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# PUBLIC EMPLOYEE RETIREMENT SYSTEMS

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1. Benefit Design
2. Differences in Funding Methods and Actuarial Assumptions
3. Political Considerations
4. Current Studies and Possible Future Legislation

CHAIRMAN THOMAS P. BLEAKNEY: A fundamental dilemma is posed in designing a benefit formula for public employee systems that will coexist with social security. Obviously, social security is a major element of any retirement package. There are logical and strong reasons for explicitly recognizing social security benefits in benefit design. On the other hand, the control of social security is outside the control of the plan designer. Incorporating a direct offset of social security into a benefit program, particularly one such as a public employee plan where benefits tend to be vested as a constitutional and traditional right, carries with it a risk of problems because of unforeseen changes which might occur in social security.

Faced with this dilemma, it is easy to take the lazy way out--deduct a portion of social security from a total benefit goal and let the chips fall where they may. Although this meets some theoretical goals, there are also some substantial practical problems, such as administrative complexity, inequity among various categories of employees, and the confusion attached to a benefit formula which the employee has difficulty understanding. I will mention two matters of equity that bother me.

Most public employee systems are contributory--that is, the employee pays a portion of the cost. Relatively few of these contributory systems have a scale of contribution rates requiring a higher percentage contribution at the higher salary levels than at the lower. Despite this, all offset plans will provide state-provided benefits which will follow that pattern--a higher benefit percentage at the higher salary levels and a lower percentage at the lower salary levels. In fact, at the very low salary levels, the social security benefit by itself might exceed take-home pay, thus presumably allowing for no state-provided benefit under an offset plan. This poses some obvious political liabilities to the designer of the scheme.

A liability of an offset plan which is even more onerous, in my opinion, is the inequity which the program carries with it for succeeding generations of retiring members. Consider two members with identical service and salary records who retire a month apart with maximum benefits of, say, 80 percent of salary, including social security. Suppose that the social security benefit increases prior to the retirement of the second member. He will be getting less from the local system than will the first, since the two were limited to the same total benefit at retirement. The inequity arises from the fact that the person who retired earlier

will have received a post-retirement increase in his social security benefit to bring it to the same level as the social security benefit of the second member. The first to retire will, thus, then and forever be receiving a larger benefit in total.

In my opinion, program design can accomplish the objectives of a reasonable total benefit without incurring these liabilities. The more desirable benefit formula is one that stands on its own feet, but is designed to keep in view at all times what the expected additional benefit under social security might be. For the purpose of designing such a formula there is nothing which can beat a projected comparison of benefits.

Turning to another topic, and for the purposes of being a devil's advocate, I will point out why some of the arguments against excess benefits strike me as being a bit overdone:

(1) Such things as stock options, savings plans, profit sharing, etc., are not available to the public employee.

(2) The average public employee, at least in the general service systems, tends to have short service and, therefore, does not reach the excess benefit levels that are typical of a few extreme examples.

(3) In determining whether a benefit is excessive or not, I feel the final salary should be compared with the contingent annuitant benefit, not just the straight life benefit.

To elaborate on the last point, in many instances the salary of a married employee will have been supporting both himself and his spouse. It would seem reasonable for the retirement benefit to have a similar function after his retirement. Even if both members of the couple have been employed, it is equally logical to consider the income as pooled before retirement, and to continue to be pooled after retirement. For this purpose, choice of the "contingent annuity" option by each person upon retirement is reasonable.

MR. R. ALVIN FIELD: In discussing benefit design it has been suggested that it might be helpful to use a typical public employee retirement system in Canada as an example and to discuss emerging trends and changes from that example. First, let us establish the profile of a typical retirement benefit program in Canada. Keep in mind that numerous variations do occur. The highlights of the typical program might be as follows:

(1) Employees contribute 5-7% of their earnings.

(2) Normal retirement age is between 60 and 65. Modifications include a rule of 85 or 90, or early retirement without actuarial reduction after age 55 and 30 years service.

(3) Pension benefits are 2% of final 5-year average earnings times years of service up to 35, integrated with the social security system by deducting 0.7% of final 5-year average earnings up to the social security earnings base for each year of service after 1966. The year 1966 originates from the effective date of the Canada/Quebec Pension Plan.

(4) A widow's or perhaps a spouse's benefit equal to 50% of the accrued pension payable on death either before or after retirement will be provided after 10 years of service.

(5) An additional pension, perhaps 10%, will be provided for each child up to 2-1/2 children.

(6) Disability benefits equal to the accrued benefits will be provided after 10 years of service.

