finance the increase out of general revenues. If enacted, this bill would result in an eventual governmental contribution equal to 5 per cent of taxable payroll. Based on present payroll levels, this would entail an immediate annual outlay from general revenues in the neighborhood of $11 billion, rising to $15 billion within a few years and continuing upward thereafter.

Proposals for general revenue contributions to the old age and disability segments of the social security program have far-reaching implications and must be carefully evaluated. One argument traditionally offered in support of such support is that the public insurance program eases the burden on old age assistance programs, the cost of which is borne jointly on a matching-grants basis by the federal government and the states, the greater portion being absorbed by the federal government. Since these grants come out of general revenues, it would not be inappropriate to channel into the insurance program the funds that would have gone into the OAA program.

A second traditional argument is that the combined employer and employee payroll tax should not exceed 10 per cent for the OASDI segment of the program, the implication being either that the cost of the program should not exceed this level or that any costs in excess of this limit should be borne out of general revenues. The argument says nothing about the earnings base to which the tax is to be applied. Under the projected schedule of payroll taxes the combined rate will reach 9.7 per

[13] The Social Security Administration has estimated that the projected schedule of payroll taxes would support a benefit increase of only 8 per cent even if the limit on the taxable earnings base were entirely removed.

cent in 1973, with an earnings base of $6,600. If the limitation is not to be exceeded, future benefit increases (other than those that can be financed from the gains to the system from a rise in covered earnings) will have to be financed out of an expansion of the taxable-earnings base or general revenues, or both.

The chief argument for general revenue financing rests on the philosophical belief that a greater portion of the cost of OASDI benefits should be shifted to the higher-income individuals. This argument relies to some extent on the notion that the present bipartite financing is regressive in nature, a most questionable assumption. The "bent" formula presently effects a certain amount of income redistribution, and an increase in the taxable-earnings base would enhance that characteristic, but the proponents of general revenue financing envision a much greater reallocation of the cost burden. The commissioner of social security has suggested the desirability of introducing "another element of progressivity into the financing of the program" through having the federal government contribute from general taxation an annual amount that might be regarded as interest on the unfunded initial and subsequent segments of accrued liability.[14] He would justify this course of action on the grounds of assuring future generations of workers benefits equal to the social security taxes paid in respect to their earnings. In effect, employer-employee payroll taxes would meet the "normal cost" of the system, accounting for two-thirds of the aggregate long-run costs, and the general revenue contribution would meet the interest on the "unfunded accrued liability," which accounts for the remaining one-third of aggregate costs. The point is made that this mode of financing would make possible a 50 per cent increase in cash benefits, without changing the schedule of projected payroll taxes.

The principal argument against a permanent, continuing contribution from the general treasury is that it would remove the primary restraint to unwise liberalization of the social security program. During the early stages of the program when payroll taxes, even at their very low rate, greatly exceeded benefit payments, Congress could have voted increased benefits without much thought for the fiscal or political consequences. As a matter of fact, this potentiality never eventuated, since Congress has consistently adjusted scheduled tax rates to conform to estimated costs of the program. Now that income and outgo are in approximate balance, program liberalization clearly cannot be authorized without increasing the schedule of payroll taxes. It seems likely that further increases in the current and projected rates of contribution will meet with strong objec-

[14] Robert M. Ball, *op. cit.*, p. 8.

tions from the labor force, especially the self-employed, which, if translated into voter reaction, could serve as a brake on further expansion of the program. If the current schedules of contributions should be frozen, with the cost of any future program liberalizations being borne out of general tax revenue, this constraint would be lost, with potentially serious consequences to the entire economy, including private insurance.

Another possible consequence of a substantial subsidy out of general revenue would be the development of pressure to introduce a means test, since the insurance characteristics of the system would be weakened. However, with workers as a group still paying one-third of the total costs and new entrants paying one-half of the value of their own protection, and with benefits related to earnings and conditioned on a specified period of covered employment, the system would still retain a sufficient similarity to insurance to argue against a means test.

Another argument against general revenue financing is that the incumbent administration at any given time might be tempted to forego or postpone scheduled contributions to the social security program in order to ease the strain on the administrative budget. The federal government's performance with respect to its obligation to the OASDI trust funds for noncontributory military service credits and its general obligation to the Civil Service Retirement System (over and above the contributions paid by individual agencies to match employee contributions) offer ample evidence that immediate budgetary considerations may take priority over contributions toward pension obligations due in the distant future.

An argument of lesser force is that a government subsidy would tend to weaken whatever values flow from a fairly direct relationship between potential benefits and projected contributions.

It has been argued in some quarters that any federal subsidy should take the form of a deduction for federal income tax purposes of employee contributions to the OASDHI program, with all benefits under the program being includible in the recipient's taxable income. However laudable this proposal is in other respects, this type of subsidy would not meet the objectives of those who favor a direct federal contribution to the program.

Public Interest in Private Pensions

The federal government has a strong and pervasive interest in the functioning of the private pension mechanism. Contributions to private pension plans constitute an important source of private savings, having significant implications with respect to economic growth, behavior of the financial market, and the concentration of economic power. The efficiency of man-power utilization is affected by the impact of pension plans on labor mobility, employment opportunities for older workers, and withdrawals from the labor force through early retirement. There are fiscal implications arising out of the tax treatment of contributions, investment income, and benefits. Finally, these plans are a potentially significant source of old age economic security, supplementing the federal program of old age insurance in a highly flexible manner at all levels of income, the supplementation being especially valuable for workers with average and above-average earnings.

Over the years Congress has manifested its interest in private pension plans through the Internal Revenue Code, the National Labor Relations Act, the Securities Act of 1933, the Securities and Exchange Act of 1934, the Labor-Management Relations Act of 1947, and the Federal Welfare and Pension Plans Disclosure Act. The most comprehensive statement of the public interest in private pension plans is found in the report of the President's Committee on Corporate Pension Funds.[15]

The President's Committee acknowledged the distinctive role of private pensions and stated that it should continue to be the public policy to encourage the sound growth of these plans through tax incentives and appropriate legal protection. It made a number of recommendations which, in its view, would strengthen the private pension institution and provide greater assurance that it would fulfill its social objectives. The most significant of these recommendations can be subsumed under the two broad headings of nondiscrimination and security of benefit expectations.

1. *Nondiscrimination.*—Until twenty-five years ago, it was possible for an employer to establish a pension plan for any segment of his employee group and enjoy the favorable tax treatment associated with a qualified status. This led some companies to establish plans that covered only the executives and other highly compensated employees. In the general tightening-up of the Internal Revenue Code provisions related to pension and profit-sharing plans that took place in the Revenue Act of 1942, Congress enacted a broad prohibition against discrimination in favor of officers, stockholders, supervisory personnel, or highly compensated employees. This prohibition was primarily designed to minimize tax avoidance by higher-income individuals rather than enlarging the social utility of the private pension mechanism. The legislation, still in effect, proscribed discrimination as to coverage, benefits, or contribution rates.

[15] "Public Policy and Private Pension Programs," *Report to the President on Private Employee Retirement Plans* (Washington, D.C.: Government Printing Office, January, 1965).

The law did not contemplate that all employees must be eligible to participate in a qualified plan, and it has been possible to exclude various groups of employees—especially seasonal, temporary, part-time, and short-service employees—without jeopardizing the qualified status of the plan. More specifically, the employer may operate a plan for only the hourly workers, only the salaried workers, only the workers of a particular plant, only the employees represented by a particular union, and so on. This has permitted much flexibility in the development of pension coverages.

Within recent years, the Internal Revenue Service has become increasingly critical of plans that undertake to cover only salaried employees, and many have been denied a qualified status on the grounds that such plans by their very nature discriminate in favor of the more highly compensated group. Reflecting the increasing concern that pension plans may be established for the favored few, the President's Committee recommended the removal of the employer's present option of setting up a plan only for salaried or clerical employees, unless it can be shown that the other employees prefer not to be covered or prefer to be covered under a separate plan or that differences in working conditions warrant differences in pension treatment. The Committee also recommended that the maximum period during which an otherwise qualified employee can be denied coverage under a plan be reduced from five to three years.

The first of these recommendations carries the concept of nondiscrimination beyond that articulated in existing law and regulations. Thus far, Congress has been concerned only with discrimination in favor of highly paid employees. The President's Committee recommendation would extend the prohibition to discrimination among broad classes of employees. While the proposal was directed specifically at the treatment of salaried versus hourly workers, the broad issue is whether an employer should be permitted to extend the benefits of pension coverage to only a portion of his employees (apart from the usual exclusion of short-service and part-time workers), irrespective of the composition of the covered group. The provisional report of the President's Committee contained the suggestion that there be no differential treatment of the various categories of employees, but the final report omitted that concept—wisely, in my opinion. Imbued as I am with the philosophy that nongovernmental pension plans should serve a social as well as a management or union purpose, and eager to see the scope of these plans extended, I am not unduly disturbed by the notion that all full-time, long-service employees of an employer should be covered by a pension plan with meaningful benefits if any classification of the employee group is to enjoy the advantages of a tax-favored plan. I hasten to add, however, that the employer should retain the prerogative, limited by collective-bargaining considerations, of deciding whether he will have any pension plan.

Shortening the maximum service period that may be required for participation in a plan from five to three years does not seem to be a matter of great consequence, although I personally would prefer a maximum period of five years as a condition to entitlement, accompanied by a stipulation that retroactive credit for these years be given in the determination of benefit entitlement and amount and satisfaction of vesting requirements. It would seem that the public interest would be served by maximizing the portion of an individual's lifetime employment service recognized for benefit purposes under one or more pension plans.

In determining whether the schedule of benefits in a new or amended plan discriminates in favor of the more highly compensated employees, the Internal Revenue Service takes into account the benefits payable under the social security system to the extent that the benefits are deemed not to have been financed by employees. The basic notion is that the benefits provided by the private plan plus the social security benefits not attributable to employee contributions should constitute approximately the same percentage of total compensation for all classes of covered employees. This concept obviously involves an evaluation of the various categories of benefits available under the social security system.

For purposes of evaluating the social security benefits, the IRS assumes that all covered employees who retire in the future will be entitled to the maximum primary benefit payable under the governmental program at the time of their retirement. It has further assumed that the value of the ancillary benefits is one-half the value of the primary insurance amount (PIA). (Thus far, the integration rules have recognized only the wife's old age benefit and the survivorship benefits.) Since 1950, the total package of social security benefits has been considered the equivalent of a life annuity payable from age 65 in an amount between 40 and 48 per cent of maximum taxable wages. For example, under the 1958 amendments to the Social Security Act, the maximum PIA was $127 per month, or 31.75 per cent of the maximum average monthly wage of $400. Ancillary benefits increased this percentage by one-half to a total of 47.625 per cent of the average monthly wage. Under the 1965 amendments to the Social Security Act the ultimate maximum retirement benefit was increased to $168 per month, or 30.55 per cent of the new maximum average monthly wage of $550. Ancillary benefits (not including disability and Medicare benefits), valued at one-half of the PIA, bring the value of the over-all package to 45.82 per cent of maximum taxable wages.

Based on the "level premium" costs for the 1965 amendments, such ancillary benefits have a value of 45 per cent of the PIA, making the over-all package worth 44.3 per cent of maximum taxable wages.

For integration purposes, the IRS credits the employer with all OASI benefits that are not directly attributable to employee payroll taxes. Since 1950, the percentage of total OASI benefits ascribed to the taxes paid by employees has varied from 6 to 22 per cent, the latter percentage having been used in determining the value of OASI benefits attributable to employee payroll taxes under the 1958 amendments.

When the above figure of 47.625 per cent was reduced by 22 per cent, the resulting residual value of OASI benefits not attributable to employee taxes was 37.15 per cent, which was rounded up to 37.5 per cent to maintain the same integration limit that has been in effect since 1950. This means that a pension plan, under the pre-1965 Social Security Act, can provide benefits equal to 37½ per cent of compensation in excess of the OASDI wage base of $4,800 without running afoul of the integration rules. If the plan covers compensation within the OASDI wage base, the annual retirement benefit for an assumed service period of thirty years can be 1¼ percentage points higher on that portion of earnings in excess of the OASDI base than on the lower portion.

The President's Committee questioned the propriety—and logic—of crediting the employer with all social security benefits not attributable to employee tax payments. On the grounds that the social security benefits are financed by equal tax contributions from employers and employees, the Committee recommended that with respect to benefits earned in the future, the employer should be given credit for only half of the OASI benefits. If this recommendation were adopted, it would mean that the basic integrating percentage under the 1958 formula would be reduced from 37½ per cent to 24 per cent,[16] and the maximum permissible integrating differential would be decreased from 1¼ per cent to about ¾ per cent. Existing plans that have taken full advantage of the integration latitude would have to increase benefits for those employees earning less than $550 per month or decrease the benefits for those employees earning more than that sum.[17]

[16] Internal Revenue Service, *Integration of Pension Plans, etc., with Social Security*, Announcement 66-58.

[17] The cost impact would be greatest for plans covering relatively low-paid employees. In testing the cost effect of conforming typical fully integrated plans to an integration limit of 24 per cent, through an upward adjustment in the benefit formula, Ed Boynton found that the cost increase ranged from 11.3 per cent to 28.7 per cent, the latter increase being associated with a plan covering the lowest-paid group in the survey.

Plans that have used a $\frac{3}{4}$ per cent differential could meet such a revised standard with little modification. On the other hand, plans funded through individual policies or group permanent contracts, the combined face amounts of which reflect the total prospective benefits as of any given time, may be faced with drastic revisions if a "grandfather" clause is not included in the new regulation that is expected soon. A "30 per cent excess" plan could be forced to cut back to a "20 per cent excess" basis, with a reduction not only in the projected retirement benefits but also in the existing life insurance protection.

The issue involved here is extremely complex or, at least, has been made so by former integration rules. On its face, the recommendation of the President's Committee may seem plausible. However, the relationship between tax payments to the OASI program and benefits payable thereunder is not as simple as the recommendation would imply. The fact of the matter is that the tax payments of any particular generation of employees and employers are not intended to pay the benefits of that generation; instead, each generation pays the benefits of the immediately preceding generation. Since the OASI system is still immature and the initial actuarial liability was not funded, the aggregate tax payments of present and past beneficiaries of the program have constituted only a small fraction of the value of the benefits. Even today, the present value of future OASI tax payments of the currently employed group of employees is only 30 per cent of the present value of the old age and survivorship benefits that will be payable in respect to these persons. On the other hand, the combined employer-employee taxes that will be paid with respect to new entrants to the system will exceed by a considerable margin the value of the benefits that they will earn.[18] Workers without dependents will themselves pay taxes somewhat in excess of the value of their prospective benefits. Sedulous adherence to the present integration approach, with no change in the method of financing, would eventually lead to an integration formula that would give employers credit for considerably less than half the benefits payable under the system, a result that could be justified only on the assumption that employer contributions, in the long run, are primarily intended to pay the equivalent of interest on the unfunded accrued liability of the system.

Questions may also be raised about the validity of the values attributable to ancillary benefits, particularly with respect to the benefits of working wives. Past rules have, in effect, treated the working wife's

[18] Robert J. Myers and Bertram Oppal, "Studies on the Relationship of Contributions of Benefits in Old-Age Benefit Awards," *Actuarial Note Number 20* (Social Security Administration [June, 1965]), Table 3.

benefit, if any, as the primary benefit, with the dependent wife's benefit being regarded as excess to this imputed primary benefit. It appears equally logical to consider that a wife is first entitled to a wife's, or surviving widow's, benefit (an ancillary benefit) and that any benefit derived from her own earnings record is only the excess over the wife's or surviving widow's benefit. Such treatment would produce a value of total ancillary benefits much greater than 50 per cent of the employee's PIA.

It might be reasonably argued that the present $37\frac{1}{2}$ per cent factor should be retained in the interests of continuity and stability. According to *Actuarial Note No. 20* of the Social Security Administration, those retiring within the next several years will have paid taxes equivalent to only 10–20 per cent of their own social security benefits. Even if the ancillary benefits were still to be valued at 50 per cent of the PIA, producing a package value of 45.82 per cent, an attribution factor of 18 per cent would develop an integrating percentage of 37.37, which could easily be rounded to $37\frac{1}{2}$ per cent. Retention of the attribution factor of 22 per cent would produce an integrating percentage of 35.7, which could be rounded up to $37\frac{1}{2}$ per cent without too much violence to the concept involved.

Another approach, developed by Ray M. Peterson and discussed informally with Treasury representatives, would be to separate the benefit structure from the financing scheme, with the integration rules looking only to the benefits side of the picture. Under this approach, old age benefits, the survivorship benefits as a group, and the disability benefits of the OASDHI program would be separately valued, and separate, mutually exclusive limits for each major class of benefits would be delineated. Then each benefit component in the private plan would be integrated with its counterpart in the public program.

According to Peterson's calculations, total old age benefits with respect to an employee, including wife's benefits and hospital benefits available during the lifetime of the employee, have a value of approximately 129 per cent of the value of the employee's PIA. Survivor benefits before and after retirement are worth about 30 per cent of the value of old age benefits, and disability benefits are the equivalent of about 12 per cent of such old age benefits. The maximum PIA for employees reaching age 65 prior to 1990 is 25–28.5 per cent of the maximum wage base. Applying 129 per cent to these percentages produces an integrating factor for old age benefits of $33\frac{1}{3}$ to 36 per cent—a quite acceptable factor.

