RECORD OF SOCIETY OF ACTUARIES
1978 VOL. 4 NO. 1

OVERLAPPING BENEFITS—THE INTERSECTION OF SOCIAL INSURANCE AND PRIVATE INSURANCE

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1. Social insurance involvement in casualty and property coverages.

2. Impact of social insurance and individual disability insurance.

3. Social insurance impact on private retirement plans, in the United States.

4. Social insurance impact on private retirement plans, and on individual insurance plans, in Canada.

MR. STEPHEN S. MAKGILL: My role on this panel is to comment on growing social insurance involvement in casualty and property coverages. Casualty coverages provided by private insurers in the United States have for over 60 years included a social insurance line, namely workers' compensation, the oldest United States social insurance program.

Each State has its own workers' compensation statute, State administered and supervised by State agencies. These laws require the employer to guarantee his employees specified benefits in case of accident or injury on the job, but for this guarantee, the employee foregoes the right to sue; that is, it is a no-fault system. The employer may insure the risk with a private insurance carrier, he may qualify for self-insurance, or he may purchase coverage from a State fund. In six tates there are exclusive State funds, private carriers being barred.

The Federal Government has established additional workers' compensation programs: The United States Longshoremen's & Harbor Workers' Compensation Act, applying to both harbor workers and workers in the District of Columbia, The Federal Employees' Compensation Act, and, more recently, The Federal Black Lung Act covering coal miners for pneumoconiosis claims. These Federal Acts are administered and supervised by Federal agencies, and there are many areas where the jurisdiction of State or Federal acts is not clear. There are other areas where the injured employee may choose which act to come under, the remedies being mutually exclusive however. The most recent change in the Federal Black Lung Act allows the Federal Government to provide the necessary insurance coverage when such coverage is not available "at a reasonable price."

The Social Security system overlaps the workers' compensation systems in the areas where the latter are paying benefits for long term disability, or to dependents in death cases. Social Security provides disability payments after a 5 month waiting period if it is expected the disability will exceed 12 months. However, if the worker is under age 62, the system limits such

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disability payment to an amount which, when added to the workers' compensation benefit, brings the total to 80% of average current earnings. At age 65 this Social Security disability payment ceases, retirement benefits automatically taking over.

The retirement provisions of the Social Security law have no similar workers' compensation offset provisions. As a result, it is not uncommon, particularly in dust disease cases, to find pre-age 65 income exceeded by the sum of the Social Security retirement benefit, a workers' compensation award, and an employer or union pension plan provision.

Note that the employer is paying the entire cost of workers' compensation, 50% of the Social Security benefit cost, and often the entire pension plan cost.

In death cases we find another overlap between the two systems, with no offset provision. Workers' compensation laws provide payments to widows or widowers until death or remarriage, and to dependent children to age 18 or beyond if in school. Social Security pays benefits from the date of death of an insured worker to a widow or widower at age 60, or at age 50 if disabled, or to a widow or widower with dependent children.

The philosophic differences between workers' compensation and Social Security are observed when we see that workers' compensation laws provide for subrogation when a third party is held liable for the employee's injury. The Social Security disability laws have no similar provision, thus paying benefits while allowing the worker to make a recovery under tort law.

Turning to other lines, the adoption of automobile no-fault laws has created another social insurance line in the casualty area. However, application of the no fault principle is limited to legislated threshold values, beyond which tort laws again apply. To date these laws have been enacted on a State by State basis, but proposals for a Federal law have been advanced in Washington. Coverage for automobile no-fault is provided by the private insurance market.

The Federal Flood Insurance Program can be considered a form of social insurance, providing property coverage against damage from rising waters at a cost requiring considerable subsidization. Servicing of this program had been handled by private carriers, but at the beginning of this year the Federal Government saw fit to take on the task.

The traditional casualty -property lines are seeing more and more State-adopted plans designed to solve one or another social problem. The general liability line has seen the establishment of joint underwriting associations to provide malpractice coverage. Product liability coverages would be reshaped by various proposals now being considered to solve runaway insurance premium problems caused by consumer safety awareness. In the property area, "Fair Plans" have been instituted to provide property coverage in high hazard, low value situations.