(7) Vesting will be provided on a generous scale, perhaps immediate vesting conditional on the employee leaving his contributions in the plan.

(8) If no other benefits are provided, then contributions are refunded, perhaps with interest at a very minimal rate.

Now that we have established the profile of a typical plan, let's do a little crystal ball gazing. The ball in this case is not entirely transparent, since some of the new ideas have not fully emerged, but are taking shape gradually. I have identified 12 trends, some of which are still in an embryonic state, as follows:

(1) Integrated plans may be replaced with stacked plans to remove the problems that arise from arbitrary changes in the social security systems.

(2) Employee contributions may be eliminated or placed on a voluntary basis. The basic plan would be a 1% stacked plan with an additional 1/2% or 2/3% in return for an employee contribution. This might be classed as an attempt to recognize the desire of employees to have flexibility.

(3) Disability benefits may be removed from larger plans and replaced by a separate long term disability program.

(4) Some interest is also being shown in replacing the spouse's benefit with a separate survivor's income benefit and, hence, removing the spouse's benefit from the pension plan.

(5) Although some plans already have early retirement without actuarial reduction, the number of such plans will probably increase.

(6) Special buy-back provisions are being introduced to permit employees to pay for prior service in a related public sector plan. Various means are used to determine the cost of buy-back, the most common being twice the employee contributions based on starting salary.

(7) The most clearly developing trend is the escalation of pension benefits, reflecting increases in the CPI, both for pensioners and deferred pensioners. The escalation provision may be subject to some special funding considerations, briefly described as modified pay as you go. The aim may be to produce generational equity with stable costs.

(8) There is increasing concern regarding variation in benefits based on age, sex, and marital status. We can anticipate having to remove clauses that discriminate.

(9) As mentioned earlier, employees appear keenly interested in having more flexibility and more involvement. The result is that public sector plans are being amended to provide consultation committees, which seem to me to be the first, or perhaps final, step to negotiating committees.

(10) The interest paid on refunds conventionally have been very small and in some cases nil. This will probably be changed to allow accrual of interest at 5% or 6%.

(11) While this item may appear somewhat removed from retirement plans, it is significant in that funding of the benefit follows many of the same principles as funding for a retirement benefit. The benefit to which I refer is a gratuity paid on termination or retirement in respect of unused sick leave. This is a common benefit for public sector plans in Canada and is one which, to date, has not been subject to advance funding except in very odd circumstances. Such gratuity payments are receiving increased attention, probably because of the number of persons that are claiming rather large amounts and the affect on annual budgetary figures.

(12) Last, but not least, is the question of the value of assets used for actuarial valuation purposes. While the valuation of assets is not part of plan design, there is no doubt that it will become a serious consideration in designing plans.

MR. RONALD J. W. SMITH: I'd like to expand on the utilization of unused sick leave. Of the several hundred public employee plans on which I work, at least 50% add the lump sum unused sick leave payment into the earnings base before computing the final average salary. This has turned out to be a real funding time bomb. There are systems that have increased their liabilities by approximately 16% from this source. Combining this with legislation in the same state to reduce the final average salary period from five to three years just about blows the funding right out of the water. It also creates substantial numbers of employees, particularly at the lower end of the pay scale, who retire with benefits far in excess of take-home pay and in many cases significantly in excess of gross pay.

MR. HUGH GILLESPIE:* I'd like to comment on the social security integration with a slightly different view than that of Tom. I am not completely biased against integration with social security. I recognize that to have an offset plan in the public sector is quite difficult, and that there are very few integrated in this manner in the U.S. But with the current trend in benefit levels, the only way to control costs might be to integrate these plans. I would be inclined to stay away from the offset, if possible. Perhaps we can come up with a moving average approach, incorporating an average social security wage base with a step-up formula as some sort of a compromise.

*Mr. Gillespie, not a member of the Society, is a Fellow of the Conference of Actuaries in Public Practice.

CHAIRMAN BLEAKNEY: For those of you who have not yet done so, I urge you to study the recent proposal of the Social Security Advisory Council for a fundamental change in the social security benefit structure. Adoption of such a formula would be a great step forward, in my opinion. It might encourage the design of plan benefits with a similar career average formula, including a built-in escalator for inflation from the time the benefit is credited to the time of retirement. Such an approach would help solve most of the problems of integration, as I see them.

MR. RICHARD G. SCHREITMUELLER: I think that the entire concept of sick leave as viewed by public employees is foreign to us in the private sector. In the public sector it is recognized that sick leave benefits are more or less a matter of right. That is, if you get to within a year of retirement and you haven't used it, you are entitled to it in one form or another, e.g.,as a higher pension or a lump sum payment.