On the other hand, if one were to concede the propriety of looking at the contribution side of the picture and were to accept the proposition that new entrants will be paying one-half of the taxes needed to support the OASDHI program (assuming no support from general revenues), it would be necessary to value the ancillary benefits, treating working wives' benefits in the manner suggested above, as a minimum, at 100 per cent of the PIA, in order to come out with an integrating percentage that is realistic by today's standards. This combination of assumptions would produce an integrating percentage of at least 30.5 per cent, which might prove to be an acceptable figure to most employers.

2. *Security of benefit expectations.*—In a panel discussion before this group in October, 1963, I suggested that the security of benefit expectations was to be found in (1) an adequate benefit commitment, (2) competent actuarial guidance, (3) a realistic funding program, and (4) effective safeguards for pension plan assets. The report of the President's Committee on Corporate Pension Funds made recommendations with respect to each of these four components and added another element which I did not regard as essential to my list, namely, reinsurance.

a) Adequacy of benefit commitment.—In the area of benefit commitment, the President's Committee expressed concern over the potential loss of accrued benefit credits through termination of service prior to retirement, pointing to the dislocations in the labor market that can be expected as the technological revolution advances. After analyzing the matter at some length, including the cost implications of various types of vesting provisions, the Committee concluded that the Internal Revenue Code should be amended to require that a private pension plan, in order to qualify for favored tax treatment, must provide a reasonable measure of vesting. It suggested as an acceptable vesting provision one which would vest at least one-half of accrued normal retirement benefits after fifteen years of service, with the vesting progressing to 100 per cent after twenty years of service, irrespective of age. Since this recommendation has aroused considerable resentment and concern among employers, unions, and pension practitioners, it seems desirable to set forth the arguments for and against vesting per se, as well as the additional factors that should be considered in arriving at a judgment as to whether a minimum level of vesting should be mandated.

There are three principal arguments in favor of providing some measure of vesting in a pension plan. The first, and perhaps the most commonly accepted, argument is that a plan participant, as a matter of equity and fair treatment, is entitled to have his benefit accruals protected against forfeiture after a reasonable period of faithful service—and possibly the attainment of a specified age. This argument draws its chief philosophical support from the "deferred wage" concept of pensions. If a group of employees is assumed to have forgone increases in current wages in exchange for a deferred benefit, it seems to follow that an individual member of the group is entitled to have his interest in the deferred wage or benefit protected against loss by virtue of termination of service, whether voluntary or involuntary. The argument draws some support from the "human depreciation" concept of pensions, which holds that an employer is morally obligated to make orderly and systematic provision for the ultimate retirement of an employee in a manner roughly analogous to depreciation allowances for physical plant and equipment. Under this concept, an employer is not justified in utilizing the services of an employee for a substantial number of years without making a contribution toward his old age economic needs. Under both the "deferred wage" and "human depreciation" concepts, the employee's pension rights can be safeguarded only through some form of vesting.

A second argument in favor of vesting is that it encourages mobility of labor, which is highly desirable from the standpoint of the nation's economy. There is no question that under certain circumstances the nonvested status of accumulated pension benefits could act as a deterrent to a change of employers. More liberal vesting provisions, therefore, would weaken the force of this deterrent. It seems worthy of noting, however, that other factors, such as seniority rights, family attachments, community affiliations, and adverse economic conditions, are believed to overshadow nonvested pension benefits as barriers to labor mobility.

A third—and possibly the most compelling—argument for vesting is its importance in enabling private pension plans to fulfill their broad social objective. If the great majority of employees covered by a pension plan as of a given point in time could be expected to remain with the employer until normal or early retirement, vesting would have only minimal significance. Such is not the case, however, and only a relatively small proportion of current participants in a plan will typically remain in service until retirement. The percentage can be expected to grow smaller as the technological revolution advances. For private plans to fulfill their social function, it is necessary that members of the labor force receive pension credits for the bulk of their lifetime employment service, irrespective of the number of different jobs that they hold. This argues strongly for some degree of vesting.

The primary argument against vesting is its cost. To the extent that any benefits of terminated employees are preserved, vesting adds to the cost of a pension plan. The actual cost of a vesting provision will depend upon the withdrawal rate among the plan participants and the amount of service required before the benefit accruals are vested. Within the limits of any given pension budget, vesting can be provided only at the sacrifice of higher retirement benefits, lower retirement age, or other desirable plan features.

Closely related to the foregoing is the question of equity. In its simplest form, the equity issue can be reduced to the question of whether, out of a given pension budget, it is more equitable to provide smaller (but more secure) benefits to a larger number of persons or larger (but more uncertain) benefits to a smaller number of persons. It is arguable that, if the plan is nondiscriminatory in all other respects and all participants are fully aware of the plan's undertaking, the deferral of vesting to point of retirement is just as equitable as full and immediate vesting—these being the two extremes. As a matter of fact, some would argue that it is more equitable to provide larger benefits to those long-service employees who remain with the employer until retirement than to grant smaller vested benefits to all employees who serve a minimum period of time with the employer. Persons who take this position view pensions as a "differential wage" for long and faithful service. They contend that long-service employees make a special contribution to the firm, not reflected in ordinary wage payments, which entitles them to preferential treatment at retirement. These contributions include the preservation of the folklore of the industry, fostering of loyalty to the firm and its traditions, and the transmission of technical skills from older to younger generations of workers. This view of pension benefits would countenance the withholding of vesting to the point of retirement in the service of the employer.

Those who feel that the arguments against vesting outweigh the arguments in its favor would, as a matter of principle, oppose any measure designed to force employers to provide a given level of vesting. Many of those who favor vesting in principle and would support any reasonable effort to encourage the practice on a voluntary basis would oppose the mandating of minimum vesting provisions as a condition for favored tax treatment.

A number of arguments have been advanced against compulsory vesting. One of the most persuasive is that it constitutes an unwarranted infringement on the prerogative of management and labor (where organized) to determine the optimal allocation of pension resources in the light of their objectives. This flows from the fact that a meaningful mandated standard of vesting is likely to have cost implications. It is argued that, aside from its obligation to prohibit plan provisions and practices that would favor the more highly compensated employees, the federal government has no duty or right to mandate substantive features of a plan. Persons holding this view contend that mandatory vesting is no more justified than a mandatory level of benefits, a mandatory age of retirement, and so on.

A second argument against compulsory vesting is that it might lead to the mandating of a minimum level of vested benefits in order to minimize discrimination against plans with relatively liberal benefit levels. Carried to its logical conclusion, the concept would call for the compulsory establishment of private plans by all employers—or all those above a certain size.

A final argument against mandatory vesting is that it would act as a damper on the further growth of the private pension institution. This is a sweeping allegation of the type frequently associated with legislative proposals having cost implications. However, it has some validity in the present context, especially since the financial impact of compulsory vesting would have an uneven effect. The cost burden would fall most heavily upon employers with the most liberal pension plans and those with the heaviest rate of turnover among their employees. This could lead to curtailment of existing plans, reluctance to liberalize existing plans, or refusal to establish plans in the first instance.

The case for compulsory vesting must rest upon a conviction that the social objectives of private pension plans can be served only if some minimum level of vesting is embodied in all plans, plus the belief that this condition cannot be achieved by voluntary means within the foreseeable future. If the private pension institution is envisioned as serving only business and union purposes, there would appear to be no justification for mandating the inclusion of vesting privileges.

An analysis of almost 16,000 plan descriptions filed with the Department of Labor under the Federal Welfare and Pension Plans Disclosure Act several years ago revealed that about two-thirds of the plans make some provision for vesting prior to normal or early retirement. The vesting provisions in roughly two-thirds of the plans with vesting would meet the minimum standard suggested in the report to the President. This means that approximately 45 per cent of all plans in operation at that time (1960) could satisfy the proposed standard without plan amendment. Others could meet the standard with only minimal increases in cost. The picture is probably brighter now than it was in 1960. Thus, the question of whether there should be mandatory vesting is becoming increasingly more a matter of principle or philosophy than of economics.

b) Competent actuarial guidance.—The President's Committee recognized the vital role of actuaries in the sound functioning of pension plans and recommended that the funding process of every qualified plan be certified at the inception of the plan and at least as frequently as every three years thereafter by an actuary with acceptable professional qualifications. Under this proposal the actuary would be required to certify that the relationship between the plan contributions and benefits would measure up to certain prescribed standards and that the actuarial cost methods and assumptions are appropriate to the circumstances.

The Committee was aware of the fact that at present there are no legal restraints in the United States on the use of the designation "actuary" or on the offering of actuarial services to the public. There is no question in my mind that the Committee contemplated the creation of a mechanism for evaluating the technical qualifications and professional integrity of persons who offer actuarial services to employers, unions, and other plan administrators. In my judgment, this mechanism should involve the concept of accreditation. Under this approach, each governmental agency whose responsibilities include the collection and evaluation of actuarial data would establish its own set of qualifications for those actuarial practitioners with whom it has dealings. Those actuaries who meet the special requirements of the agency would be "accredited," and the agency would accept actuarial certificates and reports only from actuaries who have an accredited status. Actuaries operating in areas not involving accreditation would not be subject to official supervision.

As you know, the American Academy of Actuaries was organized with the thought that it could serve as the vehicle for accreditation by any federal or state agency that might adopt accreditation procedures. The agency would establish and apply its own accreditation procedures, but membership in the Academy would be construed as meeting the accreditation standards. I was privileged to present testimony before a subcommittee of the House Judiciary Committee in support of a Federal Charter for the American Academy of Actuaries, and I did so in the conviction that the Academy offers the most hopeful approach to accreditation and that a federal charter would lend dignity and support to this objective. The Canadian Institute of Actuaries was incorporated by Act of the Parliament of Canada to serve the same purpose in Canada that the Academy hopes to serve in the United States.

c) Realistic funding program.—The President's Committee declared that the fulfillment of benefit promises is a "matter of utmost public importance" and expressed the belief that "adequacy of funding arrangements" is essential to the attainment of this goal. It further observed that the minimum level of funding required under existing tax law, namely, the funding of normal cost plus interest on the initial past-service liability, does not assure the accumulation of funds in an amount adequate to meet benefit commitments. Consequently, it recommended that a defined benefit plan be required, as a condition for initial or continued qualification, to follow a funding policy that contemplates the funding of normal costs as they accrue and the funding of supplemental liability over a period that approximates the average remaining work life of the covered employees but not longer than thirty years after the event giving rise to the liability. It suggested as a minimum standard of funding for defined contribution plans that the contribution commitments be realistically related to benefits promised and actually paid. In addition to the actuarial certification mentioned above, the Committee would have the Internal Revenue Service review the funding program in the light of guidelines and ranges of standards with respect to actuarial assumptions developed with "the advice and consultation of a public advisory body of actuaries and other interested parties." Plan assets would be valued by professionally qualified public accountants concurrently with the actuarial certification.

These recommendations raise two major policy issues and a host of subsidiary ones. The first is whether benefit security is dependent upon the funding of all accrued benefit obligations; the second is whether the government should mandate a policy of full funding even if it should be agreed that such a policy is desirable from the standpoint of benefit security. Space and time limitations forbid more than a cursory examination of these issues in this paper.

There is little room for disagreement that, purely from the standpoint of benefit security, full funding is a desirable objective. Some would argue that the financial capability and willingness of the employer to make future contributions to a plan are more important sources of security than the contributions that have been made in the past, especially if the employer is a large, well-established firm in a stable or growth industry. While the employer's ability and willingness to make contributions are the sole source of security for benefits to be earned in the future and are a potential or contingent source of security for benefits already earned, most would agree that in the great bulk of pension plans the fulfillment of benefit expectations rests essentially in the accumulation of assets at the approximate rate at which the liabilities accrue. The primary difficulty associated with the full funding concept is that it may run counter to other corporate and union objectives and may under certain circumstances be wholly impracticable.

In a stimulating paper presented at the Chicago meeting of the Society in June of this year, Frank Griffin suggests that the funding policy of a pension plan should serve three objectives of the employer: (1) level long-range pension costs, (2) security of benefit accruals, and (3) short-range financial flexibility, which he perceives to be an aspect of benefit security in that it enhances the prospects of plan permanence. He sees no irreconcilable conflicts among these objects, especially the first two, and believes that a funding policy can be fashioned to serve all these objectives.

He points out that, in pursuing the objective of level long-run pension costs, the employer may use a projected benefit cost method which under certain circumstances may lead to the accumulation of assets in excess of the value of accrued benefits. He demonstrates that with an immature group of plan participants, stationary or growing in size, the funding of normal costs plus interest on the unfunded actuarial liability, augmented with actuarial gains, can lead to the accumulation of assets equal to the value of all accrued benefits, including those attributable to past-service or retroactive benefit increases. He suggests, therefore, that the long-range objective of a funding program should be to produce the larger of: (*a*) a fund sufficient to provide in full all accrued (or vested) benefits if the plan were to terminate and (*b*) a fund sufficient (in the absence of further benefit increases) to maintain a stable contribution level if the plan were to continue. Since a plan will either terminate or continue, a fund sufficient to satisfy the requirements of either eventuality would be the maximum that would ever need to be accumulated, except possibly as a margin to allow some flexibility in plan contributions. Furthermore, inasmuch as these objectives might be achieved without deliberate funding of the supplemental liability, Mr. Griffin would oppose, as too restrictive, the recommendation of the President's Committee that the supplemental liability eventually be funded in all cases, irrespective of the actuarial cost method used to compute plan liabilities.

Even if it be conceded for the sake of argument that adherence to a policy of full funding by all plan administrators would be in the best interests of all parties concerned, many would question whether such a policy should be made mandatory, as a condition to Treasury approval of the plan. Some would object that it would be an unjustified infringement on management and union prerogatives to evolve financial policies optimally suited to broad corporate and union purposes. Others fear that it would be a deterrent to the establishment of new plans or continuation (and liberalization) of old plans. Collectively bargained, multiple-employer plans, many of which operate on a "normal cost plus interest only" basis of funding, could be especially hampered unless the transition to the higher level of funding is to be made over a long period of years. No satisfactory solution has yet been developed for the dilemma presented by pay-as-you-go plans. It would serve no useful purpose to deny an employer the privilege of deducting direct benefit disbursements in computing his federal income tax, yet it seems unfair and unrealistic to force an employer who makes a start toward full funding to go all the way. The presidential proposal permits no middle ground—if the employer wants the advantages of a qualified plan.

There is also room for concern over the proposal that the Internal Revenue Service lay down guidelines and specify acceptable ranges of assumptions as to the various cost factors. In addition to the problem of developing a set of guidelines and standards that would be realistic and universally applicable at the time that they were promulgated, there would always be the possibility, governmental bureaucracy being what it is, that modifications would not be made as circumstances demand.

Personally, I would like a declaration of public policy in favor of the objective of full funding, with the policy to be implemented by annual or triennial certifications by accredited actuaries that the actuarial cost methods, assumptions, and funding practices of their clients are consistent with the concept of full funding and, barring further plan changes, will ultimately result in a fully funded status. I would not be concerned if the articulated policy of the federal government should specify the actuarial cost methods which would be acceptable and require the funding of supplemental liabilities over a specified period, subject to the proviso that the funding need not progress beyond the point at which plan assets are equal to all accrued benefits (not just vested benefits). On the other hand, I believe that the tax law should permit a certain percentage of overfunding in the interests of flexibility and to deal with the problem of fluctuating asset values. My position on this whole matter has been influenced somewhat by the beneficent effects on funding policy that I expect to flow from the accountants' decision to require accrual accounting for pensions (a topic to be discussed later).

For those of you who find distasteful, if not abhorrent, this attempt of the federal government to raise the minimum standard of funding, I would call your attention to the fact that the same sort of sentiment existed a hundred years ago when state insurance departments set out to enforce minimum standards of reserving for life insurance liabilities. It was argued, for example, that the stipulation of mortality and interest assumptions for the calculation of minimum reserves was an improper encroachment upon management's flexibility in determining gross premiums. In other words, this was construed to be undue interference in the pricing process. Another historical precedent that is worthy of attention is the mandatory conversion of fraternals and assessment societies to the level premium and legal reserve bases that began in 1910 and is still continuing.[19]

[19] Richard DeR. Kip, *Fraternal Life Insurance in America* (privately printed; Philadelphia, 1953), pp. 102–5, 172–73.

The Pension Research Council's current inquiry into the extent of funding among private pension plans should cast a great deal of illumination on the question whether mandatory funding standards are needed and what the impact would be if various types of standards should be mandated. The study, which is under the direction of Frank Griffin and Lambert Trowbridge, encompasses all plans covering twenty-five or more employees and in the process of funding for ten years or more. The ratio of assets to the present value of accrued benefits, computed on a plan close-out basis from a uniform schedule of annuity rates, will be derived for various categories of plans and plan characteristics. In addition, the gross actuarial liability for each plan will be reported on the basis of the actuarial cost methods and assumptions actually employed. All assets will be reported on both a book and market basis. About forty leading insurance companies and actuarial consulting firms are co-operating in the study, the results of which should be available in 1967.

d) *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 transactions, however, no standards of investment conduct are imposed.

The President's Committee considered this matter carefully, since concern over the lack of guidelines to investment policy had been expressed by the Commission on Money and Credit in its report, and specific reference to the matter was made in President Kennedy's *1962 Economic Report*. The Committee stated that a pension fund has minimal liquidity needs and is ideally situated to follow a flexible investment policy oriented to long-term objectives. It pointed to various investment practices that would clearly be prejudicial to the interests of the plan participants and their beneficiaries. It saw particular dangers in the investment of a pension fund in the stock or other securities of the employer firm or its affiliates and suggested that no more than 10 per cent of a fund should be so invested, irrespective of the intrinsic investment qualities of the obligations. It concluded that the existing standards for fiduciary investment behavior are adequate and that the remedy for any departure from the established rules of conduct lay in adequate enforcement of existing law.