While automobile assigned risk plans are not new, their structure may well be affected by current social pressure to remove age and sex as a classification criteria. Additional moves to broaden or eliminate geographic boundaries in the rating can be expected to have further impact on these assigned risk plans.

Each time a casualty or property line is affected by shifts in social policy, the actuary is challenged to develop the cost implications. All too often in these socially motivated changes, it is necessary to adjust statistical evaluations by a measure of what human nature may do in the new environment to change prior patterns.

MR. GERALD S. PARKER: I am going to discuss the effect of social insurance on individual disability insurance, because it is no great trick to integrate group disability insurance with social insurance. Integration solves that overinsurance problem.

THE PROBLEM

Simply stated, the problem for individual insurance is that the benefit levels of various social insurance disability plans (and in particular Federal Social Security) have risen precipitously in the last five or six years, and the Uniform Policy Provisions Law prohibits the reduction of benefits to integrate with social insurance. So the underwriter takes his choice between losing his markets and losing his shirt.

As background, it should be noted that workers' compensation insurance used to be something that disability underwriters ignored, except when they were dealing with the blue collar workers. Many still do. But workers' compensation insurance around the country now generally provides about two-thirds of salary. The highest level of compensation is in Alaska with $552 per week. Federal employees get 75%, up to $571 per week. Translated into monthly benefit terms, which is the frame of reference of most of our present disability policies, the range is from about $2,400 per month to $217 per month with the median and mean both in the area of $650 per month.

Underwriters used to ignore entirely automobile insurance, because all we had was the tort system, and two or three years usually passed before the injured party received anything. By that time, he usually had either recovered or become permanently disabled. And it was pretty hard to relate a tort recovery to actual disability wage loss.

Now the situation is quite different. About 18 States have no-fault laws that are independent of the tort mechanism. The monthly benefits run from 60% to 85% of prior earnings. In most States, the benefits are subject to an overall dollar limit or a time limit, such as a year. The average maximum is in the neighborhood of $750 a month.

Chart I shows Social Security benefits information at four levels of earnings. This chart assumes inflation in the wage rate consistent with that predicted by the Social Security Advisory Council and the resulting effect on the benefit levels. The right-most column shows the replacement ratio: the Maximum Family Benefit in the year when the disability begins divided by the annual earnings of the previous year.

This column indicates that there really is no rational basis for issuing individual disability insurance in 1978 unless the actual earnings for the previous year were in the area of $25,000. A $25,000 a year man would have been entitled to Social Security benefits of around $1,000 to $1,100 a month. Since 60% of his earnings would be about $1,250 a month, you could reasonably offer him about $250 per month of benefit. The chart is for age 29. The 45 year old's Social Security benefit this year might be $850, so we have little more leeway with him.

The situation will be quite substantially improved beginning in 1979 when the de-coupling that was a part of the 1977 amendments begins to affect claimants. But note that this only brings the replacement ratio down to about 60% for people within the Social Security wage base. This means there is another $200 per month which can be issued to a $25,000 per year earner. Put another way, we probably now have a market with the $20,000 earner. But as the bias against older workers gradually disappears, we will be helped less with them.

WHAT IS BEING DONE

Insurance companies generally have done much weeping and wailing about the constant Social Security benefit increases which have so drastically reduced their individual disability insurance business. A few panicked and got out of the business. About ten year ago, companies began putting $150 or $200 per month of Social Security offset in their benefit formulas. They made an assumption that the insured would receive $200 a month from Social Security and issued, for example, 60% of earnings less $200 per month. About two or three years ago, companies started to wake up to the fact that they were offsetting $200 per month when actual benefits were about $500 per month, and they were getting clobbered with overinsurance as a result. The Guardian and some other companies began increasing the offset to about $500 per month. In checking with our main reinsurer, I learned last week that the level of this offset now runs from about $500 a month, as a minimum, to $800 and $900 per month. More and more companies are now offsetting as much as $900 per month.