MR. CONRAD M. SIEGEL: We have a number of unusual benefit provisions in Pennsylvania. For example, our State employees plan initially provided a 2% benefit credit. When Social Security coverage was added, a 40% offset was included. Then the offset was made optional, being eliminated if the employee chose to eliminate his contribution offset. Finally, since the plan was then not integrated, the plan was reintegrated and now provides a benefit of 2% and 4%. Most of our city employee pension plans are based upon the final day's rate of pay, rather than a five-year average salary.

In some cities the most common form of disability is "trigger-finger stiffness," which seems to totally disable policemen sufficiently to obtain a sizeable tax-sheltered disability benefit from their present employer, but which does not seem to prevent them from obtaining employment with another police department in a similar capacity.

MR. SMITH: The following article appeared in a large morning newspaper on March 7, 1970.

> "The City of ______________, often teetering on the brink of financial disaster, appears to be headed over the cliff. Because of a lack of funds, pension checks totalling some $77,000 were not mailed this week to 206 retired policemen, firemen and widows. ..... A major reason for the City's financial troubles, including a $2,000,000 debt, is a court decision which forced the City to increase pensions by $325,000 a year. The City now has to pay $1,000,000 a year in pensions but receives only $135,000 from a one-half mill pension tax and employee contributions".

This article may well contain the dominant impression held by the public at large of the difference in funding methods between public and private plans, little or no funding versus regulated actuarial reserve funding.

I do take some exception to this view, because it has been my experience that the majority of the well-funded public plans come close to meeting the funding requirements of the Employee Retirement Income Security Act of 1974 (ERISA), with, in some instances, a longer amortization of the unfunded liability. However, the ones that are really going down the tube do so in a very spectacular manner and tend to be very large systems and, hence, receive a tremendous amount of publicity.

Examination of the facts reveals a substantial incidence of underfunding among public plans, compared to private industry standards. But also revealed is the fact that a majority of public plans are being funded in accordance with generally accepted actuarial methods which differ little from the methods used for private plans.

There are numerous well-funded large public systems. You need look no further than the Ohio Public Employee System. It is funded by 11% of payroll, which pays the normal cost each year and amortizes the unfunded liability over a reasonable period.

Differences in funding policies, both minor and major, tend to result from differences in the circumstances, conditions, and laws surrounding private versus public plans. Funding policies for private plans are largely determined by the following factors:

(1) The Internal Reveneu Code and related regulations (now added to and to some extent amended by ERISA).

(2) Promulgations of the American Institute of Certified Public Accountants, most particularly A.P.B. Opinion #8.

(3) Collective bargaining.

(4) Management decisions based on profit-loss statement considerations.

Compare these factors to those which have molded public plan funding policies.

(1) The assumed perpetuity of existence of the employer has produced a different manner of meeting the unfunded accrued service costs, most commonly by longer amortization periods and/or by payment of a level percentage of projected payroll rather than level dollar contributions toward amortization of the unfunded liability. Open group financing has long been a part of public plan financing, although only recently recognized as such.

(2) The availability of taxing authority often causes responses to an actuarial report stating that if everything turns out as bad as the actuaries tell us, we can always levy additional taxes to pay benefits. In the meantime there are more important uses for the money currently available.

(3) Political considerations such as:

 (a) Lobbying efforts by public employee groups, most particularly police officers, fire-fighters, teachers, and sanitation workers. Often the legislative body authorizing benefit increases is different from the one which must pay for the increases.

 (b) Prohibitions against deficit budgeting in most states. Retirement appropriations are one of the easiest to cut.

(c) Liberal benefit levels often prevailing for highly visible groups, e.g., legislators and judges.

(4) Collective bargaining. This force is relatively new in the public area but has already resulted in significant benefit increases, often without accompanying financing. The fact that the employer's bargainers are often covered by the benefits being bargained for does not tend to place these persons in a strong opposition position.

Another factor that results in problems from time to time is that in some states and municipalities the actuarial assumptions are prescribed by law. These assumptions in many cases were developed many years ago and are not particularly applicable at this time. So as an actuary you have a real problem when you are directed to use certain assumptions which you feel are not the proper ones. How do you go about conveying this message to the client? How do you get the assumptions changed and still derive a contribution rate that will keep the system solvent?