In order to facilitate the enforcement of existing standards of fiducial conduct, the Committee recommended that the Federal Welfare and Pension Plans Disclosure Act be amended to provide for fuller disclosure of investment holdings and activities, possibly in the detail required of investment companies. It concluded that (1) there should be no limitation on the percentage of a fund, or the absolute amount, that could be invested in common stocks and (2) there is no need at present for a regulatory agency to act as guardian for the collective interests of employees and their beneficiaries.

Notwithstanding the conclusions of the President's Committee, Senators Javits and McClelland have introduced bills designed to provide further safeguards for the assets of pension plans. These bills would (1) articulate a federal standard of fiduciary conduct for plan administrators and trustees, (2) invest a federal agency with the authority and responsibility of invoking remedies through the federal court system to protect the collective interests of plan participants, (3) permit a federal agency to conduct periodic examinations of pension and welfare plans, and (4) require more detailed reporting of investment transactions. Some legislation along these lines is likely within the next year or two.

e) *Reinsurance.*—Even if all the foregoing elements of benefit security are conjoined in a particular plan, there is no assurance that all valid benefit expectations would be realized in the event of plan termination. This uncertainty arises out of a combination of factors, but the principal reason for nonfulfillment of expectations is likely to be failure to fund in full the prior-service costs of the plan before it is terminated.

In recognition of this residual source of insecurity, the President's Committee suggested that serious study should be given to the possibility of establishing "a system of insurance which, in the event of certain types of termination, would assure plan participants credit for accrued benefits." More recently, the National Commission on Technology, Automation, and Economic Progress in its report to the President and Congress, under the heading "Protecting the Earned Benefit Rights of Displaced Employees," states:

> We favor whatever legislative or administrative measures may be necessary to promote greater equity and security in the establishment and administration of private pension plans. Specifically, we recommend that careful study be given to a legislative system of reinsurance for private pension plans similar to the reinsurance of bank deposits through the Federal Deposit Insurance Corporation.

Both these recommendations simply suggested the need for study of a possible reinsurance system and made no attempt to formulate the essential features of such a system. However, a bill introduced into the United

States Senate in 1964 by Senator Vance Hartke of Indiana and reintroduced with minor modifications in 1965 and again in 1966 spells out in some detail the features that such a reinsurance scheme might incorporate. Prompted by the closing of the Studebaker plants in South Bend in 1963, the Hartke bill, identified as S. 1575, would invoke the reinsurance scheme only when there has been a partial or complete termination of a pension plan due to cessation of one or more operations in one or more facilities. Participation in the program, which would be operated by the Department of Health, Education, and Welfare, would be a condition to a "qualified" status under IRS regulations, except for certain self-employed and owner-employee plans. The reinsurance would not be in effect during the first three years after the establishment of a plan or, with respect to the new benefits, within three years after a "substantial" amendment of the plan. The premium rate would be uniform for all plans and could not exceed 1 per cent of unfunded liabilities. An employee's accrued benefits would be reinsured only up to $500 per month or 50 per cent of the highest five-year average monthly wage, whichever is the lesser, with survivor benefits being protected in an amount "reasonably related" to the employee's limit.

If it should not be practical, financially or administratively, to reinsure benefits for all participants, priorities could be established in accordance with categories set forth in the bill. Reinsurance would be provided against loss of assets occasioned by forced liquidation for the payment of benefits. The premium for this protection, which would be in addition to that for benefit reinsurance, could not exceed $\frac{1}{4}$ of 1 per cent of the assets. The premium rate could vary by class of assets. There would be an advisory council, appointed by the President, to advise the HEW with regard to (1) setting of premium rates, (2) determinations of assets and unfunded liabilities, and (3) establishment of priority classes.

A penetrating analysis of the concept of pension reinsurance and of the specific provisions of the Hartke bill was made by a joint ALC-LIAA study group, headed by Harry Blagden, and I commend its report to you. It is far more comprehensive than any evaluation that I can attempt here. The study group tested the concept of pension reinsurance against the commonly accepted criteria of an insurable risk and found that such a program would not satisfy all the criteria. Neither do some existing programs, such as bank deposit insurance, mortgage insurance, and unemployment insurance, with which pension reinsurance might be compared, but these programs have operated satisfactorily thus far—possibly because they have not had to cope with a severe economic crisis. The study group concluded that insurance of pension benefits would be as feasible as deposit insurance, mortgage insurance, and unemployment insurance if the technical problems of determining the occurrence and amount of loss can be overcome. The report of the study group was critical of certain aspects of the Hartke bill, especially its ambiguity and its failure to set forth with sufficient specificity how the program would function—deficiencies conceded by the sponsors.

Any proposal that looks toward the strengthening of the private pension institution deserves careful consideration, and the Hartke proposal is no exception. Implementation of the idea, however, would require solutions to many troublesome aspects of the proposed arrangement. One of the most serious problems is that the event insured against, itself a rather indeterminate matter, is intimately associated with the risks arising out of fundamental economic changes and, even more specifically, the risk of business failure. Nevertheless, there are several insurance programs, some of them strictly commercial and privately operated, that deal directly with the risk of business failure. Credit insurance coverages of nonlife companies come immediately to mind, and here the risk includes unwillingness as well as inability of the debtor to pay. Export credit insurance is an extension of the basic credit insurance coverage under which private insurers assume the normal business risks and the federal government, through a reinsurance arrangement, assumes the political risks. Many states operate guarantee funds to ensure payment of workmen's compensation benefits when the insurer or the employer, as a self-insurer, becomes insolvent. New York has a guarantee fund for claims under automobile insurance policies and another for life insurance policies. Under the uninsured motorists provision of an automobile insurance policy, the insured's own policy may pay claims that would otherwise be payable by the insolvent insurer of a third party.

In all these cases, the state fund is protecting benefit rights to the limit of its resources against the broad economic hazard of insolvency and, moreover, the insolvency of insurance companies. It is worthy of mention that the current investigation of property-casualty insurance companies by the Subcommittee on Anti-Trust and Monopoly of the Senate Committee on the Judiciary has led its chairman to suggest the need for an arrangement to reinsure the liabilities of insolvent insurers.

The Hartke bill proposes that the premium rate assessed against the unfunded liabilities of a pension plan be the same for all plans, ignoring differences in probabilities of termination. This proposal seems to be based on two assumptions: (1) that the premium rate needed to meet the long-run obligations of the reinsurance mechanism would be relatively inconsequential and (2) that plan terminations of the type covered under the bill would generally be the result of fundamental economic forces, the social cost of which should be apportioned on a pro rata basis over all plans enjoying the protection. The general proposal need not stand or fall, however, on the basis of the suggested rating structure. There is a relevant body of rating and claims experience among credit insurers which classify their risks on the basis of Dun and Bradstreet credit ratings. The rating practices of mortgage insurers also reflect attempts to predict the consequences of business fluctuations.

The levying of the premium charge against a plan's unfunded liabilities, while eminently logical, would involve a judgment as to how the liabilities of the plan are to be valued, not to mention the assets. One approach would be to accept the valuation figures of the plan actuary; another would be to have the advisory council stipulate the actuarial cost methods and assumptions to be used. The latter prospect raises the specter that hereafter separate valuations may be required for (1) income tax deductions, (2) preparation of financial statements, (3) computation of the reinsurance premium, and (4) internal management purposes.

The provision of the Hartke bill that calls for insurance against asset losses seems to be unnecessary unless it is viewed as part of the rating structure. The basic feature of the bill would have the reinsurance mechanism make good on any default on benefit payments, which by definition would arise out of a deficiency in plan assets. For purposes of the reinsurance arrangement, it should be a matter of indifference that the deficiency was caused or enlarged by losses in asset values. On the other hand, there are two basic sources of loss to the guarantee fund: (1) failure of the employer to pay the necessary monies into the plan and (2) diminution in value of assets already accumulated. Hence, it may be logical to use separate premium rates and measures of potential loss for the two types of risks involved. Some have argued that the second type of risk, namely, the diminution in value of accumulated assets, is the only one that lends itself to a guarantee fund, being analogous to the risk underwritten by the FDIC.

One potentially insoluble problem is that employers would find it less costly to pay premiums on the unfunded accrued liability than to make the payments necessary to fund their accrued liabilities. This could lead to a lower level of funding than that which would take place in the absence of a guarantee fund. If this situation should develop, the federal government might find it necessary to insist upon full funding of prior-service liabilities over some stipulated period of time.

Participation in the program would be voluntary, although it would be a condition to a qualified status under existing tax law. Thus, there would be little inducement for pay-as-you-go plans, which as a class stand in greatest need of a guarantee fund, to participate in the arrangement. Furthermore, an employer who decides to discontinue funding of his pension obligations could withdraw from the program with no penalty to himself but with potentially great loss to the participants. The plans which are the most soundly funded, and have the least need for a guarantee fund, would face the greatest penalty for nonparticipation, namely, loss of deductibility of substantial contributions and the tax-exemption of the plan's investment income. If a guarantee fund were to be established, it would seem that participation should be mandatory for all plans falling within specified categories.

Finally, one might question the propriety of an arrangement under which a continuing firm could discontinue certain operations and slough off onto a guarantee fund the unfunded pension obligations associated with those operations. A strong argument can be made for the proposition that if a firm continues in operation, either as a separate entity or as a part of a more complex corporate structure, such as through a merger, the unfunded accrued liability of its pension plan or plans should continue to be its obligation in the sense that such liability would be assumed by one or more continuing plans with which the firm might be identified. This would mean that the insured event would be defined to embrace only those plan terminations arising out of the final dissolution of the firm, whether by bankruptcy, insolvency, or a voluntary winding-up. In the distribution of the firm's assets, unsatisfied pension claims should be given a priority status equal to that of unpaid wages, possibly with some limitation as to amount. The guarantee fund would then become responsible for the residual amount of unfunded pension benefits. There would be both conceptual and practical problems associated with this approach, but they would be no more formidable than those involved with the present proposal.

Interest of the Accounting Profession

The problem of developing generally acceptable concepts and procedures for reflecting the cost of pensions in corporate accounts and reports has received the attention of the accounting profession for the last twenty-five years, if not longer. The general objective is to achieve continuity and consistency, and, in the minds of some, comparability in the recording and reporting of operating results. There are many facets to the problem, but the basic issues involve (1) the timing of the charges to expense, (2) the measurement of the amount of the periodic charges to expense, (3) disclosure of information about pension costs and liabilities in corporate financial statements, and (4) professional responsibility for determining the amount of periodic charges. Underlying the first three issues is the fundamental question of whether pension costs should be accounted for on a cash or accrual basis. The fourth issue involves the question of the respective roles of the accounting and actuarial professions in determining the appropriateness of pension expense charges.

Various aspects of the broad problem were considered over a period of years by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants, which expressed its preferences in *Accounting Research Bulletins* promulgated in 1948 and 1956. The most recent and comprehensive of these publications was *Accounting Research Bulletin No. 47*, issued in 1956. In this bulletin, the Committee expressed its preference for accrual accounting, stating that "costs based on current and future services should be systematically accrued during the expected period of active service of the covered employees, generally upon the basis of actuarial calculations" and that "costs based on past services should be charged off over some reasonable period, provided the allocation is made on a systematic and rational basis and does not cause distortion of the operating results in any one year." In recognition of the divergent views then existing, however, the Committee modified its position by stating that "as a minimum, the accounts and financial statements should reflect accruals which equal the present worth, actuarially calculated, of pension commitments to employees to the extent that benefit rights have vested in employees, reduced, in the case of the balance sheet, by any accumulated trusteed funds or annuity contracts purchased." The Committee made no recommendation concerning the acceptability of the various actuarial cost methods then in use.

Despite this expressed preference for accrual accounting by the accounting profession, employers, by and large, continued their traditional practice of equating pension costs to amounts paid to a pension fund or applied to the purchase of annuities. This practice permitted wide fluctuation in the amounts charged to pension expense from year to year within a single company, as well as substantial differences in pension costs within a single year among companies with similar plans and employee groups. In view of this situation and the increasing importance of pensions, the Accounting Principles Board (which succeeded the Committee on Accounting Procedure in 1959) authorized a study of pension accounting as part of the newly established research program of the AICPA. Sometime thereafter, the Society of Actuaries appointed a committee to co-operate with the AICPA in the conduct of its study, which would have significant implications to the actuarial profession.

The early stages of this research project were rather unsuccessful and highly disturbing to the actuarial committee monitoring the work. Eventually, Ernest L. Hicks, Partner, Arthur Young and Company, undertook to complete the project, and with the help of a project advisory committee, which included a number of actuaries, he produced a comprehensive set of recommendations, well supported by analysis, published in 1965 as *Accounting Research Study No. 8: Accounting for the Cost of Pension Plans*. Fred Sloat of the Society served as actuarial consultant to Mr. Hicks and subsequently to the Accounting Principles Board, and in my opinion the actuarial profession owes a great debt to Mr. Sloat for the many hours he devoted to the project and the wisdom of his counsel.

In his monograph Mr. Hicks reaffirmed earlier judgments of the accounting profession that pension costs should be charged to expense on an accrual basis. In determining the amount of pension costs to be assigned to various periods of time, Mr. Hicks would accept the cost accruals produced by any of the actuarial cost methods in common use today, excluding terminal funding and pay-as-you-go arrangements, which are not regarded as actuarial cost methods. He rejects the notion that past-service costs need not be taken into expense and recommends that such cost should be charged off systematically over a reasonable period following the inception of the plan. He would regard as reasonable a period no shorter than ten years and no longer than forty years. He would treat cost increments arising out of retroactive benefit increases in the same manner as past-service cost, with the period of amortization extending from the effective date of the amendment. He recommends that actuarial gains and losses be spread over the current year and future years, unless the special circumstances of a case would indicate that spreading is not appropriate. He favors systematic recognition of unrealized appreciation or depreciation of pension fund assets under a formula that minimizes short-term market fluctuations. He thinks that it would be improper to show the unfunded prior-service cost of a pension plan as a liability on the balance sheet of the employer.

On the other hand, the differences between the amounts charged to expense in accordance with his other recommendations and the sums actually paid over to a pension plan should, in his judgment, be reflected in the balance sheet under a caption that makes it clear that the item does not represent a legal liability. If, as may occur in rare instances, participants' vested benefits are guaranteed by the employer, the unfunded present value of such benefits should appear as a liability, possibly with an offsetting deferred charge. Routine pension disclosures should ordinarily not be necessary in the financial statements of companies in which accounting for pension costs conforms with the recommendations of the study, but, if a change in accounting practice affects the comparability of the employer's financial statements from one accounting period to the next, the change and its effect should be disclosed.

Finally, Mr. Hicks commented on the question of responsibility for determining the amounts to be charged to pension expense. He asserted that the corporate executive responsible for the employer's financial statements ordinarily bears the responsibility for the amount of pension cost recorded. The calculation underlying the cost charges should be performed by an actuary whose choice of actuarial cost method and actuarial assumptions should be reviewed by and be acceptable to the executive.

In auditing the financial accounts and statements, the independent public accountant would have the right and responsibility to inquire into the factors underlying the actuary's recommendations, just as he questions other experts on matters pertaining to their specialties. In making his audit, his objective would be to satisfy himself that the actuarial cost method is acceptable for accounting purposes, that the actuarial assumptions, taken together, are reasonable, and that both the actuarial cost method and the assumptions have been applied in a manner acceptable for accounting purposes. In pursuit of this objective, the accountant may examine the actuary's calculations to the extent necessary to confirm his understanding of the procedure followed.

In the months following publication of the Hicks study, the Accounting Principles Board of AICPA considered the recommendations that emerged from the study and sought the views of all interested parties, including the Society of Actuaries' Committee To Study Pension Accounting. In July of this year, the Board circulated a tentative opinion in the form of a so-called Exposure Draft and in November promulgated its final conclusions, which differed in some details from the exposure draft, as "Opinion No. 8."

The Board concurs with most of the conclusions of the Research Study. It endorses the concept of accrual accounting and agrees with Mr. Hicks that any of the actuarial cost methods described in Appendix A of the Opinion should be acceptable when the actuarial assumptions are reasonable and when the methods are applied in conformity with the other elements of the Opinion. The Board also accepts the conclusions of the Research Study concerning the spreading or averaging of actuarial gains and the recognition of unrealized appreciation.

The Board likewise shares Hicks's thinking as to the inclusion of items in the balance sheet. If contributions to the plan are less than the amounts charged to expense, whether attributable to normal cost or prior-service costs, the difference should be shown on the liability side of the balance sheet and described in a manner to make clear that it does not constitute a legal liability. An excess of contributions over expense charges determined under the Opinion should be reflected on the asset side as a deferred charge.

The principal departure from the conclusions of the Research Study relates to the treatment of past-service or prior-service costs. The Board expressed a preference for the Research Study's recommendation that charges to income should reflect the entire cost of benefit payments ultimately to be made to the existing group of participants, but it did make a concession to those who argue that the costs of a pension plan should not be associated with particular employees but should reflect the cost of benefits to be paid to a continuing employee group as a whole.

Adherents to this latter view argue that pension charges should not be required to exceed normal cost plus interest on the unfunded prior-service cost. Thus, the Board concluded that the annual provision for pension cost should not be less than the total of normal cost and an amount equivalent to interest on any unfunded prior-service cost, plus, if necessary, an additional sum calculated in such manner as to ensure the full accrual over a twenty-year period of the costs associated with vested benefits.[20] Alternatively, the aggregate annual provision for pension cost need not be greater than

> the total of (1) normal cost, (2) an amount equivalent to amortization, on a 40-year basis, of the past service cost (unless fully amortized), (3) amounts equivalent to amortization, on a 40-year basis, of the amounts of any increases or decreases in prior service cost arising on amendments of the plan (unless fully amortized) and (4) interest equivalents . . . on the difference between provisions and amounts funded.