Chart II indicates the impact of this on the market, using a $750 per month offset. It shows that anybody earning less than $20,000 per year is pretty much ruled out of the individual disability insurance market. In effect, you cannot issue your maximum limit, of which $3,500 would be a representative example, to anyone making less than about $85,000 per year.

How long can you really afford to issue policies for $250 per month? The premium for that policy usually will not exceed about $150 per year --which is generally believed to be the expense of putting the business on the books.

A further step taken by the Guardian and The Monarch Life, and under study by a number of other companies, involves issuing a rider which provides an additional benefit, for example $750 per month or whatever the potential Social Security benefit is, payable for any disability that qualifies under the basic policy, but for which no benefits are actually being received under no-fault automobile insurance, workers' compensation, or Social Security. Unfortunately, the State of New York has not yet agreed that this rider is legal under the Uniform Policy Provisions Law, although 40 other jurisdictions think it is.

EXPERIENCE UNDER PRESENT PRACTICE

What have we accomplished with the measures taken within the last four or five years? Many are weeping rather bitter tears about the results. Chart III presents the Schedule H numbers of a group of leading companies selling disability insurance to business and professional risks. I can assure you that companies that specialize in blue collar business are not better off!

The supplemental loss ratios are based on noncan only, because Schedule H doesn't separate out the guaranteed renewable loss of time from the health care, so you cannot tell much from it. But there is no reason to suppose that the results are very much different on that line of business. Now leaving aside life insurance accounting and the fiction in Schedule H that your expense ratio ought to be measured by dividing your expenses by your earned premiums, let us assume that you run a pretty tight ship and that you can get your expenses down to somewhere around 40% to 45% of written premiums. That is better than most companies can do. It does not take very advanced arithmetic to compare that against the supplemental loss ratios experienced last year and to figure out that not many people were making underwriting profits. Indeed, only one of the companies we surveyed made an underwriting profit, and that amounted to a break even because its $49,000 of underwriting gain was on more than fifty million dollars of noncan premiums. Granted, there were some pretty substantial investment earnings generated, and not everybody was in the red on the bottom line. But most of them were. Most of these companies had combined ratios, as the casualty people call them, of anywhere from 115% to 120%.

The significance of these results is that, if you had looked at that same column of loss ratios in 1973, they would have been about half to three-fourths of those figures. For example, Company I had a 1973 supplemental loss ratio on noncan of 46.1%. That is a 42% increase in four years. The bulk of the increase may be attributed to the overinsurance situation. Admittedly, some of it is due to some recession and unemployment, but far too much of it arises from a deterioration in the claim termination rates on claims that were submitted on policies issued between about 1968 and the end of 1973.

The three columns on the right are on the chart in case somebody asks if we have all been stashing away excessive reserves. There are some branches of our business where that is not unknown. Lines 55 and 56 on page 14-B of the annual statement deal with all individual health insurance, not just noncan loss of time, but most of the companies on this list write little or no individual health care business. Practically all of it is noncan loss of time. As you know, line 56 shows the claim liability and reserse set up at the end of the previous year, and line 55 shows the amounts still reserved on the same claims at the end of the statement year. If line 55 is greater than line 56, it is an indication that claim reserves are pretty thin. I divided the difference between the two by the amounts set up in the prior year and derived the percentage. As will be seen, most of them were negative or inadequate.

WHERE DO WE GO FROM HERE

To end on a more positive note, let us hope that lessons have been learned from recent experience and that the individual disability insurance line can get back in the black and companies stay in this business.