We have noticed a growing utilization of some form of a projection funding method. Mr. Fleischer's paper entitled "The Forecast Valuation Method for Pension Plans" has made an opportune appearance. Many public plans have been following open group/forecast funding methods without recognizing either the method or its implications. The paper points out many of these implications and the volatile relationships between the numerous assumptions. My own observations of forecast funding methods indicate that:

(1) There is an extremely long-term sensitivity to changes in the age pattern of new entrants and cost of living assumptions for retired persons.

(2) A false sense of security can be instilled if the forecast is terminated too soon.

(3) An acute need for lucid communication between the actuary and the public employer exists.

MR. GILLESPIE: One major area of difference between public and private retirement plans is in making provision for post-retirement increases. The difference arises, of course, from the fact that relatively few private plans provide for automatic increases in benefits after retirement, whereas a significant proportion of public systems provide for increases that are generally tied to the movement of the consumer price index. Many of the automatic post-retirement increases are provided on a cash disbursement basis and are not a part of the funded program. However, many of the larger systems include various degrees of advance funding.

The brief summary on the next page of post-retirement increase provisions in 13 state teacher retirement plans indicates that eight make provision for a CPI increase. Four systems out of the eight meet the cost on a cash disbursement basis, two systems provide for a guarantee of all past increases and up to four or five future increases, and two systems incorporate full advance funding to the extent of two or three percent per year.

BRIEF SUMMARY OF POST-RETIREMENT INCREASE
PROVISIONS OF CERTAIN STATE TEACHER RETIREMENT SYSTEMS

| State Teacher Retirement System | Type of Automatic Post-Retirement Increase | Method of Funding |
|---|---|---|
| Alabama | None | - |
| Georgia | Semi-annual, CPI related, limited to 3% per year. | Advance funding to extent of 2% per year. |
| Louisiana | * | None |
| Maryland | Yearly, CPI related, no limit. | Special Appropriation |
| Mississippi | None | - |
| New Hampshire | None | - |
| New Jersey | Yearly, 1/2 increase CPI. | Special Appropriation |
| New York | Yearly, CPI related, based on first $8,000 of disability pensions and service pensions of those over age 62. | Special Appropriation |
| North Carolina | Yearly, CPI related, limited to 4% per year. | Fully funded to extent of all past increases and 4 future increases. |
| Pennsylvania | None | - |
| South Carolina | Yearly, CPI related, limited to 4% per year. | Fully funded to extent of all past increases and 5 future increases. |
| Tennessee | Yearly, CPI related, limited to 3% per year. | Special Appropriation |
| Vermont | Yearly, CPI related, limited to 5% per year. | Advance funding to extent of 3% per year. |

*Biennial full CPI related increase for retirees before 1965 who are not covered by new benefit formula.

Pay-as-you-go funding may be at the bottom of the list in terms of desirability, but actually it is the most common method used by the systems in the sample with automatic post-retirement increases.

An interesting funding approach is the procedure followed under the North and South Carolina Retirement Systems. These states did not want an automatic CPI increase on a pay-as-you-go basis and could not afford to prefund the increases. The legislation finally provided that any increase beyond the first five annual increases would commence only if the additional terminal reserve liability incurred did not require an increase in the employer contribution rate. Both systems were, and still are, in a period of rapid growth in active membership, which has made it possible to go beyond the original five increases, raise the annual increase from three to four percent,and still maintain the amortization schedule of the unfunded accrued liability. The arrangement is, of course, a short-range solution to a long-range problem. The next problem is that pressure will be exerted to extend the amortization period of the accrued liability in order to pacify the retirees, who are a potent political force.

Some public systems that do not have automatic escalator provisions have adopted the practice of increasing the pensioners' benefits periodically and spreading the additional liability over a period of 20 or more years, which, of course, drains the assets built up for active members.

I would like to make a point about the need for special care in connection with the selection of certain of the assumptions necessary under plans for firemen and policemen. I am expressing a note of caution and the need for attention to actual experience and changes in the definition or determination of accidental disability or accidental death. Most police and fire plans include provisions for accidental disability retirement benefits that in many instances are much greater than the regular service retirement benefits. Ordinary and accidental death benefits are also included in many such plans. The case in point is a fire and police retirement system of a large city on the east coast (not New York).

The last two five-year experience investigations, particularly the latest, indicated that the ordinary and accidental disability rates were climbing rapidly, and there was no good evidence or convincing argument that the rates would return to previous levels. A drastic change in the assumptions was called for and was recommended to the Board of Trustees. A comparison of the number of expected cases on the basis of the data for the latest valuation and the old and new active service assumptions resulted in the following statistics:

| TYPE OF RETIREMENT | EXPECTED NUMBER OF CASES ON THE BASIS OF: OLD ASSUMPTIONS | NEW ASSUMPTIONS |
|---|---|---|
| Ordinary disability | 8 | 20 |
| Accidental disability | 9 | 61 |
| Service retirement | 91 | 48 |
| Total | 108 | 129 |

In addition to the foregoing, it was recommended that the disability mortality table be strengthened significantly to a basis almost as conservative as that used for service retirees. As a result of these changes, which were adopted by the Board of Trustees, the cost of the retirement system increased by almost 50%.