The Board concluded that the annual provision for pension cost should not be greater than the total of (1) normal cost, (2) 10 per cent of the past-service cost (until fully amortized), (3) 10 per cent of the amounts of any increase in prior-service cost arising out of an amendment

[20] The Opinion states that "provision for vested benefits should be made if there is an excess of the actuarially computed value of benefits . . . over the total of (1) the pension fund and (2) any balance-sheet pension accruals, less (3) any balance-sheet prepayments or deferred charges, at the end of the year, and such excess is not at least 5 per cent less than the comparable excess at the beginning of the year." In other words, this approach contemplates a minimum annual reduction of 5 per cent in the excess of the actuarial value of vested benefits over the amount computed in the manner described.

of the plan (until fully amortized), and (4) interest equivalents on the difference between pension charges and amounts funded.

The Board recognized that the computation of pension cost for accounting purposes requires the use of actuarial techniques and judgment, and it stated that such cost should generally be determined from a study, made by an actuary, giving effect to the conclusion set forth in the various elements of the Opinion on pension cost accounting. It noted that the actuarial cost methods and their application for accounting purposes may differ from those used for funding purposes.

The Board and the Research Study concluded that the costs of a pension plan being financed on a pay-as-you-go basis should be accounted for in accordance with the same concepts applicable to plans being funded in advance. The Board adopted the view that the pension cost of a defined contribution plan for any particular year should be the contribution applicable to that year, unless the circumstances surrounding the case suggest that the substance of the plan is to provide defined benefits, in which event the principles postulated for defined benefit plans should be applied.

The Board took the position that certain salient information about the pension plan should be disclosed in all financial statements or their notes and suggested the substance of the disclosure. Among the data to be disclosed are the excess, if any, of the actuarially computed value of vested benefits over the total of the pension fund and any balance sheet pension accruals, less any pension prepayments or deferred charges.

This Opinion is to become effective for fiscal periods beginning after December 31, 1966. The burden of justifying departures from Board Opinions must be assumed by those who adopt other practices, and such departures must be disclosed in footnotes to the financial statements or in independent auditors' reports when the effect of the departures on the financial statements is material.

In my judgment, the endorsement of accrual accounting for pension costs by the Accounting Principles Board and the promulgation of rules to determine the amount of these costs are milestones in the development of a sound, socially responsive private pension institution. While the adoption of these principles may only result in the establishment of another set of pension accounting records, with no impact on corporate funding policies, the most beneficial consequence would be for employers to adapt their funding practices to the pattern of cost accruals generated by adherence to the procedures described herein. By recognizing the validity of all commonly used actuarial cost methods and then providing for considerable flexibility in the treatment of unfunded prior-service cost, the accountants have made it possible for the funding and accounting practices to coincide. There is a possibility, of course, that, in conforming accounting and funding practices, the employer may accrue his pension costs at the lowest acceptable level, bringing about a lower degree of funding than that which might otherwise have taken place.

While I could quibble with some of the conclusions of the Accounting Principles Board, I recognize the need for compromise on certain issues to achieve agreement on the fundamental objectives, and I think that both the accounting and actuarial professions are to be congratulated on this significant advance toward rationality in pension accounting and financing.

BENJAMIN T. HOLMES:

At the present moment, the general dimensions of the roles played by public pension plans and private pension plans in the United States and Canada are surprisingly alike, especially since the paths by which the present positions have been reached have been far apart. There are, of course, significant differences.

We have introduced in our recent revisions a major difference in our public pensions. In both our universal uniform pensions and our earnings-related pensions there are to be automatic increases with increasing price levels, and the earnings-related pension is to be automatically increased with increasing general wage levels before retirement.

The relative role of private pensions is also very like that in the United States as outlined by Dan McGill, with the same outstanding growth record in the last twenty years. There is one major difference. Employee contributions are income-tax–exempt. As a result, there is a substantial employee contribution in most Canadian plans.

As in the United States, further substantial increases in the public pensions are already being proposed. In fact, another addition to our pension seems imminent. This leads me to make three brief comments about publicly provided pensions.

1. In spite of widely different histories in our two countries and different approaches toward cost control, there has so far been a steady upward movement in relation to national income. This cannot go on forever. At some stage the cost aspect must carry more weight in the decision-making process.

2. Growth in public pensions beyond a critical point will discourage rather than encourage growth in private pensions or even replace them. A sampling of insured private pension plans during our recent major increase in public pensions showed some 39 per cent of the plans making reductions in future pur-

chases. This was more general in the larger plans, so that some 75 per cent of the employees were affected.

3. A formula automatically increasing public pensions in proportion to increases in wage or price levels seems a mistake to me, although this is what we have done in Canada. It weakens the defenses against inflation in two ways: (*a*) by making widespread saving in the private sector less attractive and (*b*) by removing a moderating influence on the cost-push pressures from those who look only to the government pension for their old age. There are better ways of dealing with the problem.

With regard to the regulation of private pension plans, our income tax in Canada is also administered by our federal government. For many years the contribution of both employers and employees to registered pension plans, up to certain annual sums, has been free of corporation and income tax, while the resulting pensions have been taxable. A closely parallel treatment has been available for the self-employed. Some of the rules for acceptance and registration have been directed against excessive discrimination, but this whole approach to regulation through approval for income tax has not proved too effective.

The effort to regulate pension plans has, therefore, now taken the form of the provinces, led by Ontario, requiring that (if there is to be a private pension plan at all) it must in future conform to certain standards. The proposals for legislation in Ontario were preceded and followed by extensive hearings from all affected parties. Proposals for a central agency to receive portable pension credits and for provision of "reinsurance" or "guarantees" were dropped or shelved during these studies. The result is now in effect as The Pension Benefits Act, 1965, of Ontario (with its regulations) and closely parallels legislation in Quebec and Alberta. Other provinces will follow an almost identical pattern. I am basing my comments on the legislation and the results to date in Ontario.

1. *Adequacy of Pension Commitment*

Vesting of pensions is *required* on three conditions (employee contributions and the pensions that they purchase are also then locked in):

a) The pension is for service after the effective date of the law.
b) The employee is over 45 when he leaves.
c) The employee has ten years of continuous service when he leaves.

A private pension plan is permitted to provide that, where vesting applies, an employee may commute up to 25 per cent of the value of his total vested and locked-in pension.

This final result of the long discussion on vesting in Ontario seems moderate to me. I think that the method by which it was reached is as important as the specifics of the regulation. Those already operating pension plans and affected by it had a large voice in its formulation.

2. *Competent Actuarial Guidance*

As Dan McGill has pointed out, we have been more successful in getting the Canadian Institute of Actuaries incorporated federally than you have been with the Academy in the United States. We were none too soon. For guiding Ontario, I should mention members of this Society—Messrs. Coward, Rudd, Sheppard, and Eckler. The Ontario regulations state simply, "Actuary means a Fellow of the Canadian Institute of Actuaries." We did not meet with serious question of our small profession's need to incorporate federally, but Mr. Humphrys piloted our bill through its critical stages. Originally Ontario contemplated cost certificates every five years, but this period has now been reduced to three.

3. *Realistic Funding Program*

If one accepts the need for some public regulation of pension plan funding, as I do, he is still faced with a series of problems.

The Ontario Act requires adequate funding "in accordance with the tests for solvency prescribed by the regulations." The regulations, in their turn, require the employer to pay into any plan (*a*) all current service costs, including employee contributions; (*b*) any initial unfunded liability by equal annual payments over no more than twenty-five years when the liability existed at the beginning of 1965, dropping to fifteen years when new plans or revisions are made involving unfunded liabilities in 1975 or later; and (*c*) any experience deficiency, in equal annual payments over a term not exceeding five years. While the Act permits the regulations to "prescribe tests and standards for solvency of pension plans," the regulations have thrust this responsibility squarely on the shoulders of the actuary.

When comparing this treatment with the provisions of insurance acts, where objective standards of valuation are prescribed in great detail, the differences in the two situations need to be emphasized, in particular the complete absence in pension plans of the cash surrender and other nonforfeiture options. The deadline for the first cost certificates in Ontario was January 1, 1966. The financial results will be tabulated and published next year but are not yet available. Cost certificates have been furnished on all 9,000 plans registered in Ontario. Perhaps three to four thousand of these will have been types of plan where cost estimates by an actuary would be required to validate the cost certificate. There do not seem to have been any serious problems in connection with the first submission of these certificates.

The wide powers to make changes in the regulations have caused some uneasiness on two points: (1) a trend may develop toward more required complexity in the form of the actuary's cost certificate and in other areas and (2) a trend may develop toward stipulation of valuation bases in the regulations. I share the view that either trend would be regrettable and would only be justified if our profession fails in one or more of its present obligations. These extend to the spirit as well as the letter of the Act.

4. *Effective Safeguards for Pension Plan Assets*

The regulations devote considerable attention to this question. Starting with the types of investment permitted to life insurance companies, they enlarge this in certain directions. Common shares, for instance, may be purchased if the earnings or dividend record complies with the Insurance Act, but the limitation of common shares to 25 per cent of total assets does not apply to pension funds. Loans are prohibited to people closely connected with the business or fund, and no more than 10 per cent of assets may be invested in any single organization other than a diversified investment organization, for example, a mutual fund. Up to 10 per cent of the assets can be in qualifying securities issued by the employer. Five years is allowed to revise asset holdings at the time the Act was passed.

The regulations specify the variety of legal organizations which may administer the funds of the plan. They effectively prevent payment out of the pension plan to an employer, without consent of the supervising commission.

On the question of pension benefit reinsurance or guarantees, as I have said, proposals that might have initiated immediate experiment have been dropped. In my opinion, moves in this direction now would be premature, to say the least. After pension funds have been meeting defined standards long enough to face a variety of economic conditions, and some conception of the losses falling on individual funds under these conditions is obtained, the cost of such guarantees and their effect on fund management might be estimated. It will take some time to raise standards to the point where assets ought to be able to meet liabilities incurred to date, irrespective of the continuance in business of the employer. Even when that stage is met, the guarantee of performance of *all* promises made by *all* such funds will need to be approached with a great deal of caution. In my opinion, an undertaking by a private pension plan to pay past-service pensions in addition to current-service pensions should not be regarded as a liability which is shouldered outright. What we are talking about may reach 25 or 50 per cent of a year's payroll. It is an undertaking to carry out a program over a period of years, contingent on the continued success of the enterprise. The period of years to fully shoulder this liability in Ontario is now twenty-five years and is to reduce in the future to fifteen. This is an ambitious standard. If we rely on the bottomless purse of governments to solve our problem here, then there will be heavy losses followed by transfer of private pensions to public operation.

In summary, while the large recent increase in publicly supplied pensions has led to widespread modification of plans in Canada, the moderate Ontario regulation of plans does not seem to have led to any wholesale abandonment of them. In fact, the number of new plans registered after the effective date of the Act has exceeded the termination of plans by three to one.

WENDELL A. MILLIMAN:

Dan McGill's review of the major policy issues in American private pensions brings into focus the many problems in the political and regulatory area faced by private pension plans in the United States. After listening to this review, one can scarcely doubt, whether or not he agrees that more regulation of private pension plans is desirable, that we will have it. The question is, Will the pattern of this regulation be developed with our advice and participation or over our protests?

If there is to be more legislation and regulation with respect to private pension plans, it appears vital that the various groups concerned with the further development of private pensions should develop plans for affirmative action which will be helpful in guiding and molding such legislation and regulation. Because of his unique competence in the pension field, the actuary should be actively involved in developing such plans. It is heartening to see that the life insurance industry, through ALC-LIAA, has adopted, or is on the verge of adopting, a proposal for affirmative action to help resolve the problems which have given rise to the pressures for increased legislation and regulation in the pension field.

However, the main and more fundamental question raised by Dan McGill is that of the proper division of responsibilities for the provision of retirement income, in our increasingly affluent society, between public and private pension plans.

We have seen over a long period of years a continuous program of expansion of social security benefits. The coincidence of the timing of these liberalizations of social security benefits with national election campaigns suggests that these changes are influenced more by political considerations than by social, financial, or actuarial considerations. There are some who fear that there is danger of this process being carried to a point where the whole system of private pensions, and that of private insurance as well, will be endangered.

The fact is that these private institutions perform an important social function, quite aside from their primary purpose of providing retirement income and life insurance protection. They are major vehicles in this country for the accumulation of capital funds. The economic growth of our country, the continuous and substantial rise in our standard of living, is dependent upon the increased mechanization made possible by such reservoirs of capital.

One of the basic reasons for the establishment of pension plans is the difficulty that the average individual has in systematically accumulating savings during his working years to provide for his retirement needs. Employee social security contributions may look, to the employee, like savings for retirement purposes. The fact of the matter is, of course, that these contributions, or taxes, are part of a system for the current redistribution of purchasing power—a transfer of goods and services from those who produced them to those who are no longer in the labor force. Consequently, the social security system is not a vehicle for savings, and employee social security contributions should not be looked on as having the characteristics of savings.

Part of the contributions to private pension plans may be funds which are redistributed from workers to nonworkers in much the same way as are taxes under social security. For the main part, however, they constitute savings for retirement purposes and become capital funds until recalled to pay retirement benefits.

It seems to me that the pressure which appears to be building up for more vesting of pension rights can be characterized as a desire on the part of employees to have a more direct and identifiable share in this savings process. Conversely, some of the confusion and misunderstanding concerning pension plans results from failure to realize that conditional pension rights may not be backed up by savings, and, even when they are backed up by savings, these savings are not necessarily identifiable on an employee-by-employee basis. All of which leads to the question of the tax treatment given to employee contributions to qualified retirement plans.

If there is any important omission in Dan McGill's enumeration of major policy issues with respect to private pensions, it is the absence of discussion of the question of the extension of tax deferment to employee contributions to pension plans. As Ben Holmes reminds us, in Canada employee contributions to pension plans are exempt from income taxes. While it would not be a panacea, deferment of tax on employee contributions under qualified pension plans, with appropriate provisions for locking in such contributions, would go a long way toward resolving some of the apparent shortcomings of private pension plans.

The fact that the tax laws in the United States encourage noncontributory pension plans and tend to discourage contributory pension plans has increased institutional savings through pension plans and has tended to reduce personal savings. It is, I suggest, unfortunate that the employees on whose behalf pension plans are established do not have a more personal and apparent stake in this savings process. Not until an employee has acquired a vested interest under a pension plan does he have an identifiable interest in the savings which are accumulated under a noncontributory pension plan. Even then his equity is usually defined in terms of deferred income, not in terms of a dollar share in the accumulations of the pension fund.

Employee contributions, on the other hand, do give rise to identifiable and fully vested equities for the individual employees, equities which are expressed in dollars and which are properly considered by the employees as their personal savings for retirement purposes. Employee contributions of even modest proportions, if accumulated over the employee's entire working lifetime, can support rather sizable retirement benefits. If such employee contributions are locked in, there can be no frustration of the pension equities based on these contributions. Furthermore, if employee contributions were locked in, terminating employees who have been covered under contributory plans could not, as they frequently do at present, forfeit the vested benefits created by employer contributions by withdrawing their own contributions. Such a development would further reduce the possibility of frustration of pension equities.

The report of the President's Committee recognized the important contribution which savings through pension funds make to the growth of the economy through financing of business expansion. A strong argument can be made for encouraging systematic savings by individuals through the medium of pension funds. The extension of the same tax deferment to employee contributions as is now given to employer contributions would be the most effective means of providing such encouragement.

This line of argument could, of course, be readily extended to support the proposition that all workers should have an equal opportunity for tax deferment on systematic savings from earnings put aside during their working years to provide for their retirement needs, regardless of whether they are covered by qualified pension plans established through their places of employment. I will not pursue this argument today, but the idea is a logical one which is not without appeal to those who are interested in equity of tax treatment among all taxpayers.

In any event, a return to popularity of contributory pension plans would help to solve other problems with which private pension plans are faced or at least to reduce their magnitude. To mention a few: The problem of integration of benefits under the plan with social security benefits practically disappears under contributory pension plans. If a part of the costs of a pension plan is met by employee contributions, more liberal vesting of employer-financed benefits can be provided without increase in the employer cost. Again, the extension of private pension plans to cover a larger porportion of the total working force, an objective which we all believe to be desirable, should be substantially easier if the costs are shared by the participating employees.

MR. JAMES L. CLARE: I echo the thoughts of Mr. Milliman. There is a question of whether we have a future for private pension plans. I am not alone in questioning this. There are a number of other actuaries at the beginning of their careers who are quite sure that social security can operate in its place and that private pension plans can go on from strength to strength—provided affirmative projects of the sort Mr. Milliman referred to are carried out.

Dr. McGill put his finger on the key to the pension "reinsurance" issue, I think, when he said that the trouble with some terminating pension plans is (*a*) that they have larger liabilities than assets, therefore (*b*) somebody goes without.

I do not accept, however, the analogy of the savings and loan association guarantees. It seems to me that, in a savings and loan association, you may have a $10,000 liability, but you also have a $10,000 asset, so you have things in balance from the start. Pensions are different. Consider a company with no pension plan on December 31, which has, on January 1, a pension plan with past service. The most that it will have as assets on January 1 will be one month's future-service contributions and one month's past-service amortization. So it goes from having no assets to a little assets. To suddenly take on a great amount of liabilities is obviously the root cause of being unable to meet all pension promises. The promises are made too fast and too soon.