CHART I

1977 SOCIAL SECURITY LAW BENEFIT CHANGES

AGE 29 DISABILITY

YEAR OF DISABILITY	ANNUAL EARNINGS IN PRIOR YEAR	PIA	PIA R.R.	MFB	MFB AS % OF PIA	MFB R.R.
			LOW EARNER			
1978	$ 3,885	$270.70	81.6%	$ 455.40	168.2%	137.1%
1979	4,308	214.80	59.9%	322.20	150.0%	89.8%
1985	6,273	318.00	60.8%	477.00	150.0%	91.2%
			AVERAGE EARNER			
1978	$10,001	$494.00	59.3%	$ 864.30	175.0%	103.8%
1979	10,811	381.90	42.4%	689.40	180.5%	76.5%
1985	15,742	503.80	43.0%	1,020.00	180.9%	77.8%
			$17,700 EARNER IN 1978			
1978	$16,500	$622.30	45.3%	$1,089.00	175.0%	79.2%
1979	17,700	502.60	34.1%	879.60	175.0%	59.7%
1985	25.774	743.40	34.6%	1,301.00	175.0%	60.5%
			MAXIMUM EARNER			
1978	$16,500	$622.30	45.3%	$1,089.00	175.0%	79.2%
1979	17,700	502.60	34.1%	879.60	175.0%	59.7%
1985	36,000	866.50	28.9%	1,517.00	175.0%	50.6%

Foot Notes:

PIA = Primary Insurance Amount

R.R. = Replacement Ratio

MFB = Maximum Family Benefit

CHART II

EFFECT OF PRESENT PRACTICE - $750/MO. OFFSET

SALARY (PER YEAR)	60% (PER MONTH)	OFFSET	ISSUE LIMIT
$12,000	$ 600	$750	$ -0-
$15,000	$ 750	$750	$ -0-
$20,000	$1,000	$750	$ 250
$30,000	$1,500	$750	$ 750
$40,000	$2,000	$750	$1,250
$60,000	$3,000	$750	$2,250
$85,000	$4,250	$750	$3,500

CHART III

EXPERIENCE WITH RECENT PRACTICE

COMPANY	NONCAN SUPPLEMENTAL LOSS RATIO	NONCAN UNDERWRITING GAIN	PAGE 14B, L55 - L56 / L56		
			1975	1976	1977
A	71.6%	($6,490,584)	(9.2%)	(28.7%)	(10.0%)
B	62.6%	($5,903,443)	(16.8%)	(4.8%)	(4.8%)
C	51.8%	$ 48,840	3.7%	4.2%	3.2%
D	61.7%	($4,386.003)	5.9%	(.8%)	5.8%
E	67.9%	($3,215,501)	(3.1%)	(3.5%)	(8.4%)
F	68.4%	($4,214,781)	(10.6%)	4.9%	.5%
G	62.5%	($2,674,494)	16.5%	(33.8%)	(4.1%)
H	79.4%	($2,827,215)	(47.9%)	(49.2%)	(39.4%)
I	65.8%	($1,514,289)	10.7%	1.3%	(1.8%)

MR. JAMES F. BIGGS: Let us consider some of the characteristics of the U.S. Social Security system which are pertinent to a consideration of the system's impact on private retirement plans. The extent to which these characteristics have been present has varied over time. They are the following:

1. The virtual universality of coverage, or at least as close to universal as Congress can make it given the constitutional problems relative to State and local government employees and the political clout of Federal employees.

2. The floor of protection concept, which has always been given lip service although there has been recurring debate over the years on the question of whether it should be a rough pine floor or a polished hardwood floor, whether it should have a rug, and just how thick that rug should be.

3. The concept of equal cost sharing between employer and employee.

4. The emphasis in the system on need opposed, to some extent, to equity. This is manifested in two ways. First, the heavy front loading of the benefit formula, which has the effect of providing proportionately higher benefits for those who have low wages or only a relatively short period of coverage under the system. Second, the retirement test; you must be both age 65 and out of employment status.

5. The protection against increases in the cost of living, both before and after retirement.

6. The portability of protection from employer to employer.

7. The provision of substantial additional family benefits.

8. The constancy of change in the system, particularly in election years -- perhaps the most significant of all.

Obviously, a system with these characteristics has to have a very substantial impact on the creation and maintenance of private retirement plans. First, in a general way, by providing a floor of protection, Social Security helps to justify and make possible the creation of modest private retirement plans. An employer presumably could not or would not consider the establishment of a retirement plan for his employees which only provided benefits of 10% or 15% of pay for most employees. However, when he knows that this is going to be combined with a social insurance benefit, and that the two together will provide a reasonably adequate total benefit, his private plan becomes possible. The other side of this coin, of course, is that if the rug on the floor gets too plush, Social Security can eliminate many private plans by making them entirely unnecessary. This was a very real possibility under the 1972 amendments to the Social Security Act before the recent decoupling, and this competitive problem is intensified by the fact that the Social Security benefits are tax-free whereas private retirement benefits normally are taxable. A second general aspect, as we may see in the near future, is the fact that increases in Social Security taxes can discourage employers from spending more money on private plans.