The conclusion, of course, is that it is extremely important in connection with first-time studies to attempt to secure some experience information. It is also necessary to watch closely for changes in the eligibility requirements for disability and death benefits, in view of the extremely heavy bearing on costs that such changes can have. As might be expected, in cases where hypertension or heart disease is presumed to have occurred in the line of duty, it can be assumed that there will be very heavy rates of accidental disability and accidental death.

CHAIRMAN BLEAKNEY: As a footnote to Hugh's last remarks, we have noticed in some fire and police plans that retiring for duty disability is more common than for service. One of the reasons for this is that the uniformed personnel look upon heart and lung disorders as being duty-related. Another cause for this phenomenon is the major federal tax advantage given to disability pensions before the normal retirement age.

MR. SIEGEL: Mr. Robert J. Myers and I are presenting a paper to the Conference of Actuaries in Public Practice concerning an actuarial funding method which has been used primarily in governmental employee pension plans. This particular funding method is very sensitive to the adequacy of actuarial assumptions, and our paper contains several comments as to its appropriateness for plans involving the benefit provisions typically found in governmental employee systems.

CHAIRMAN BLEAKNEY: I suspect that everyone in this room agrees with the concept in the code of ethics of the Society and the Academy which states that the ".... member will exercise his best judgment to insure ... that any assumptions made are adequate and appropriate ....." As a specific example of the problems which our profession faces in this regard, I cite an example recently witnessed by a colleague of mine. He was present at a meeting of a committee where a state senator, in discussing the board of a proposed new state retirement system, indicated that one of the responsibilities of the board was to "shop around until they found an actuary who would use the assumptions that we want to use." The statement was apparently not made in jest, nor was it challenged by any of the other senators on the committee. I hope we don't have any actuaries whose services can bought under those terms.

With respect to the communication subtopic, I am sure we have all struggled with the problems of communicating the niceties of actuarial cost procedures to the general public. I regret that the early practitioners of our profession were not more farsighted in one area. I think they would have been far better advised to have borrowed a trick from the doctors and the lawyers. Thus, rather than combining common English words into phrases such as "normal cost" and "unfunded liability," I think we would be much better off if they had used "impensa ordinaria" and "nimium impendiae supra bona." These fancy Latin phrases would certainly be all "Greek" to the layman. The use of such words would probably increase,

rather than decrease, our true communication to the public, since we would say what the phrases really mean, rather than have anyone else jump to his own conclusions. Moreover, it would certainly enhance our professional image by giving us an aura of esotericism, even if that is not necessarily deserved.

MR. FIELD: The emphasis on policial considerations that seems to be evident in establishing this as a singular topic of conversation has questionable justification. The actuary should be an independent advisor having those professional ethics that will enable him to examine a situation objectively and present his honest opinion as to the characteristics that result. For a public employee retirement system he must be in a position to present his honest opinion as to the solvency of the system and as to the contributions required to support the system. Of course, the Society of Actuaries and other professional actuarial bodies have developed and are developing definitive codes of ethics for guidance in this area. The actuary's first responsibility is to himself as a professional. If this responsibility is fulfilled, then his further responsiblities to a client or to the profession should be fulfilled also.

In many instances communication plays an important role in achieving responsibility. It is not sufficent to say in two lines that the pension fund requires current service contributions of X% of salary and currently has a deficit of Y dollars. The client, be it the public, the legislature or the employees, has a right to know much more of the actuary's thinking and opinions in arriving at those conclusions. It should be within the actuary's capabilities to explain all of the methods and considerations that have gone into his final conclusions. That isn't to say that his audience must necessarily agree, but it should be possible for it to understand. Where it is obvious that the actuarial techniques and methods are going to have to be explained to a completely uninformed audience, then steps should be taken by the use of examples to ensure that a complete understanding will be achieved.

The effect of employee group pressures may be reflected on decisions reached by the legislature or the retirement board or whatever body has such responsibilities, but should not be reflected in the recommendations made by the actuary. It is the actuary's responsibility to present the results of his review and to make such recommendations as he feels appropriate. The client is not necessarily bound by those recommendations.