Mr. Fitzhugh made a remark in his Presidential Address which struck me as being most significant. He said that actuaries have a responsibility not just in funding assumptions and solvency calculations but also in the design of the benefit liabilities which are going to be promised by the available assets. Mr. Holmes mentioned that the actuary's function under provincial legislation in Canada is restricted to funding and cost certificates. Therefore, consultants without actuarial qualifications can design benefits. However, I think it is up to us—as actuaries—to show what the possibilities for design are. It is for us to illustrate these so that other people appreciate more fully the choices open to them.

We, as actuaries, realize that there are limits on costs. Employers cannot put in unlimited money. At the same time, if private pensions are to survive indefinitely, the benefits must be adequate.

Retirement at age 65 is not, in my opinion, always an essential part of adequacy. To suddenly throw in age 65 retirement, resulting in all the unfunded gap caused thereby, is not necessary. It is up to us as actuaries to show that you can have both (*a*) low-cost adequate benefits and (*b*) full funding, if you start with a high retirement age and bring it down as you go along, so that at the end of what would have been your full funding period you have the ultimately desired retirement age.

That is only one way of doing things. There is another alternative. Private pension plans may be set up in the traditional way, with reasonable costs and adequate benefits and without insisting on full funding at all times. Then the plan can move toward full funding—in the Ontario-Quebec fashion or something similar. But on termination you could always have full funding, not by reducing the benefits but by adjusting the age of retirement at the time of termination.

MR. FREDERICK P. SLOAT: I will give you a brief résumé of the status of the "Opinion on Accounting for the Cost of Pensions." The Accounting Principles Board received over 250 letters from employers, actuaries, and others and gave considerable thought and study to them. Obviously, since the letters expressed opinions on each side of the question, the Board could not comply with all of them.

The Accounting Principles Board met for three days the week before last and reached final decisions on what will be included in the Opinion. This left some further work for drafting, to make sure that it says what the Board decided. It is now in final form, and a ballot draft is out to the members of the Board for their vote; there is no indication of a lack of concurrence. This is expected next week and should conclude the initiation of this project with the issuance of the Opinion.

The Research Study, done by Ernest L. Hicks of Arthur Young and Company, provided the background material. The drafting of the Opinion itself was headed by Julius W. Phoenix, Jr., a partner of Haskins and Sells. Mr. Hicks participated in the final stages of the drafting.

It is the intention of the Board to issue a companion article soon after the issuance of the Opinion to give the background and reasons for various things that are included and to make the Opinion more readily understandable.

The exposure draft gave an effective date of December 31, 1966, and that will stand. This means that it will be applicable to fiscal years beginning after that date, so the first fiscal year involved for any company would be the fiscal year 1967. For those whose fiscal years begin other than January 1, it would be the fiscal year beginning after that time.

There are several matters of particular interest to actuaries. I will read a couple of sentences from paragraph 7.

> The computation of pension cost for accounting purposes requires the use of actuarial techniques and judgment. Generally pension cost should be determined from a study by an actuary, giving effect to the conclusions set forth in this Opinion.

The Opinion will also include, in the Glossary, this statement:

> There are no statutory qualifications required for actuaries. Membership in the American Academy of Actuaries, a comprehensive organization of the profession in the United States, is generally considered to be acceptable evidence of professional qualification.

Thus, while it could not refer exclusively to the Academy, it will enable an accountant to know that he can look to a member of the Academy as being one who would be properly qualified.

It is also the intention of the Board that the actuarial cost methods and assumptions, as well as the application of them, will be in the province of the actuary. But, as you know, when the accountants issue an audit opinion with respect to a company, they feel that they must satisfy themselves that various things have been taken into account (if they are actuarial, that they have been taken into account by the actuary; if they are legal, by counsel; if they are engineering, by engineers).

It is of particular interest to pension actuaries that, in the minimum specified in the Opinion, the twenty-year projection that was in the exposure draft has been dropped. The Board recognized that it would be rather onerous and time-consuming. They have, however, put in its place another minimum based on a current vesting test. In lieu of the twenty-year test, it applies a 5 per cent test to each year. If the excess of the value of vested benefits over the amount on hand drops at least 5 per cent during the year, then normal cost plus interest is a sufficient minimum. If the excess does not drop 5 per cent, it is necessary to add to normal cost and interest the amount to build it up to 5 per cent or the full 5 per cent if it has increased. There is also an alternate whereby the minimum is the lesser of normal cost and interest plus such "5 per cent" or normal cost plus a forty-year amortization of past-service cost. Thus, this recognizes that a forty-year amortization of past service would always be within the minimum limit.

This difference between the actuarial value of vested benefits and the amount in the fund, plus any accounting accruals not funded, is an item that will be included in the disclosure. So it would appear that such a figure would need to be compiled in each case, even though a company is not using minimum accrual. The maximum accrual is normal cost plus 10 per cent, as in the exposure draft.

It is not intended that there can be a year-by-year fluctuation within the minimum and maximum amounts. The basis determined should be used consistently from year to year. If there is a change in any year in the actuarial assumptions or methods, it will constitute a change in accounting or facts which would be included in items to be disclosed, but this would not qualify the audit opinion. If, of course, the pension cost does not come up to what is called for in the Opinion, then the audit opinion may have to be a qualified one.

Provisions have been inserted for individual policy plans to recognize some of the special situations there, such as that the premiums and the dividends under that type of plan give sufficient recognition to a spread of gains so that no further spread of the dividends would be required. Gains from terminations will need to be spread within the ten- to twenty-year period specified in the Opinion. There are some other special references to individual policy plans which will be of interest. These provisions apply only to a plan which uses them exclusively or to a plan which uses allocated group annuity exclusively.

One thing which is important is materiality. In many cases, companies will be able to continue doing as they have been doing because the difference between that and what might be called for by the specifics of the Opinion would not be deemed to be material. Materiality is not intended in relation to pension cost but in relation to the employing company's net income and to other matters affecting it. Materiality is in the province of the accountant to determine.

The disclosure paragraph has been adjusted from that in the exposure draft by dropping out the need for showing unamortized past service. This gave considerable concern to actuaries because it can vary widely, depending upon the actuarial cost method in use and the actuarial assumptions. Thus, a bare figure of unamortized past service is completely meaningless, but it might be used by many as if it did have a significance. In its place is the disclosure of the excess of the value of vested benefits over amounts funded or accrued, as described above.

The Opinion will call for recognition of unrealized appreciation and depreciation on a spread or averaged basis, preferably by using one of the methods in use for taking account of average annual appreciation.

This refers to appreciation and depreciation of assets which belong to a pension plan. Under most plans funded with insurance companies, the assets of the insurance company do not attach to the pension plan except as specifically recognized under the terms of a particular contract. Thus, unrealized appreciation and depreciation of insurance company assets would usually not have to be taken into account.

The Opinion specifies that costs should be determined with respect to all employees who may be expected to receive benefits under the plan without regard to eligibility provisions of a plan. This is from the accounting concept that pension cost arises throughout an employee's service and not just within that part of his service which may be used in applying the formula of benefits to be payable thereunder. The inclusion of employees of short service or relatively young age, whether or not determined by plan eligibility requirements, would in many instances not have a material effect when realistic turnover rates are taken into account. The impact of omitting such employees will be a question of materiality, which is discussed above.

The Opinion is strictly in terms of cost to be charged to expense and not in terms of the amount funded for a year. While it is likely that funding and the cost accruals will match, this is not necessary. Actuarial computations of pension cost are based on the assumption that the amounts recognized as cost will earn investment income thereafter. Therefore, where amounts recognized as cost are not funded, it is necessary to make up for the investment income which will not be so forthcoming between the time that the amounts are accrued and the time that they are funded. This interest makeup is referred to as interest equivalent and is taken into account as an adjustment of pension cost throughout the Opinion.

MR. DAVID YANIS: Mr. Milliman and others have suggested a positive program with respect to areas in the pension field in which the government is interested. I fully concur with them.

References have also been made to the fact that the Accounting Principles Board has taken a position on pension funding. At the session on "Actuarial Principles and Practices in Relation to Private Pension Plans," the issue was raised as to whether the Society should also take a position on generally acceptable actuarial practices in the private pension field.

I was disturbed to hear several actuaries express the opinion that it was all right to prepare a textbook on this subject but not to prepare a handbook containing recommendations as to what generally accepted actuarial principles are. In my opinion, this kind of thinking will lead to a weakening of the actuarial profession. If we cannot agree on what acceptable actuarial principles are, some other organization will step in and fill the vacuum. I am gratified to hear that the Society is attempting to provide machinery by which the actuarial profession can express its opinion collectively.

MR. J. DARRISON SILLESKY: Dr. McGill proceeds from the basic premise that private pension plans should be evaluated in terms of broad social purposes as well as in terms of their direct contributions to private-business objectives. Dr. McGill has mentioned that he has encountered some persons who take strong positions to the effect that, since private pension plans are established primarily for business reasons, further governmental regulation should not be based on the extent to which such plans carry out social purposes. I feel that the truth lies somewhere in the middle ground and that there are at least two closely related reasons for a modest amount of additional governmental regulation at this time.

Our Society is accustomed to the basic principle that, when a person enters upon a purely voluntary course of action, he is nevertheless required to exercise reasonable care in its performance. This applies to establishment of a private pension plan.

Also, in the case of pension plans, the employee and his employer or union, as the case may be, are not truly equals. One party is too greatly dependent on the other to allow the relationship to be treated as a normal contract subject to normal remedies for deficiencies in performance. Further, the financial impact of the loss of individual pension rights may well be catastrophic to the individual, whereas the corresponding impact on the employer or union might be relatively inconsequential. Under such circumstances, any evidence of shortcomings in the voluntary handling of this relationship will necessarily call for the creation of authority and responsibility for corrective action by governmental bodies.

Dr. McGill indicates that there is a growing interest in this entire area at both the Cabinet and congressional levels in Washington. This is an area in which I am sure that, had time permitted, he could have expanded his paper by many pages.

Mr. Milliman pointed to the need to develop plans for affirmative action which will be helpful in guiding and molding the pressures for increased legislation and regulation in the pension field. Obviously, if we assume a constructive attitude, we may be able to channel and control forces which might otherwise shatter the delicate structure of the private pension movement. If we ourselves identify and pinpoint the precise areas in which regulation could be effective, we may avoid broad-gauge approaches that threaten to sweep in vast areas where there appears to be no evidence of weaknesses.

In identifying the problem areas and designing solutions, we face a situation which is different from that which actuaries encounter in many of their day-to-day activities. Our proposed solutions must be acceptable to the world of politics as well as the world of business. Therefore, suggestions must be weighed not only in terms of technical considerations but also in terms of attractiveness to the voting public. In short, answers are only valuable if they are politically viable.

MR. DORRANCE C. BRONSON: Dr. McGill, presenting credentials via a lengthy paper as well as by way of a reputation as an astute scholar and author of the United States pension scene (private and public), was a "natural" to strike the opening gong for our curriculum in this graduate school's pension-orientation course. That is, this curriculum is adumbrated by Dr. McGill's paper and was supplemented orally by him this morning with certain emphases, nuances, and caveats. This all adds up, in my opinion, to an excellent portrayal by Dr. McGill of the numerous simultaneous performances, with varied *mise en scène*, respectively, now playing, just closed for the season, or about to open.

A large canvas is required to depict these several pension activities wherein our human brethren (friend or foe) join in a gamut of roles, aimed at alleged objectives which, likewise, have a wide gamut of purpose in the aggregate. The simile suggested above, involving brush, paint, and canvas, in respect to Dan's paper, leads one to a realization of (1) the magnitude—the very count of projects comprehended in the paper; (2) the number of people engaged thereunder; (3) the numerous unrelated, as well as overlapping, efforts; (4) some very clever acting; (5) a relatively high proportion of wise men, an equal complement of mediocrity, and certain participants that one or more of us would label clowns or dub fools—but whatever the characterization, and whether true or false—the whole of this motley group has a common denominator, namely, as being human beings.

Dr. McGill gives predictions of private pension funds reaching $200 billion by 1980, but no source is given for the figure. It probably came from D. M. Holland's National Bureau of Economic Research study (just published in hardback as *Private Pension Funds: Projected Growth*).[1] The study is not new to me, as I am on the National Bureau's Advisory Committee on Pension Studies. The projection wherein Dr. McGill's 1980

[1] Distributed by Columbia University Press.

figure lies is one of many in the printed study (and many more are available as worksheets). These differ, one from another, by reason of different sets of assumptions considered. For example, in the book cited the lowest figure for 1980 is $93 billion, the highest, $225 billion; the latter is some 240 per cent of the former—a wide range.

Without finding time for a proper analysis, I have long felt that the upper projections (which include Dr. McGill's choice) go too high because of understated elements in the projections: (1) too low a growth of pension outgo; (2) likelihood of companies to temper contributions short of a fully funded status; (3) lowering of benefit formulas (and, hence, contributions) from successive benefit raises in OASDI (to say nothing of the sudden drastic contribution drop if there is actually an implementation of IRS Announcement 66-58);[2] and (4) earlier retirement and more liberal options, with also more maximized service benefits appearing as more and more attain a full complement of service years under the plan. The increased outgo or reduced income from causes such as those above could, I feel, reduce the growth of the upper-level category of projections quite substantially.

Dr. McGill has presented a catalogue of important happenings in pensions over the last few years. The only point that seems omitted here (although he covers it adequately later) is mention of the need for, and efforts of, the United States actuaries to obtain legal recognition. To this end, and as a start, the American Academy of Actuaries (Illinois) has been incorporated.

Dr. McGill states that "general agreement" exists for characterizing the benefits (cash and service) of the over-all program of OASDHI as constituting a "floor of protection." I have noticed that the once-frequent use—in and out of government—of this term has, through sublimation or some more studied means, largely disappeared from page or platform. For example, in reviewing the last Report of the Advisory Council on Social Security, I commented that (and the subsequent 1965 Amendments have speeded the desuetude) ". . . the retirement benefits of OASI were characterized, and had been for years, as a 'floor of protection.' Lately, one hears this term less frequently; for example, it may be quite significant that neither it, nor a synonym, is found in the present Report" (*TSA*, XVII, 116). However, I am glad to see Dr. McGill holding to the "floor" concept.

The author opines that the most critical issue for OASDI lies in the potential of "indexed benefits." He does not dwell on method, that is, the numerous techniques for "variability," such as by linking benefits to

[2] Further reference to this Announcement will be made later in this discussion.

the consumer's price index (CPI) or by using a "standard of living" correlation. Regretfully I admit the present-day rationale and the importance of indexed benefits (e.g., the Civil Service Retirement system has, for the first time since the feature was enacted in 1962, found that a 3 per cent CPI increase had, cumulatively, been reached; hence, increased benefits will soon commence for the retired rolls, although no specific funding provision exists in the Act to meet these increases). Considering, however, (*a*) the pension occurrences enumerated early in Dr. McGill's paper, (*b*) a mental count of new ones since he wrote the paper, and (*c*) the recent publicity on benefit escalation, it is my considered opinion that the already-existing holes in the federal financing dike, plus the relatively large number shaping up for much greater amounts of federal subvention, direct or indirect, all *out of general revenue* (whether or not bearing the euphemism "contributions"), make this struggle between the funding principles of the past and the drastic changes threatened for the future the real bête noire to take first place as "the most critical issue" in OASDHI at the present time.

Dr. McGill touches upon the nature of social security–matched contributions (i.e., FICA payroll taxes). He points out that certain economic writers or lecturers have assigned to these taxes a highly "regressive" coloration; to this he registers emphatic opposition by reason of the benefits heavily favoring the lower-paid, which is obvious from the formula. The views of professed economists, I have noted, jump all over the lot, with no discernible agreement, or even majority, on this subject. There must be a considerable bibliography on it after some thirty years, but, without research and analysis, I will not attempt either a history or a score sheet. I will but name a few sources here and in the succeeding paragraph. A particularly interesting memorandum was recently prepared by R. J. Myers, F.S.A., in which he defends the benefit formula of OASDI, sweetened, as it is, for the lower ranges of pay in such a manner that he finds the net effect is to yield nonregressive taxes (this conflicts with the asseverations of certain economists who would appear to be wearing blinders against the light of the benefit formula). One interesting case of seemingly intended blinders is found in the President's Committee report (January, 1965) where, for the first time, the employer's contributions (taxes) are deemed to be of equal weight with the employee's, irrespective of the latter's proximity to retirement. This sudden reorientation without supporting demonstration threatens to raise all kinds of upsets in established pension plans, including dismay by employees at seeing their benefit expectations suddenly curtailed. These drastic changes derive from the "integration" requirements of IRS, now proposed to be amended (particularly since no substituting "grandfather's clause" is being offered).

The woods are full of economists (and not just this year's woods but forests primeval, stemming from 1935) who have made studies seeking to prove that these taxes fall in a certain way on some certain party or parties or who, without specific research, have stated their opinions as to how these taxes are allocable in respect of the applicable parties.

For instance, Margaret S. Gordon, associate director of the Institute of Industrial Relations of the University of California, seems inclined to agree with the compensatory benefit concept described earlier.[3] A distinctly "blindered" position seems to be that taken by Joseph A. Pechman, director of economic studies at the Brookings Institution (Washington, D.C.), who, just recently, under the aegis of Brookings, issued a rather comprehensive volume entitled *Federal Tax Policy.* Chapter vii is on "Payroll Taxes" and includes consideration of those applying to the cash benefits programs of social security. It reaches its conclusion with but one slight, unweighted passing mention of benefits arranged in favor of the lower-paid.