Besides these general influences, we have specific influences by Social Security on the design of particular provisions of private retirement plans. The existence of a substantial social insurance retirement benefit has to enter into an employer's thinking on the design of the benefit formula or the contribution formula under his private plan. The most obvious example, of course is a plan which is specifically integrated with Social Security, whether it be an excess plan, a step-rate plan or an offset plan. Beyond this you have what might be called implicit integration, such as a situation in which the employer provides a modest flat dollar retirement benefit for his hourly employees with a more generous pay-based pension plan or a profit-sharing plan for his salaried employees. Even in those situations where the employer has neither explicit nor implicit intggration, the benefit level under his private plan is chosen keeping in mind the combined income including Social Security.

There are other influences which Social Security has or may have had beyond the benefit level itself. Certainly, the pervasive presence of Social Security has helped to make age 65 the standard normal retirement age in private plans. The existence of a fully portable national retirement program has helped to justify in the minds of many employers less liberal vesting in private retirement plans. The substantial taxes required on employees under ocial ecurity has helped to discourage contributory private retirement plans, and obviously the discouragement becomes greater as Social Security taxes increase. The cost-of-living provisions in Social Security have tended to encourage a demand for similar protection in private plans while at the same time perhaps reducing the urgency of such provisions. Private plan disability provisions very often are keyed to the OAS DHI definition of disablement, and in fact the integration rules encourage and to some extent mandate this. There has been some evidence of liberal administration and liberal judicial interpretation of the Social Security disability provisions in recent years. This, of course, has proved costly to the Social Security system, but it has also proved costly for those private plans that have used Social Security receipt of benefits as evidence of disablement. Many plans have developed specific provisions for early retirement supplements or Social Security adjustment options which themselves are designed to fill the Social Security gap on early retirement. Finally, past limits on Social Security covered earnings, along with the cost of other employee benefits, have encouraged employers to work people overtime rather than to add additional people to their work force either on a full-time or part-time basis.

The system also influences employee conduct,and therefore,it influences the experience which the private plan will have. Most obviously, the availability of adequate benefits encourages employees to retire --witness the heaping of retirements at age 62 in private plans covering hourly-rate employees. Another factor encouraging retirement which is not commonly considered is Medicare. Large medical expenses have always been a major fear of older persons. Adequate individual insurance was either unavailable or prohibitively expensive, so that employees found in the past (and might be finding currently in the absence of Medicare), that hanging onto their jobs and keeping their group insurance in force would be their only defense against this very real burden. The earnings test, and until recently the lack of a reward under Social Security for postponement of retirement, have encouraged employees to remove themselves from the labor force at or around the normal retirement age. Portability, that is, the transferability of Social Security protection from one employer to another, encourages mobility of labor and as a result has an impact on the turnover experience under private retirement plans. Finally, with respect to plans for those public employees who do not have Social Security coverage, the Social Security front loading has encouraged moonlighting, and it has encouraged early retirement followed by a second career covered under Social Security, in order to maximize total retirement benefits.

Some recent changes have an impact on a number of the things that I have just discussed. Very briefly, to the extent that the recent Social Security amendments reduce the benefits below the levels that would otherwise have been paid, they will increase the amount payable under offset plans in the private sector. This increase, coupled with the increased taxes which will be paid in the future by employers and employees, will put a distinct cost pressure on private plans. At the same time, the liberalization of the earnings test and constant pressure not only to liberalize the test but to eliminate it entirely and the increase to 3% in the annual increments for delayed retirement will encourage continued employment. In the past this might not have been so significant because the employee might not have had the opportunity to continue in employment but, coupled with the increase in the legal mandatory retirement age to 70, it may well result in a definite increase in the average retirement age. Finally, the Carter Administration has proposed changes in the basic concept under which private plans are integrated with Social Security, and that, if passed, could require wholesale revision in private plans.