Similarly the actuary should be responsible for establishing the actuarial procedures to be used, but only after having had the opportunity to review in detail the objectives of his client, be it the legislature or the retirement board, and after having had the opportunity to explain and discuss the implications of various actuarial procedures. Only then can the actuary conclude which actuarial procedures would, in his opinion, be more appropriate. Furthermore, the actuary is not bound to present the results on only one set of actuarial procedures, but may present results on several different bases. He should explain the pros and cons of each basis and his conclusion as to which one of the bases is to be recommended.

MR. GILLESPIE: The term "responsibility" is defined as "a particular burden of obligation." The consulting actuary is faced with responsibilities to himself, his clients and the profession. It goes without saying that there are many situations in which there are difficult conflicts to be sorted out by the actuary. I have the privilege of serving as actuary for the Board of Trustees of a large city retirement system. The city administration has its own actuary, and the employee association has its actuary. Three actuaries with, many times, different objectives.

In the area of communicating actuarial implications to the public, the legislature, and employees, there are many opportunities today to set things straight. In a number of states there are sunshine laws, that is, meetings held by the boards of trustees are required to be open. At the state retirement system level these meetings are generally well attended by representatives of the employee groups, appropriation committees, and sometimes, the media. In addition, the actuary is generally required to attend appropriation hearings or special legislative committee hearings regarding legislation. At these meetings, the actuary may get a chance to comment upon any problems that exist in connection with the funding of the retirement system. He will certainly be questioned as to how he arrived at the appropriations requested. In a number of states, the actuary is invited to attend association meetings, either teachers' or employees', and explain to them proposed benefits or proposed changes in the funding of the retirement system. Most state retirement systems are extremely conscious of the need to communicate and, in the last five years, have made great strides towards enlightening their memberships of the benefit structures and the financial bases of their retirement systems.

As might be imagined, the effect of employee group pressures on benefit formulas, funding, and board actions is truly significant. The number of covered employees under state retirement systems is very large, numbering in the several hundreds of thousands in the larger states. Also, the employee groups today are much more militant than at any time in the past. In many situations the employee members attend open board meetings in force and make themselves heard.

Under most of the state systems with which I am associated, the procedures such as method of funding, method of determining the normal rate, and the period of past service funding are usually specified in the law, and are changed only by legislative action. The actuary recommends the assumptions other than the interest rate, and these are adopted by the board of trustees. It should be noted, however, that the board of trustees may not always agree with the actuary's recommendations, depending upon its effect on contributions to the system. There are situations in which the board may delay the adoption of more conservative assumptions for some period of time. There are some systems under which the board of trustees has the authority to set the accrued liability funding period and thereby establish the accrued liability contribution rate. In these situations the board of trustees might be overridden by the legislature. When any questions or problems arise in connection with any of the procedures to be followed in determining the cost of the retirement system, our usual practice is to confirm the procedure to be used with

the board and advise them of the cost implications of the particular recommendation.

In conclusion, the consulting actuary for public systems is under increasing political pressure, hardly news to anyone. In most of these situations the actuary must be present at more meetings than ever before and must be able to make a convincing case for every position he takes on every issue. Gone are the days of the mail order actuarial consulting business.

MR. JUAN N. KELLY: I have a practical example--I'd be interested in comments from the panel. I am a consultant to a policemen's retirement system that has been in effect since 1947. They have a written policy of no funding. Benefits are half salary after 20 years of service with pension benefits based on current pay at the time payments are made. The fully funded benefits cost 100% of salary. While you mull over that and any possible suggestions you might want to make as to what the actuary's responsibility would be, I can make a couple other points.

Concerning buy-back provisions, the biggest problem I have seen is that even if the payment for the service which is being repurchased is twice the contribution for that period, it is less than the reserves that should have been accumulated at the time of retirement, primarily because of inflation. One other point, unisex mortality is a problem in the U.S. The female teachers from one of the retirement systems that I have consulted with obtained a court decision in their favor which required a recomputation of all the annuities. As a result, since we didn't reduce the male benefits, the system had to make up the difference.

MR. SIEGEL: The actuary may frequently be in the middle of some serious conflicting interests where the employees, through their union, have gained control of the retirement board. In this capacity the employee representatives often fill three capacities. As a union, they negotiate with the individual employer units to obtain large compensation increases. As a lobbying organization, they lobby at the State legislative level for pension benefit liberalizations, citing investment earnings in excess of the actuarial assumption as a justification. As board members, acting in a fiduciary capacity, they adopt inadequate salary scale assumptions which are, it is hoped, to be partially offset by excess investment return and which result in inadequate employer contribution rates.