In short, Pechman finds regressive taxation rampant throughout the system and cries for rectification and, beyond that, calls for the erasure of all pay ceilings in the determination of the tax side of the program. It would appear that he makes no pretense of fairly comparing payroll taxes but, "Excelsior," rides on, carrying the "strange device" (under our democratic precepts up to now) which reads, "Taxation, steeply progressive at every turn." Upon closing the chapter, he offers, rather gratuitously it seemed to me, an anticlimactic punch line reading, "In the long run, both the employer and employee payroll taxes are probably paid by the workers" (implicitly censuring both consumers and owners).

Well, as I said above, over the years there have been economists by the gross, including obvious crackpots as well as, in the main, serious students seeking truth. Yet, from out of it all—through reading their opinions for some thirty years—I fail to recall any rigorous and conclusive demonstration as to who pays what and when, under the FICA, in connection with OASDI (ignoring, for now at least, the new ingredients under TSI,[4] HI, and SMI).

Dr. McGill briefly describes a suggestion of the commissioner of social security which, from the description of it in his paper, would result in the

[3] *The Economics of Welfare Policies* (New York: Columbia University Press, 1963; sponsored by the Ford Foundation), pp. 68–69.

[4] Temporary sickness insurance, by reason of the relaxed definition of disability for benefit qualification.

magic of increasing the OASDI cash benefits by 50 per cent without costing anyone a nickel of increase in payroll tax. This legerdemain would appear to be accomplished by imputing to this OASDI system, which is funded approximately on a pay-as-you-go basis, such qualities of an actuarially valued private pension plan as to bring out the actuary's amount of the unfunded accrued liability resulting from such valuation. The implied purpose for social security is that, having labored and brought forth an analogous mountain, if annual interest thereon is only forthcoming via the painless route of "general revenue," then the *raison d'être* of the "interest" payment, namely, to keep the unfunded liability from increasing, can be cast aside and thus release this "interest" for translation into higher benefits, referred to in the paper as 50 per cent higher (a release of something not being paid anyway!).

One wonders whether there is any need to worry that such a 50 per cent benefit increase would cause, in turn, somewhat more than a 50 per cent increase in the discarded unfunded accrued liability. The "interest" payment has disappeared, through benefits, in respect of the original 100 per cent unfunded liability; in short, something alluded to as "interest" was paid or accrued, but the concept that such "payment" would actually be applied as "interest," under the methods used in private plans, was wholly fictitious, it seems to me. In any event, a "new round" on the same fictitious basis would be possible: just get appropriate interest, again, out of general revenue computed on the fresh 50 per cent increase in unfunded liability; if this second amount of "interest" is applied to the first round's 150 per cent benefit, this benefit could be increased some 15 per cent to become nearly 175 per cent of the original benefit! And so on, ad infinitum.

The above are the thoughts on this proposal which I envision from Dr. McGill's description. When you turn from the paper to the June, 1966, *Social Security Bulletin*, wherein Mr. Ball touches on a miscellany of topics concerning that Act under his article "Policy Issues in Social Security," you find, under the heading of "General Revenue Contribution," that a rather peculiar actuarial mixture intertwined with the above has been used by Mr. Ball to rationalize the first 50 per cent increase in benefits. You will find that there is more to Mr. Ball's actuarial devolutions than the alleged "interest" payment on some "unfunded accrued liability," although he does say (and here I must admit to being more confused than ever) that a government contribution would be "in lieu of interest that would have been available from full reserve financing." This strikes me as a contradiction in terms, since interest available for full reserve financing is unavailable for anything else or you no longer have "full reserve financing."

Next, Mr. Ball comes forward with an offer of an alternative actuarial funding method to meet the 50 per cent benefit increase. This funding of the new 50 per cent layer would, by his continued thesis, apparently be satisfied "if general revenues were to take care of [meaning of "take care of" not explained] the entire one-third attributed to accrued liability." If this were done, then we would have "one-half again as much money [in hand, or in what form?] as at present . . . available for program improvements."

The first paragraph of the author's discussion on the subject of "Public Interest in Private Pensions" impresses me with the strong and pervasive interest which the federal government is claimed to have in the "private pension mechanism." The paper then goes on to expand this by reciting the areas in which, so far, this pervasive interest has been felt; for example, plans are an important source of private savings, they play a role in the financial market, they influence efficiency of manpower utilization and, certainly not to be left out, they play their part in supplementing OASDI after retirement. Dr. McGill, in a similar vein of listing encomiums from the Report to extol the private pension institution, characterizes the President's Committee (January, 1965) as issuing the most comprehensive statement of the public interest in private pensions plans and in their continuation and, indeed, endorses a continued public policy to encourage the sound growth of this private segment, through tax incentives and appropriate legal protection. The Committee Report set out certain suggestions for further study to strengthen, in its view, private pension plans to fulfill their social objectives. These suggestions, as subsequent paragraphs of the paper show, include tentative proposals for mandatory funding periods or, again, for mandatory vested benefits after a reasonable service period. (Actually, both of these are pretty well-traveled routes already, without the indicated mandate.)

Private pensions, in spite of cloying praises and recent encouragements from the White House level down, have proceeded—with extra stimuli of events over the last decade or so—on their long-standing normal course of initiative, experimentation, savings, supplementation of OASDI, and so forth. It was a sudden, rude awakening on September 19, 1966, to grasp, what their composite mind could hardly conceive, the dismaying import of what one read. A news flash was there, in IRB No. 1966-38, which, in effect, said:

To Whom It May Concern: This IRS Announcement 66–58 gives fair warning that studies will go forward on regulations placing all private pension plans, which *already* or henceforward have benefit formulas or conditions which "integrated" with social security under prior regulations, into a position whereby such "integration" must conform to the aforesaid new regulations. These new requirements will be designed to assure, in all usual cases, that employee benefit expectations involving pay above the social security ceiling—whether such expectations are of twenty years' standing, newly set up, or only planned for the future—shall be reduced in more or less substantial degree (or, alternatively, that benefit levels, and hence the costs, for the lower-paid be raised to absurdly high levels relative to pay). The new restrictive benefit rules—without any precedential "grandfather's clause"—would take effect, retroactively if possible, in order that the IRS can decide that any given pension plan is of an approved and qualified type, such that employer contributions will be tax deductible, investment income to funds of either insured or trust fund types will not be subject to income tax, and omission of penalty tax on employees would be granted to those terminating with nonforfeitable rights and benefits.

It is just this peculiar, unexplainable juxtaposition of the above-threatened dictatorial legislation by department and all the earlier praises and encouragements given private pension plans that has upset the whole fabric of the private pension institution since the now-famous, or heinous, appearance of Announcement 66-58. As this is being written, the tail-end comments are flowing in to IRS to meet their November 30, 1966, deadline for "speaking your piece" on the Announcement (although it seems impossible to me that they could clear a matter of such importance without scheduling open hearings also).

My discussion here will turn to an important topic, namely, "Adequacy of Benefit Commitment." The particular point of adequacy on which I wish to comment deals with the principles and practice of "vesting" or of "vested benefit," the latter being a more specific term in respect of definition and discussion. Dr. McGill describes the President's Committee viewpoint in this area and then goes on to present what he deems to be the three principal arguments in favor of vesting or vested benefits. The most compelling argument in his opinion is one that falls within the natural context of my discussion taken up in a later paragraph. The observation, however, that I would like to underscore now may be summed up by inventing this quotation:

> Everyone is talking about vesting, but seldom does it happen that even the two participants of a colloquy on the matter have in their respective minds (if, indeed, either one has *any* particular delimited concept in mind at all) precisely the same specifications for the term they are discussing, that is, as to what it really means and encompasses within a mutually similar lexicon.

In other words, I have been struck more by the differences of definition and concept from person to person than by any similarities. Space and time do not permit me to develop these dichotomies in the form of the longer dissertation that could be written up. But, from my collection of imprecise, incomplete, or erroneous descriptions of vesting, let me pick one to illustrate the usual sort of imprecision or incompleteness.

A convenient sample is from an interesting paper presented earlier at this Miami meeting—"Cost of Vesting in Pensions," by W. F. Marples. An alleged "pension plan parlance" definition is given by Bill Marples (with a second one closer to the views of "law"). The "pension" one reads (with italics and reference numbers inserted by me) as follows:

> A vested benefit in *pension plan parlance* [1] is a *benefit* [2] to which *an employee* [3] has a right, *contingent upon survival* [4], but *unaffected* [5] by his work history subsequent to his acquiring the right.

Taking up the reference numbers briefly, reference 1 draws forth my comment that there is no uniform pension plan parlance in existence. For instance, consider Jim Hamilton and me, in describing vesting on page 34 of our book, *Pensions*.[5] We were using what, we tacitly supposed, was "pension plan parlance," but our result (with its own imprecisions)[6] does not resemble the above or anyone else's statement on the matter. Reference 2 indicates that answers are omitted on two questions, namely, What amount of benefit? and When is it due? The purpose of reference 3 is to point out that, in practically every plan, it is only *certain* employees that attain a "vested position." Reference 4 is for flagging the omission of other contingencies, the principal one being whether the fund, or applicable contract allocation, will have the capacity to meet the vested benefit when Bill's contingency of "survival" has been surmounted. Finally, reference 5 is for pointing out that in some plans a benefit can be reduced, suspended, or forfeited when the "vested" ex-employee gets into pursuits inimical to the previous employer's interests. This ends my notes for the above quotation. I am sure that Bill Marples was aware of imprecisions and incompleteness in his wording, though certainly unaware that he was giving me a handy current example for use here. I am also sure that Bill will not object to my use of it, and, of course, for his unintended help I thank him heartily.

The point is that generalized discussions of vesting or proposals for mandatory vesting, such as those recommended in the President's Report

[5] James A. Hamilton and Dorrance C. Bronson, *Pensions* (New York: McGraw-Hill Book Company, 1958).

[6] To even the score, I will inform the readers (who may include Dan McGill) that my collection of imprecisions and incompletenesses includes the definition of vesting that was promulgated by Dr. McGill's Committee on Pension and Profit-sharing Terminology.

(and obviously favored by Dan's paper), are one thing; but the sort of vesting concepts actually in mind, the ideas held, if any, on how they would operate, and considerations on their suitability for becoming required IRS provisions of the plan are quite another matter.

There are several arguments of long standing in favor of vested benefits as a desirable feature of the modern private pension plan. The type of plan that Dr. McGill views as presenting the most potent argument for vested benefits is the plan that considers such benefits (and, in his view, I infer, the more liberal the vesting, the better) as demonstrating the plan's "broad social objectives." These quoted words appear, in one form or another, a number of times in Dr. McGill's paper; for example, a few lines below this quoted phrase, we find "fulfill their social function." From phrases of this kind, plus other frank indicia of direction revealed in the paper, one may opine that the author's belief and conviction is that United States private pension plans have, whether or not admitted by their administrators, a moral allegiance toward more adherence by its members (employers mostly) to the banner of "Broad Social Objectives" than to managerial slogans such as "Efficiency and Active Economic Competition." Certainly each one of us still has the right to formulate, hold, and defend his own beliefs, as well as the right to disagree with and argue fairly about, the beliefs of others.

As for my views, briefly, they are to the effect that the greater the number of adherents that rally under Dr. McGill's banner, "Broad Social Objectives," the smaller grows the adjective "private" regarding pension plans. Any considerable growth in the group of such adherents, augmented by the more pervasive governmental regulations now threatened, will more and more cause the word "private" to react as if Alice in Wonderland were feeding it pieces of the Caterpillar's mushroom, which caused the eater thereof constantly to shrink in size, even to Alice's fear, disappearing altogether.[7] I personally do not feel that our private pension plan institution has, from inside or outside forces, been so transformed to date that the traditionally greater weight of its managerial prerogatives

[7] This disappearance act is a figment neither of Alice's imagination nor of mine. The possibilities thereof are presently discussion points on Capitol Hill. For example, I refer any Doubting Thomas to a congressional *Joint Committee Print* on "Old Age Income Assurance," prepared by the staff of the Joint Economic Committee and released in November, 1966. Just to furnish the glance that I have the space for, section 3 thereof itemizes the ways by which private plans can be manipulated by the federal government or "crushed," and section 3.4 touches on the "levelling" of plans by enforced "merger," e.g., "To be fully successful, . . . would require that all plans merge into one and this plan have universal coverage."

has suddenly been superseded so that its greater weight now derives from its function as a social instrument.

Dr. McGill sets out certain duties of the plan's actuary, as the President's Report proposes, with the actuary having "acceptable professional qualifications." As of valuation dates at minimum intervals, he would certify that his applicable valuation results met "certain prescribed standards" using "actuarial cost methods and actuarial assumptions that are reasonable." It is not clear what degree of freedom is envisioned by Dr. McGill for the plan's actuary; and reference to the President's Committee Report beclouds the question further, because, for one thing, the Committee itself—it is possible to infer—might get into the act. Both the Report and Dr. McGill's paper appear to agree, however, that whatever the actuary's freedom otherwise, it would be circumscribed through the Report's three proposals: first, that IRS[8] come onto the stage to review the work of the plan's actuary; second, that such review be based on "guidelines and ranges of standards with respect to actuarial assumptions" as to which bases for standards "a public advisory body of actuaries[9] and other interested parties"[10] would have already "guidelined" IRS into using for such review; and, third, that "concurrent with actuarial certification," a "professionally qualified public accountant"[11] would dash onto the stage and madly scrabble through the whole portfolio (very large, in many cases) or cope, somehow, with unallocated assets (except for specific allocations under "separate accounts") in respect of plans using insurance companies. If this accountant's duty will be to value each applicable security, whether by stated bases or by esoteric methods, it seems to me that, unless he starts far in advance, he will need to be a "mental EDP Ponzi" to complete the full asset valuation (if that is his job) coterminously with the actuary's valuation of the gross liabilities.

[8] Would this not put IRS into actual or alleged "conflict of interest" positions, since the Committee wants to *scale up* funding level while IRS wants to *keep down* the size of deductible contributions?

[9] What happens when the pension plans of these actuaries, respectively, are up for review? Does this bring about any conflict-of-interest situation?

[10] Those administering qualified plans, including the pension actuary as well as the principals to the plans and funding media (i.e., employers, unions, trustees, insurance companies, etc.), would have liked to know the sort of composition of the "other interested parties" that the Committee had in mind. This, I feel, is an unfortunate omission.

[11] Welcomed with open arms by insurance companies and trust companies or by natural person trustees! What is he looking for—book values, market values, "compound interest" values, yields, proportional investments, physical existence (with tally), or what?

The proposed program, as outlined in Dr. McGill's paper and as supplemented with questions in my preceding paragraph, will bring onto the stage several characters not heretofore in the act—the IRS, wearing its second hat; potentially (if awkward questions or arguments arise), the IRS's advisory body, mentioned above; the accountant, to do whatever it is he is supposed to do about assets; and possibly, on occasion, a representative of the President's Committee, which authored the performance to begin with. I suppose the employer or the pension fund would be expected to pay for much of this, which, obviously, would multiply complexity and, I think, cause great delay. I refer to complexities and delays compared with the heretofore straightforward jobs of conducting and certifying to the valuation, with an accompanying report, on the part of the plan's actuary and the furnishing of tabular displays of asset amounts for the plan (determined by whatever regular method has been followed for the valuation of assets) on the part of the plan's trustee or insurance company.

The asset amounts are used, *inter alia*, by the actuary in obtaining the unfunded liabilities of the plan. Complexity and delay are, in turn, indicative of substantial increases in workloads for those involved. For example, would IRS be equipped to take on the review job for the tens of thousands of pension plans in force, including that of meeting each desirable timetable for clearance of a plan's valuation? And would the plan actuaries, the trustees, insurance companies, employer counsel, and so forth, have the latitude, without shortchanging other clients or work, to run attendance on the plan reviewers and on the "asset man" while he is doing whatever it is he does? In fact, are there enough "asset men," professionally qualified public accountants, to man the duties that would be expected of them (duties concerning *assets*, which, incidentally, would apparently neither be supervised nor subject to the sort of review proposed in respect of *liabilities*, i.e., via IRS as to the work of the plan's actuary)?

On the dubious assumption that the above program has had mature analysis and, as so analyzed, is as described in Dr. McGill's paper (and back of that, in the President's Report), I will conclude my discussion of it, subject, however, to this personal comment from appraising the proposal as described in those two sources. It seems to call for considerable effort on the part of many, for multiplied increase in time, and for correlative additional expense, all to cure an alleged funding malady which no one has diagnosed or demonstrated as having either meaningful or contagious existence.

We should have no quarrel, certainly, with the President's Committee's proposal, as described in Dr. McGill's paper, that funding certifications be the responsibility of an "actuary with acceptable professional qualifications." It is the general hope, I believe, that such qualifications may be deemed acceptable on evidence that the applicable actuarial person is a member in good standing of the American Academy of Actuaries (now chartered in Illinois, with activity under way for as rapid a spread as possible of similar status in the other states).

Furthermore, hope is not abandoned for obtaining a federal charter. In his paper, Dr. McGill modestly alludes to his having been privileged to present testimony at hearings in Washington in support of such a charter, looking toward its becoming a medium for "accreditation" of actuaries. These hearings were before the so-called Rogers Subcommittee of the House Judiciary Committee, on February 16, 1966, concerning similar Academy bills (89th Cong., 2d sess.; H.R. 4470, H.R. 5987, and S. 1154). The hearings have been published and run about 100 pages. I commend Dr. McGill's written statement therein to your attention; you will appreciate the great amount of time, effort, and care that he expended in its preparation. Having been present at the time, I can assure you (and I am sure John Miller will heartily agree) that in orally presenting the highlights of his prepared statement, Dr. McGill was a most impressive witness on our behalf. We are all greatly in his debt for his contribution to the cause.