Let me conclude by just mentioning two ways in which Social Security affects private plans indirectly through its impact on the economy. This impact is less measurable, it is subject to far more widely varying interpretations and to some extent is proably more in the realm of the economist than the actuary, but I suppose I can talk about it since we are expanding our horizons.

One aspect of it is that the system charges a uniform tax rate on covered earnings, but at the same time provides much greater benefits at the lower end of the earnings scale. Most of us think of this as a subsidy from higher compensated employees toward lower compensated employees. But at the same time it means that high wage employers, whether they are in high wage industries or in high wage areas, pay proportionately more than their share of the cost for the benefits their employees receive. To be parochial about it, New York has for 40 years been helping to subsidize the retirement costs of the sun belt States. It is just possible that Senator Moynahan and Mayor Koch might like to call attention to that next time they are in Washington.

The second arises out of the fundamental purpose of social insurance. This is generally to provide a safety net for those citizens who fall victim to one of the contingencies of life, and out-living one's financial resources is certainly one of those contingencies. However, in providing a safety net, social insurance programs represent a transfer of money from producers to non-producers. They represent an encouragement of consumption as opposed to investment. If they are carried too far, whether in design or in administration, they can encourage withdrawal from the labor force by otherwise productive citizens. The consequences of all of this can include inflation on the one hand, and a squeeze on corporate profits with resulting poor investment performance on the other. We have been living through this sort of two-pronged dilemma for at least ten years now. In the long run, if this combination, whatever its causes, persists, it certainly poses a threat to the very viability of the private pension movement.

MR. KEITH H. COOPER: My role on this panel is to provide you with a perspective on the impact that Canadian social insurance programs are having on private plans today, as well as future trends on individual retirement, death, disability and health needs. To put matters into proper perspective, I intend to provide a brief background, including a few basic statistics, to put us all on common ground. Then I will attempt to forecast some possible trends based on my knowledge of the Canadian benefit scene.

HEALTH PROTECTION

Canada, through provincial hospital and medicare programs, provides what is essentially universal health coverage to all its citizens. Ward hospital coverage and most medical services are provided through these programs. Their cost is subsidized approximately 50% by the federal government with the remaining 50% being raised in various ways by the provincial governments. For example, Quebec has a payroll tax shared by employees and employers in conjunction with general revenues. Ontario uses a combination of general revenues and a specific premium from individuals under age 55 ($22 per month if single, $44 with one or more dependents), while Saskatchewan's program is funded entirely from general revenues.

Also, in a few provinces dental coverage for children is provided. The federal government contribution does not apply to dental coverage.

The private sector is therefore left to insure hospital coverage above ward care and those medical services not covered by provincial medicare programs, which, incidentally, are not uniform in the level of coverage provided. Private dental protection is a growing benefit in Canada and will undoubtedly continue to grow over the next few years. Government encroachment in the area of dental protection will continue, but at a modest level because of the significant cost implications of hospital/medicare protection in Canada.

For example, Ontario projected such medicare costs at 28.2% of its total 1978-1979 budget. Individuals contributed another 8.0%. So the total cost of Ontario's health programs is projected at 36.2% of its 1978-1979 budget and that is only half the cost since the federal government picks up the balance.

PROTECTION FOR SURVIVORS

Before discussing protection for survivors, some statistics shall prove helpful. In 1978, covered Canada Pension Plan ("CPP") earnings equal $10,400. This ceiling will grow by 12½% per year until it reaches the average industrial wage (expected in 1983), at which point it will then follow this index. Contributions from employees and employers are 1.8% of earnings up to the ceiling which is reduced by 10% ($1,000 in 1978). So in 1978, the maximum CPP and also Quebec Pension Plan ("QPP") contribution is 1.8% of $9,400 ($10,400 - $1,000) or $169.20, an amount far below the 1978 maximum of $876.15 required by U.S. Social Security (exclusive of the medicare contribution). CPP contributions are tax deductible and all benefits paid are taxable.