MR. KENNETH ALTMAN: On the subject of social security integration I think it is a pipe dream to hope that public employee systems will adopt integration at this late hour when unions are finally coming into their own. In New York integration is a dirty word. You simply can't discuss it before a legislative body. We have tried and it's absolutely hopeless.

Excess benefits are the name of our game in New York State. Actually, the title of the heading of this topic is benefit design and the public retirement systems in New York State were not really designed. What happened was that we had a succession of benefit liberalizations to the point that the benefit structure with social security is redundant. The benefits are excessive to begin with. Our retirement age is 55 with a three year final average salary in some plans. Unfortunately, we also have a one year final average salary in some of our police plans.

There have been some victories, admittedly minor, however. The definition of one year final average salary precludes its being more than 20% higher than the three year final average salary. We also tried to ameliorate the effect of these lump sum payments at the time of retirement. In effect, we spread them out so that a person receiving a lump sum adjustment of two thousand dollars with 20 years of employment would receive credit for 3/20 of that in a three year final average salary plan. With respect to the concept of one year final average salary, I think we actuaries have a responsibility not to apply a salary scale which assumes only a 5% or 6% annual increase, no matter how realistic the yearly increase is. We have the responsibility not to just apply a scale of yearly increases, but to determine the cost of the one year final average salary plan reflecting the padding that occurs in many of these plans. Employees, with the assistance of the administrative authorities, sometimes will work enough overtime to achieve double wages in their final year and in these instances the cost of the plan is enormously increased.

My philosophy with respect to funding public plans is that they should adhere to more severe funding requirements than private plans, because the people who authorize these plans are the legislators, who may not be around to pay for the benefits. There is a predisposition to granting a benefit in order to win friends in the next election. In New York State we use a conservative funding method, an aggregate cost method with rather quick amortization of past service liabilities. It is one of the few safety devices in our funding.

We have all the problems that have been described here with respect to the uniformed services plans, including the disability problems and political considerations. The actuary who works for a politician has the problem of expressing his views and yet keeping his job. We very often have to express views which don't win popularity contests, but we do have to put our necks on the line and we do from time to time do exactly that.

Union pressures are enormous. One of the things we have done in New York State to counter union pressures is to require that all retirement legislation have a fiscal note prepared by an actuary. We at the retirement system in New York State prepare these notes without charge for any group filing a retirement bill, regardless of how hairbrained the idea is. We do it gratis, because if we don't, someone's brother-in-law will and we know the results of that mistake.

MR. BLACKBURN H. HAZLEHURST: I disagree with the comment that the actuary should say what he believes without regard to the environment in which those people he's addressing are living. You can assist a plan sponsor ameliorate a bad situation by first showing the full, upright cost as you would normally, and then you can show the cost under various arrangements that will take them from the present undesirable funding situation to the desirable fully funded situation. The move doesn't have to be accomplished in one step, but in a series of gradually improving ones. Governmental plans are usually built from the bottom up. The employees come to the legislature saying give us the benefits now and 20

years later get an actuary to determine the cost. The actuary then comes in and finds an unsound situation. They're putting in 6% of payroll and they should be putting in 36% of pay. If you tell them this, they ignore it, because they just can't cope with paying 36% of payroll. But there are devices by which you can gradually nudge them forward. If you are patient, you can accomplish a lot. It isn't wise to go in and say 36% of pay, period. Show the 36%, but also show alternatives which can improve the situation. In most cases you can do a lot over a period of years. You can probably get accepted the idea that no further benefits be legislated without actuarial studies of the cost implications. Perhaps you can go further and provide that no benefit improvements be made unless the plan would be no worse, actuarially, after the change.

It would be wise for any federal legislation to set guidelines which allow some kind of grading from the present situation to that mandated by the legislation.

MR. SMITH: It appears that the public pension legislation stemming from ERISA will be introduced much sooner than originally anticipated. It was rumored at the recent Municipal Finance Officer's Association meeting that legislation would be introduced in about one month to six weeks without the benefit of the study that was mandated by ERISA. If such legislation passes the constitutionality test, it will probably contain funding requirements and portability standards. It may not contain requirements pertaining to reporting to the federal government or to the plan participants. There are a number of states, Michigan being one, with legislative resolutions calling for studies of the public employee retirement systems in the states. The purposes of these studies are funding and benefit structure. Below the federal and state levels there are numerous survey-type studies of public employee retirement systems, generally emphasizing benefit structure, valuation of assets, or analysis of the actuarial assumptions. Ordinarily they do not cover other subjects.