I would also like to take advantage of this occasion to express for posterity in our journal the great appreciation and thanks of our Society to another professor. I refer, here, to the late Professor Edward W. Patterson, professor emeritus of Columbia University, long associated with insurance department affairs in New York State. In the course of House hearings[12] in 1961, on amending the "disclosure" legislation, Professor Patterson—without any supporting actuarial cast at all—testified in favor of including in the then amendments, provision for qualified actuaries. "There is no provision anywhere," he said, "for qualifying actuaries. This would be the first one." Also, in his interesting book[13] published under the aegis of the Pension Research Council (Dr. McGill, research director), Professor Patterson kept hammering away at the existing lack of legal recognition of actuaries. Thus, the actuarial profession—not just our Society—has had two good and able friends in court in regard to the profession's need for means of accreditation.

[12] *Hearings before the Special Subcommittee of the House Committee on Education and Labor, re Amendments to Welfare-Pension Plans Disclosure Act* (87th Cong., 1st sess.), pp. 70–74.

[13] Edwin W. Patterson, *Legal Protection of Private Pension Expectations* (Homewood, Ill.: Richard D. Irwin, Inc., 1960).

Dr. McGill utilized eight paragraphs for his discussion of a "Realistic Funding Program." As his springboard for the subject, his orientation lies in the proposals for mandatory funding and surrounding conditions, set forth in the President's Report. His treatment of this "funding" subject seems a good and thorough one to me, considering his space limitations. He starts with a capsule résumé of the Report's proposals and then proceeds to adduce—with his reasons—certain doubts and questions thereon, all quite direct, with examination of certain well-taken apposite points. From my review of the paper, two or three comments come to mind. First, as to a possible omission, after showing the proposed mandated funding structure to be quite rigid as well as potentially onerous for certain marginal plans struggling for viability, the author might well, it seems to me, have pointed to a probability that the Committee imported this rigidity from Ontario, Canada. However, because the mandatory funding methods recently set by the province of Ontario took over, in large part, the previous rigorous funding principles practiced in Canada, transition difficulties were more minimal there than would obtain here under a sudden transition to the Report's mandated funding structure.

In regard to another point under the Report's proposal, Dr. McGill refers to a dilemma with respect to pay-as-you-go plan types, with no solution in sight. I do not follow the author on this particular point because unfunded pension plans never have been eligible as a qualified plan, anyway; thus, such a plan could, I should think, go on as heretofore[14] with no change by reason of the Report's proposal.

Continuing my discussion of the funding portion of the paper, I note that one of his concerns is that the Report's proposed IRS guidelines will be subject not only to a possibility of actuarial disagreement but also to the danger that residual bureaucratic inertia will resist desirable later modifications. After ticking off the pros and cons which he finds in this funding matter, the author gives his personal inclination for a mandatory funding structure with an objective of ultimate full funding, to be implemented, however, only through the qualified actuary certifying periodically that the funding being followed is reasonably "on that beam." Dr. McGill admits that his preference has been largely molded by the almost concurrent activities of the accounting profession in drafting their proposals for the accrual accounting method of charging pension costs to operations. I confess that it is my vague feeling (to which I will allude in

[14] While this is true as to funding per se, the reader will have seen further on in Dr. McGill's paper that with respect to the proposed new rules of the accounting profession which would establish "accrual accounting" for all private pension plans, funded or *unfunded*, the practice "heretofore" would *not* continue to be followed.

a later paragraph of this discussion) that the author may have unintentionally gotten himself boxed in.

As a final observation on this funding section, I note that the author would ward off adverse criticism of compulsion exercised by central government by likening the proposed mandated basis to the governmental actions of about one hundred years ago, when fresh young state insurance departments promulgated, *inter alia,* the temporarily disturbing but not really disruptive directives for minimum reserve standards of life insurance contracts, with the actuarial bases thereof stipulated in those directives. I rather doubt, for many reasons, that this is a particularly good or potent analogy or argument in the premises. Holding myself down to but one of these reasons, I will cite a danger (which I am sure is susceptible of demonstration), namely, that the dead hand of the past is often too heavy and too tightly gripped for us, today, to disengage it from the antiquated rule book that it grasps!

Under Dr. McGill's heading "Effective Safeguards for Assets," I have two brief comments. His first sentence tells us that funds, once contributed, (*a*) must be used exclusively for plan participants and (*b*) *must be* administered with minimum risk to principal consistent with reasonable rate of return. This sounds like a paraphrasing of either law (or regulations) or proposals of the President's Report. Requirement (*a*) *does* conform to the requirements of the IRC [Sec. 401(a)], but (*b*) is found neither in law nor in the Report, which give no criteria on "minimum risk" or "reasonable return." Thus, the sentence, or at least part (*b*), could well have been prefaced as "author speaking." This is a quibble, no doubt, but it *did* have me, for one, puzzled with regard to the imperative "must be."

My second comment concerns the second paragraph, in which he correctly says that the Report has no proposals for changing present investment standards. This, however, leads me to raise a question on recommendation 5 on page 54 of the President's Report. There it is stated: "The *actual value* of . . . assets is necessary . . . in measuring the adequacy . . . between contributions, fund earnings and benefits" (italics supplied). There is no expansion of this, either in the Report or in Dr. McGill's paper. The most literal meaning of the term "actual value" is "market value" at the time of asset appraisal by the special public accountant. If this is intended, then, contrary to the above "no changes proposed for investment procedures," a very decided change is required. This lies in the fact that the use of market values for "assets vs. liabilities" (the difference being the "unfunded") is a practice adopted for only a very small proportion of trust fund plans. To require market values for assets would—without a long transition period—upset the scheme of things greatly.[15] Furthermore, it would mean great fluctuations, from year to year, in unfunded liabilities and in any related annual actuarial costs, compared with the present more slowly changing results of current practice. The unanswered question is, then, Does the President's Committee mean, in its Report, a mandatory use of market values for funding purposes?

Next, this discussion will consider, briefly, the final topic of Dr. McGill's paper, which deals with the recent greatly increased interest by the accounting profession in pension cost accounting. The author gives an excellent résumé of this development, reserving his own commentary thereon until the end. At the time that he prepared this documentary, the closing episode thereof had not occurred. For reference, I list below the main chapters of the development, including the final item which was not available in time for the author's use:

1. *Bulletin No. 47*, of 1956, expresses preference for "accrual accounting," but methods were not adopted much in actual practice.
2. New research program (1959) was set up; its committee changed in membership from time to time and "backed and filled" as to a final report.
3. Hicks study group (September, 1963) puts high focus on program of item 2, resulting in 1965 publication of report carrying comprehensive recommendations.
4. "Exposure Draft" (July, 1966), based on Hicks' study of item 3, is released by Accounting Principles Board, seeking "quick" comments and suggestions.
5. Opinion No. 8 (dated November, 1966) is published by Accounting Principles Board as governing guide, superseding item 1.

Earlier I commended Dr. McGill for his accounting résumé. In this, the Hicks study is, as it were, a turning point from the less definite accounting positions obtaining under items 1 and 2 to the more specific call on the profession in 4 and 5 for the adoption of overt changes so that provision for pension costs would, in actual practice, follow the "accrual accounting" methods as proposed. Hence, the author's inclusion of the highlights of the Hicks Report and of its transition to the Exposure Draft seems to me to be a very interesting record for our *Transactions* to carry.

Dr. McGill quite deservedly mentions the actuarial profession's debt to Fred Sloat for his work with Mr. Hicks. I would like to suggest that we also proffer thanks to several other actuaries who, at considerable time and effort, have analyzed, conferred, and reported to our Board, concerning the proposed accounting methods along the road of their development;

[15] The effect is different here from that resulting from the use of market values for the accrual accounting methods of the alternative bases proposed by the accounting profession, discussed hereinafter.

without listing all the various names, the members of the Society's committee on the subject (F. L. Griffin, Chairman) should be cited, as well as certain of our members not of that Committee who have been advisers to some of the accounting groups from time to time.

Dr. McGill correctly states that terminal funding procedures were not regarded in the Hicks Report as actuarial cost methods. However, I believe that actuarial texts include such procedures in the cost methods category; also, such inclusion seems to be admitted in the subsequent accounting reports, namely, items 4 and 5 of the above listing. (I am in agreement with this inclusion.)

The author describes, at some length, the Hicks position that the accountant would definitely follow through on the alleged responsibility that he has "to audit the actuary," that is, to examine the actuary's various valuation bases applicable to accounting method—such as cost method used, actuarial assumptions, manner of their application, and all the various actuarial calculations—to the end of satisfying himself both with regard to his understanding of what the actuary has done and with regard to the accountant's appraisal of the reasonableness of these elements for accounting purposes. When I read this description in the paper, it sounded like one more probable clogging up, the addition of more complexities and additional delay in the actuarial valuation, its procedures, and its timetable. This emphasis, however, contained in the Hicks Report, appears to be mitigated in the subsequent developments of items 4 and 5.

Still in reference to this Hicks proposal for close "auditing of actuary by accountant," I wondered how it would go when the actuary involved was a member or employee of the accounting firm involved. I cannot see how an audit of one arm by the other arm could be viewed by outsiders as completely free of elements of a conflict of interest.

In Dr. McGill's ninth paragraph he gets into proposals for funding vested benefits, discussing the Exposure Draft in comparison with the Hicks Report. The Hicks Report apparently would not require any definite period for amortizing the vested benefits envisioned at the end of the amortization period, but the Exposure Draft put in a twenty-year period. In this connection I will advert to item 5, the final Opinion; two methods for this vested funding are therein given, the lesser one extending forty years.

I have one last query in these random points on Dr. McGill's description. He uses the phrase, with respect to funding of accounting charges, "over the remaining service lives of employees." This phrase intrigues one as to its meaning and its implementation. Some of these lives have service ending imminently, while other lives are young and their service may extend forty years or so. Certainly, I do not believe that decreasing amortization amounts are in mind, so perhaps the concept is more like a set period based on a weighted average. In any event it seems to me the phrase, when used, deserves some clarification or definition.

As previously stated, Dr. McGill withheld most of his own commentary on this accounting matter until the end of the section; my final observations will stem from his closing portions.

I indicated earlier that the subsequent reports of items 4 and 5 in my listing of the accounting development would show less emphasis on the "accountant auditing the actuary" than is in the Hicks Report. Thus, considering item 5, paragraphs 23 and 24 of the released Opinion No. 8 omit this Hicks emphasis. However, one can infer from the wording of these paragraphs that the accountant can take upon himself investigations of the actuary's methods and appraisals thereof as to reasonableness for their use in appropriately determining the accounting provision. If true, the complications that I envision would still be possible, on occasion.

Dr. McGill points out that both the Hicks Report and the Exposure Draft (and I will add to these, Opinion No. 8) propose that pay-as-you-go pension plans should be subject to the similar "accrual accounting" proposed for funded plans. Now, this seems innocuous enough to state, but has its actual implementation been fully understood? I do not know the number of pay-as-you-go plans extant, but, from *BLS Bulletin No. 1394*, of May, 1964, there were found in the Disclosure Office files nearly 700 such plans, both sufficiently formalized to constitute a "plan" and covering at least 25 employees (the rule for filing D-1 information with that office). How many such plans have fewer than 25 employees no one knows. But let us assume there are 1,000 pay-as-you-go plans in all (an understatement, I am sure); this means something wholly new to the employers involved. It will necessitate—if this accounting rule is followed—the calling in of 1,000 actuaries to conduct 1,000 valuations under the enunciated accounting procedures in order that appropriate figures for each of these plans be made available—and this, within the time limit for closing up each employer's books for the fiscal year—for the accountant's use in making the appropriate pension charge to operations. I have my doubts whether 1,000 employers can compile 1,000 sets of actuarial employee data in suitable form and find 1,000 qualified actuaries to take the data, analyze the provisions obtaining for 1,000 plans, assemble appropriate actuarial assumptions, consume the time (considerable in many cases) for involved discussions with employers new to this sort of thing, proceed with 1,000 valuations for accounting purposes, and issue certifications in special reports to 1,000 employers. All this strikes me as being a rather large order in addition to the usual recurring work load of these actuaries!

There are two spots in the last paragraph of Dr. McGill's paper which trouble me. One is his comment on the beneficial results if employers make their actual funding contributions identical with the cost accruals for accounting use. This, I believe, would tend, first, to destroy the employer's flexibility for channeling moneys to various needs among his operations, other than pension contributions; second, to dampen his further experimentation and his union bargaining in the area of pension changes; and third, to offer the IRS the chance to place a drab unanimity on tax-deductible methods. Also, it would operate quite unfairly, I believe, between the situation of one employer as opposed to quite different circumstances obtaining for another employer.

The other spot for comment is at the very end of the final paragraph, where Dr. McGill acclaims this new accounting Opinion, with the actuaries co-operating along the way, as a significant advance toward "rationality in pension accounting and financing." To my mind, it does not suddenly create the quality of rationality in the word's usual sense of "in conformity with reason"; possibly Dr. McGill has in mind a newer concept of "rationalize," as the application of modern efficiency methods to a business or an industry and, if so, he may be right, without endowing it with the aforesaid "quality."

Dr. McGill points out the possibility that to have funding contributions follow, in one-to-one correspondence, the accrual accounting amounts could result in lower funding, on the average, than might otherwise occur. The juxtaposition of (*a*) this lower funding resulting from the activity of the accounting profession and (*b*) that portion of the Report of the President's Committee which makes a plug for higher funding levels certainly presents an interesting comparison for contemplation. One may wonder, for instance, how the Committee will view this accountant influence, deriving from technicalities, toward lower funding. (Indeed, the author himself cites his own disappointment that Opinion No. 8 did not recommend the ultimate attaining of a fully funded position.) Hence, for the accounting methods to discourage higher actual funding by employers would not seem to find very loud applause from the President's Committee. Also, one would not expect to uncover great enthusiasm for this result from those (such as HEW) who might become the administrators of a so-called reinsurance fund under the Hartke bill or similar organization; such administrators, one would think, would like to see their risk (the unfunded) shrink in size through maintenance of higher employer contributions, I note the author's emphasis that, owing to the flexibility in the accountants' proposals as to the treatment of unfunded costs, it would permit the actual funding amounts and the accounting charges to coincide. Aside from my doubts, regarding the accrual basis, as to this being a greatly to be desired practice, I wonder how likely it is, anyway, that it would be followed year in and year out, considering the alternating strains that must successively be resolved by all employers in fixing on the optimum application of each year's various expense disbursements in their operations.

Concluding my comments on this accounting section of the paper, I must admit to having fearsome thoughts about this whole expedition of the accounting profession into the already tossing waters of the private pension sea. The President's Report is blowing gusts in numerous parts of those waters, and these winds may well intensify. The Treasury and the IRS have unleashed at least a temporary whirlwind on "plan integration" by their Announcement 66-58. Then, this so-called reinsurance matter, discussed briefly later herein, does not seem as if it will provide oil to calm the waters. Other disturbances which are evident lie both in the numerous proposals for drastic social security changes and in certain, hardly free-society sounding, emanations of the Joint Economic Committee. Taken together, they all make for a period of flying storm signals within which would be launched this complicated and, on many points unclear, codification of rules for a "new deal" in methods of private pension plan accounting. Dr. McGill sees these rules as representative of a milestone for the private pension institution. It strikes me, at times, however, as more likely to become a millstone on the actuarial and operational tasks in administering private pension plans!

"Reinsurance" is the heading used by Dr. McGill for a subject to which he devotes ten paragraphs of his paper (and is the last specific one of this discussion). It deals with the concept and operation of a means for protecting, against loss or reduction, the otherwise "contingent" private pension accruals for credited service to the then current date (covering employees, ex-employees with vested benefit, and those retired). The concept part is easy; most any *deus ex machina* could be called on to furnish that, but none, I think, would have both the ability and the patience to hang around and devise, implement and police, the transition from concept to full practical operation. Even among those far more sanguine than I about the *concept*, puzzlement seems rampant concerning the details of transition and the later maintenance thereof. As a first emphasis of this, I refer the reader to the last paragraph of Section VII of the Report of the

President's Committee; several cogent questions are set, as hurdles, between *concept* and *practical operation*. Dr. McGill, without citing these questions, per se, *did* explain that the Report came out, not with a specific program, but with the suggestion of serious study of the problem (as did another commission's report to the President mentioned by Dr. McGill).

His paper then proceeds to the Hartke bill (1966 version), which he finds more venturesome with details than the President's Committee (and, consequently, more rife with puzzlement and questions, between the lines, as one reads the bill). The paper outlines a few essential features of the structure proposed by the bill, one of which—having considerable interest to us—is that still another HEW advisory council would be set up, whose properties would include a launching pad for yet another—a fourth or fifth, I have lost count—invasion by outsiders into the operational areas of the qualified pension actuary, whether insurance company or consulting.

From its first, long-view look at Hartke, the paper turns, with deserved commendation, to an ALC-LIAA study group (H. E. Blagden, F.S.A., chairman), pointing out that its report (provisional, when I last saw it) contained searching analyses of both "concept" and "practical operations," mostly via the Hartke-type approach. As Dr. McGill brings out, the study group report (*a*) criticizes the Hartke bill (as did its sponsors) for lack of operational specificities, but (*b*) feels that some "insurance" method would be as feasible as some in force today, *if* [N.B.] technical questions of incidence and amount of risk "can be overcome."