CHAIRMAN BLEAKNEY: There are many opinions as to whether ERISA should be extended to public plans, and, if so, whether it should be applicable as is or with some changes. In my own analysis, I like to separate the provisions of ERISA into two types--those which affect the benefits of employees and those which affect the financing of those benefits. In the former area are the plan participation requirements, the vesting requirements, spouses' benefit requirements, etc. The latter include funding requirements and benefit guarantee provisions.

I find the arguments unconvincing that public plans should be treated any differently in the former category--that is, the one which governs benefit provisions of plans. These are direct employee rights, and I think the public employee should be given just as generous vesting provisions, for example, as his private counterpart. This is going to pose some problems for public employee plans because of present benefit provisions which are uncharacteristic of private plans. The most significant of these, I believe, is the widespread use of a retirement age prior to age 65. This is going to complicate some of the vesting and spouses' benefit provisions, but I hope that is something that can be handled so as to minimize the differences between the public and private plans in their coverage under ERISA.

With respect to funding requirements, I think there is a good argument for separate treatment of public plans. As much as I would like to have every large state plan properly funded from an actuarial standpoint, it strikes me as being very difficult to prove the need for such funding from the conventional benefit security point of view. About the only meritorious point which comes to mind is the argument that the federal government should mandate funding requirements on large state plans because of the many financial ties between the federal government and the states. The federal government is providing substantial income to state governments for salaries to state employees and therefore might require that fringe benefits--specifically pensions--should be properly cost-accounted at the time the service is rendered. However, the counter arguments--primarily the objection to imposing federal controls on a state budget--seem more persuasive to me.

The situation is much less clear, however, when considering local government units--cities, counties, etc. Although cases of local systems reneging on pension obligations are all but nonexistent, the smaller units do not have unlimited taxing power, and therefore might reasonably be blanketed in under the ERISA rules.

In all of this, the matter of the Pension Benefit Guaranty Corporation comes up. I find it very difficult to justify the dollar per head tax on public plans where the risk of plan termination is essentially nil. My solution to the problem, for both the large state plans and the small local plans, is a suggestion that any federal legislation blanketing public employee systems under ERISA should allow for waiver of the plan termination insurance requirements. The waiver would be effective, the way I visualize it, in any state where the state legislature formally adopts a guarantee of all public employee retirement benefits existent in the state, both at the state level and at a local level. Obviously the guarantee would be largely as specified in the federal law.

Such a provision would have substantial advantages. In the first place, the federal government would not be put in the somewhat awkward position of collecting several million dollars a year in revenue for the Pension Benefit Guaranty Corporation for a risk which is essentially zero. Incidentally, I would be hard pressed to theorize how subrogation to the extent of 30% of corporate assets could be extended to state plans.

From the viewpoint of the state legislature, a benefit guarantee should cause some states which have been rather lax in this regard to take a close look at what is happening in the local retirement systems. If the state government is going to guarantee that benefits will be paid, it obviously should be satisfied that the local political subdivisions are not letting things get out of hand. Although this can create some political problems, the net effect in the long run should be salutary.

Obviously all of this is speculation at the moment. On the other hand, since legislation along this line appears to be imminent, it would seem provident to spend some time thinking through the ERISA problems as they might be applicable to public employee retirement systems. We should be prepared to get commentary before Congress in other than that of a

negative sort--"leave public systems completely out." In no way do I think that tactic is going to work.

MR. RUSSELL J. MUELLER: Maybe I can clarify exactly where federal legislation regulating public employee retirement systems stands. The study of public employee retirement systems has been mandated by ERISA. There will be a study by a pension task force, and I would like to extend an invitation to individuals or groups to submit to the task force or to me their recommendations on what the issues are, their extent and range, and what ought to be done.

I also work in a political environment. Since I have always assumed that the worst that could happen is to be fired, I will speak out. I support federal legislation for vesting, for fiduciary standards, and for funding. And I think that funding can be made applicable to not only local plans, but also to state plans. Certainly, you can't apply ERISA standards overnight, but they can be graded in. The state systems that have been on a pay as you go basis have shown how to do that. I think a bill will be introduced by Congressman Erlenborn, perhaps joined by Congressman Dent, Chairman of the Labor Standards Subcommittee. There will be extensive hearings on the bill over several years. Congress wants to take a hard look at it. There is not going to be any overnight legislation. There wasn't overnight legislation in the private pension area.

I extend an invitation to individuals to write and express their views. A number in this room have already, and I hope that everyone who has an interest in the area will do so.