In his next paragraph, the author, while interposing further questions needing answers, names additional "insurance programs" in effect which may be pertinent. Between the programs he cites from reference sources and those of his own adducing. I have prepared the listing given in the tabulation on page D476. All these "risk systems" (my term) are not intended by the paper, I feel sure, to illustrate apposite parallels to the reinsurance plan that he is discussing; some are, no doubt, given for their tangential interest or even, possibly, to serve as horrible examples. However, I am not competent, myself, to grade them. It does strike me impressively, however, that none on this list appears to involve so many elements and forces of "push and pull" and of unknown risks (including that of longevity of life for benefit receipt) as would exist under a Hartke type of approach to the implementation of the concept under discussion.

I would call attention also to the tabulation in respect to the identifying characteristics of those (all but 4, 6, and 15) now in effect in the United States. These characteristics fall into either of two categories: (1) those of, or closely akin to, social security attributes and (2) those with attributes in the nature of a guarantee (or reinsurance) for the performance of a contract. I feel that, if possible precedents can be found only in the area of (1) or (2), then to press them into use as analogues for action here is to squeeze the principles of private pension plans into new shapes, that is, into category (1) or (2). Furthermore, I wonder whether the very term "reinsurance,"[16] which Dr. McGill has used for this part of his paper, is not a misnomer, being in conflict with the traditional noncontractual, long-long-term[17] nature of private pension plans. Thus, it seems to me that, both in the emphasis conveyed by the term "reinsurance" and from the search for precedents per the tabulation below, there are—without intentional design—aids and abetments to the above-mentioned "squeeze play" on private plans. The listing, often referred to in this paragraph, of certain "risk systems" is given in the tabulation on page D476.

Dr. McGill's six paragraphs on this subject take up, again, the Hartke bill approach. The paper takes looks at the bill from various angles, like a tourist's camera successively turned to snap a subject that he deems highly interesting or photogenic. A few of the resulting "slides" invite some comment. One of these pictures shows the levying of the "premium rate" against unfunded liabilities; it is labeled "Eminently Logical" and further described as only needing judgment on valuation methods for liabilities and assets.

Dr. McGill's picture of "eminent logicality" might be challenged on the grounds that (as he himself had just noted in his preceding paragraph) rates for insurance differ by class of risks; they also differ by qualities of a particular risk—substandard to superstandard; and certainly vast second-order differences must exist between two or more pension plans with regard to their respective chances for attaining a "fully funded position" for accrued pension credits at future dates, the chances that the gold will go, leaving but the dross, incapable of meeting the ever higher "premiums,"

[16] The term "reinsurance" is used throughout most of this part of Dr. McGill's paper; it is also used in the Hartke bill (including its "short title") and in the words of sponsors as reported in the *Congressional Records*. But the President's Report uses the term "insurance," as does also the Blagden study group. Then, too, I note that Professor M. C. Bernstein's book, *The Future of Private Pensions* (New York: Free Press of Glencoe, 1964), does not deem the term suitable, either (e.g., see pp. 253–55 thereof). The book proposes, anyway, a scheme of *transfer of vested values* between plans on some, vaguely described, "clearing house" idea (which would seem to me destined to end up, again, in the great new empire of HEW). And, finally, Dr. McGill's paper's last few paragraphs on this subject seem to "take up with" the term "guarantee fund," whether synonymous with "reinsurance," I am not certain.

[17] This term automatically excludes the temporary duration of union pension agreements of collective bargaining.

like some assessment histories. Perhaps I quibble again. So, whether or not logical, the action of applying the "premium rate (or rates)" to the unfunded would, as the paper indicates, bring to bear the many questions concerning how liabilities and assets would each be valued.

On this matter, I sense that a sort of actuarial shudder gripped the author when he was listing, as one possibility, the appearance of the aforesaid Hartke (HEW) advisory council to set the actuarial rules; this would, in his words, "raise the specter" of several actuarial valuations for as many (or fewer) different reasons. Several of these ghastly figures hover, already, in the wings.

Dr. McGill again causes me a twinge of pain with his adjective "logi-

RISK-SYSTEMS CITED IN THE PAPER AS EXAMPLES

FEDERAL

1. Deposit Insurance Corporation (FDIC)
2. Housing Administration (FHA)–Mortgage Insurance Funds
3. Unemployment (and Sickness) account of Railroad Retirement Board*
4. Senate Judiciary proposed insurance plan for insolvent "property-casualty" insurance companies
5. Federal–State Unemployment Insurance (deriving from Social Security Act of 1935)

FOREIGN

6. Pension plan form of credit insurance in Sweden (per n. 2 of Blagden study group)†

STATE

7. Workmen's Compensation Fund (direct)
8. Workmen's Compensation Fund (reinsurance)
9. New York Guarantee Fund for Auto Claims
10. New York Guarantee Funds for Life Insurance
11. Federal–State Unemployment Insurance

PRIVATE CARRIER

12. Export credit insurance (federal bears *political* risks)
13. Credit insurance issued by non-life carriers
14. Uninsured motorist clause of one's own automobile contract
15. Employer guarantee of pensions as his own liability*

* Items 3 and 15 I have inserted. Under item 3, to meet claims, the RUI account has had to borrow heavily from the Railroad Retirement account; has paid back a little but at 6/30/66 still owed an amount about equal to 1¾ years' full 4 per cent rate of contribution on $400 per month pay ceiling. As for item 15, it is referred to in several spots of Dr. McGill's paper but not suggested by him, I believe, as an example (nor by me as a *good* example for all; a few large companies, however, *do* so reinsure).

† This refers to the "PRI-scheme" complex, arranged by certain segments of the Swedish labor-management groups. The plan was experimental as set up in 1960; was subject to likely changes after 1965, both from internal operational corrections and from expected legislated directives (on which changes, if any, I have no current information); was very complicated (e.g., see flow chart on pp. 560–61 of Ericsson's paper in Volume II of the *Transactions*); and though, perhaps, manageable for its end-of1-962 coverage of about 150,000 employees there, it would hardly seem to be of a type applicable in the United States to some 170 times that number of employees. (In addition to Ericsson's paper above, I note, on pages 587–96 of the *Journal of Risk and Insurance* for December, 1966, that this Swedish experiment is described, but in no great detail and with no figures, by Vlademar Carlson, professor of economics at Antioch College, Ohio, in his article "Institutional Change in a Welfare State: Sweden." Since his article was submitted in May, 1966, it probably has no later currency than the fall of 1965, in regard to the dates above.)

cal," that is "logical" to use separate "premium" bases for (1) risk of employer default of plan contribution and (2) risk of depreciation of asset values. It seems to me that any distinction in "premium rates" for two risks, neither of which is more measurable than the other and both of which are quite unmeasurable at all, can only be called *pro forma.* The author spies another hovering danger that could materialize; this lies in employers' behaving badly and preferring to pay just the Hartke "premium" without improving their unfunded risk. He warns that such actions might cause the federal government to force amortization onto all covered employers. But this federal action would hardly seem to solve things happily for the Hartke system, because employers who could meet the amortization requirements would, the sooner, depart as "premium-paying participants," and those who could not meet the requirements would, the sooner, not only depart as "premium-paying participants" but turn, then, into "claim-collecting creditors." In Dr. McGill's penultimate paragraph for this topic, is there not a contradiction in terms? He speaks of "voluntary participation" in the system with the same breath that he speaks of participation being required for approval of the plan by IRS.

In his final paragraph under the heading "Reinsurance," Dr. McGill introduces another idea with its own complications, whose structural principles seem to be based upon that Mosaic Law which visits the sins of the father upon his children for some generations. In brief, a fractionalization of an employer, whence one fraction dies and leaves the other living (either still identifiable as to ancestry or, through merger with or acquisition by, some other company, not so obviously traceable) would visit the accrued pension credits from the dying piece upon the liability page of the viable fraction. Indeed, this process would seem repetitive for successive later splits. In this way, only the "one-hoss-shay" type of collapse—the whole at once—would find pension succor in any "insurance," "reinsurance," or "guarantee fund" backstop—and then only after the collapsed employer had distributed any tangible gross assets in such a way that pension liabilities are given the priority of "unpaid wages" (but I believe that such "priority" over general creditors runs only to a quite limited amount in most all jurisdictions). The idea's answer from his final sentence (italics supplied) only paraphrases all previous ones: "There would be both conceptual and practical problems . . . , but they would be *no more formidable* than those involved with the present proposal."

I am constrained to close this long discussion with a few notes not directly bearing on Dan's paper.

If one intensifies his focus on this "social objectives business," he is apt to wonder where—in all this search for new principles and practice regarding pension plan termination, whole or partial—the proximate cause of Hartke, namely, the Studebaker case,[18] would find relief? And, if any were found for that case, where would help lie for similar, now fast-receding, other terminated plans—for example, Packard, Kaiser-Frazer, certain plants of International Harvester, and so forth? It took the Social Security Act thirty years to open up a $35-a-month hatch to folk who never had been covered by Title II of the Act. (We may recall that one actuary, at least, W. Rulon Williamson, F.S.A., had felt all along, and another actuary, the late M. Albert Linton, F.S.A., further along, that those excluded at the start by accident of birth date or of husband's too-early death should have been "social budgeted" into at least a minimum benefit under Title II.)

Among the various writings referred to in Dr. McGill's paper, there seems to be either an ignorance of existing termination-of-plan provisions (even though required by IRS to qualify a plan) or a glib assumption that law, regulation, or suggestive hypnosis will brush aside or trample down the priorities for asset or annuity allocation in the event the plan should terminate. For example, the subject is not mentioned in the President's Report, and the C.P.A. proposals proceed on the assumption that plans do not terminate (in spite of Table IV-1 of Bernstein's book).[19] The Blagden study group's report, however, recognizes this omission in the Hartke proposal; the report says (in my provisional copy), "It is also not clear how any pension plan termination provisions which establish different priority classes of beneficiaries . . . would be affected by the bill." It is pertinent that in the Kaiser-Frazer case, the court struck down one *employee* group's attempt to push aside the termination clauses of the plan and trust; that is, the court refused to rewrite a clear intent of a legal document. Would courts now recede and invade such documents in deference to a *governmental* group of plaintiffs?

The last of my notes that I will use here reads, "I. Outside Hats; II. Valuation Hats; and III. Signature Hats." What I have in mind can best be explained by setting forth a listing for each of the three sets of "hats" (none of these lists is claimed to be complete):

1. *Outside hats.*—Under present practice, the pension actuary—insurance company or consulting firm—may expect that his cost and valuation

[18] An interesting factual and nonalarmist description and analysis of this plant-closing and its effect on the pension plan were given by Mr. R. E. Royes, of A.T. & T., in a paper on the Studebaker case in the light of the President's Committee Report, presented to the 19th Annual Conference on Labor at New York University, April 19, 1966.

[19] *Op. cit.*, p. 87.

reports, summaries thereof, and perhaps some details of the work itself, will be seen or properly called for by certain parties, all depending upon the circumstances of plan documents or of existing law or regulation. Thus, the first five of the following items—one or more—may be found in present practice. The other five—one or more—could well become new parties in this area if all the seething mix of current proposals should—heaven forfend—jell into identifiable requirements.

List 1. Actual or Potential Viewers of Pension Actuary's Procedures or Results

a) Employer: The employer or employer's association whose plan is involved.
b) Union: The union or unions which negotiated on the plan.
c) IRS: As to actuarial elements of plan contributions for deductibility.
d) Disclosure laws, federal: To the extent called for in D-2 reports.
e) Disclosure laws, state: Similar to (*d*) for the few states with such laws.
f) IRS as actuarial guide: As proposed by President's Report, recommendation 4 of chap. vii (new function for IRS and new curb on actuarial independence).
g) Employer's C.P.A.: Such C.P.A. acting on his own, per paragraphs 23, 24, 30–33, and 42 of APB Opinion No. 8.
h) Joint C.P.A.-Actuaries Advisory Committee: Such a joint body has been proposed.
i) Presidential Advisory Council for HEW: For actuarial phases of running the Hartke "reinsurance" proposal.
j) Actuaries' Guidebooks-for-Actuaries Committee: Proposed guidebook[20] could hardly be published, *period;* some standing committee or panel seems required for revising and watching (policing).

2. *Valuation hats.*—The definite purchase types of insured plan (unit-purchase group annuities, group permanent, and individual policies) have valuation and cost bases stipulated in the contract; the various insurance company D.A. contracts may or may not have these bases stipulated; and the trust fund types serviced by consulting actuaries only very rarely stipulate these bases in plan documents. In any event, current practice after a plan's inception is that usually only one actuarial valuation need be conducted as of a valuation date; this valuation has been used by management, by unions where applicable, and for IRS filing. Occasionally, for special informational reasons of management or of unions, another valuation has been conducted using different actuarial bases. Since such "special information" valuations may well increase in the coming Brave New Great Society World, I include that item among the newcomers in the list below. Last on List 2, I include the well-known trio, not because I feel that they themselves would show up voluntarily with their

[20] See Ray M. Peterson, "The Future of Private Pension Plans," *Journal of Risk and Insurance* (December, 1966), pp. 612–13.

benefit security ratios at future valuation dates, but because of the bare possibility that some members of the B.N.G.S.W. would call for it as a regular thing (perhaps by an Advisory Council on Benefit Security Ratios). Here, then, is List 2, wherein the first item is with us now. The other five items—one or more—could, each one, well require its own special actuarial valuation by the plan's own actuary, either on his own or as aided, abetted, coerced, or superseded by some outside hat; that is, if "all the seething mix of current proposals should . . . jell."

List 2. Number of Actuarial or Potential Periodical Actuarial Valuations of Plan

a) Plan's own actuary, on bases set by plan or chosen on his best judgment. This valuation serves the employer, the union, if applicable, and the IRS with respect to costs and funded ratios.
b) Variations on (*a*) for special information of employer or, if applicable, of union.
c) Valuation for "accrual accounting" purposes of APB No. 8 (see items (*g*) and (*h*) on List 1).
d) Possible further trials and tribulations for Canadian actuaries making pension valuations for Canadian operations of a United States company if applicable financial statements are intended to conform with (*c*) for inclusion with statements on the United States operations.
e) Computation of Hartke "reinsurance" premiums by HEW might find that body or its Presidential Advisory Council calling for actuarial valuations of prospective benefits accrued for service to date; of liabilities, gross or net or in between; liabilities funded, unfunded, or to be funded. (This item could have a multiplier all its own.)
f) Griffin-McGill-Trowbridge benefit security ratios trio.

3. *Signature hats.*—Actuarial reports, certifications, filings under statutes, and so forth, in regard to pension plans, public or private, have usually been submitted, I believe, on letterhead of the actuary's firm (insurance company or consulting, or board or committee, etc.) over signatures of the actuary (or actuaries). Such signature has carried, at the most, the actuary's title with his firm and his professional affiliation(s) spelled out or by initials. We now may be entering the era of "Proliferating Hats" for signatures. Here, then, is List 3, wherein the first two items are currently in use. The other four items—one or more—could, each one, call for the signature refinements indicated, that is, if "all the seething mix. . . ."

List 3. Various Actuarial Signatures That Might Be Needed

a) Firm's title: For example, vice-president and actuary.
b) Professional actuarial affiliations: Examples, FSA, FCAPP, Mem. AAA, etc.
c) Accredited actuary: To meet some federal or state statute.
d) Conforming actuary: Under APB Opinion No. 8.

e) Conforming actuary: Under Actuaries' Actuarial Guidebook.
f) Actuarial member of HEW Advisory Council No. 13.

Looking again at List 3, one may envision what an impressive sight would follow an actuary's name if he qualified for all six categories of designations and if he used them all at once!

I have heard it said that a "conservative" is one who knows the cost of making a change. An allied measurement was given by Mr. S. Huber in a recent National Underwriter article to the effect that one can tell how old a man is by the degree of pain shown on his face when exposed to a new idea. I like to think that neither of these appraisal methods would excite the pointing needle much if applied to me—*provided*, however, the *singular* is used, that is, "a change" or "a new idea." But, in the scenes Dr. McGill has displayed, how much *singularity* obtains? None. For in the various proposals he draws on, one finds a bewildering *plurality*. It is in this great plurality, where very little comes into focus on practical or operational lines, that conservative reactions may be registered. Back of this relatively simultaneous and uncoordinated plurality, wherein is used, mainly, the lexicon of "concepts," are there not too many Omars who,

> . . . with Fate conspire
> To grasp this sorry Scheme of Things entire,
> Would not we shatter it to bits—and then
> Re-mould it nearer to the Heart's Desire![21]

It seems to me that the net effect of all these "re-moulding desires" can but underscore an observation—of both jest and dead seriousness—attributed to the late Norbert Wiener (of cybernetics fame) along the lines of: The disintegration of civilization is likely to occur, not through the atomic bomb but through the wildly proliferating man-made complexities of life!

Perhaps to some I have seemed overcaptious in parts of this long review; to others, not nearly captious enough. Whatever the score on that may be, I have not intentionally directed deeply mordant darts against the author. Dr. McGill has presented a fine paper to our Society. He had to pick up a handful of nettles and wanted us to get a feel of the batch also; some hands are tougher than are others—the nettle barbs less felt or sooner fled the prickings. The paper's discourse on the nettles was a tough task to undertake, and the results are patent evidence of arduous work and dedicated time put in by Dan McGill, a good friend to our profession. I am sure that we are all grateful to him for his coverage of this difficult wide-ranging subject.

[21] From Edward FitzGerald's *Rubáiyát* translation (2d ed.).