The Canada Pension Plan provides a modest lump sum death benefit and a pension to the surviving spouse and dependent children under age 21 of an eligible contributor (one who has contributed for at least 3 years and for not less than 1/3rd of the years in which he could have contributed).

A lump sum C/QPP death benefit is provided equal to at most 10% of covered earnings in the year of death - $1,040 in 1978. Survivor benefits are payable if the spouse is over age 45 or, if under age 45, as long as there are dependent children. Benefits to the surviving spouse cease on death or remarriage. The benefit equals 37½% of the contributor's projected retirement pension plus a flat dollar amount. The combination of the two generates a maximum pension of about 14% of covered earnings, or $121.11 per month in 1978. Dependent children under age 21 each receive the same amount of flat dollar pension which is payable to the spouse, or $48.19 monthly in 1978. A family of four children and their parent, for example, would receive $313.87 per month (36% of covered earnings). All of these benefits are fully indexed annually to changes in the cost of living. (A surviving spouse over age 65 would receive 60% of the employee's pension - maximum $116.66 in 1978, or 13% of covered earnings.)

The Quebec Pension Plan, which parelleled the CPP up to 1972, provides the same retirement pension but larger death and disability pensions. The QPP survivor's pension amounts to 23% of covered earnings compared to 14% under CPP. The dependent children's benefit under QPP is $29.00 per child and this benefit, unlike the flat dollar benefit under CPP, is not indexed. In the case of a surviving parent with 4 children in the province of Quebec, QPP survivor income would equal 36% of covered earnings - the same as under the CPP.

To be adequate, income to a surviving spouse should be at least 50% of the income of the breadwinner, and possibly more like 60% to 66-2/3%. Even higher levels are required if there are dependent children. Consequently, there is room for private insurance and survivor coverage over and above C/QPP benefits, although the amount of protection needed in Quebec is more modest. Of course, on earnings above the level covered by the CPP (referred to as the YMPE - Year's Maximum Pension Earnings), the only source of protection is through private coverage.

All provinces have workers' compensation programs. Death that is due to occupational reasons generate non-taxable lump sum and survivor benefits in addition to any C/QPP benefits. These benefits vary by province. In Ontario, for example, such benefits would provide a surviving spouse 33% of the C/QPP 1978 YMPE level - tax free. The combination of C/QPP and workers' compensation survivor benefits would total in excess of 57% of the YMPE (66% under QPP) for a surviving spouse without dependent children. Although this coverage is not excessive, in the instance where there are children the total monthly income could be a substantial portion of the breadwinner's income.

The need for protection for survivors in the future will depend on the direction of the growth of the C/QPP. Increases in the level of the YMPE (above one times the average industrial wage), or the formula benefits provided, would decrease the degree to which private coverage would be sought. Adoption of the QPP formula benefit levels by the CPP would obviously reduce the level of private protection required by CPP contributors.

DISABILITY PROTECTION

Disability benefits provided by the CPP are lower than those produced by the QPP. Disability benefits are available to all those who have contributed in at least 5 of the last 10 years <u>and</u> at least 1/3 of the years in which contributions could have been made. Disability must be essentially total and permanent, i.e. unable to support oneself.

CPP maximum disability pensions are about 23% of the YMPE ($194.02 per month in 1978). QPP maximum disability pensions are about 31% of the YMPE ($269.42 in 1978). Both plans provide flat dollar pensions to dependent children similar to those payable on death. All benefits except the children's benefit under QPP are indexed to changes in the cost of living. The Ontario Pension Benefits Act allows disability pensions to be offset by any CPP disability benefits payable but not by any subsequent increases in CPP benefits resulting from cost of living indexing. The Superintendent of Insurance for Ontario has advised insurers to follow a similar practice under disability income contracts. The other provinces have taken similar positions.

Under existing arrangements there is ample room for private coverage to develop disability benefits at adequate levels, although in Quebec the need is not so great.

Workers' compensation benefits are also available under conditions where the disability had an occupational origin. These tax-free benefits approximate 75% of the YMPE level and when combined with C/QPP benefits are excessive. Private program benefit formulas usually offset both C/QPP (children's benefits are normally excluded) and workers' compensation benefits in order to avoid aggravating an already excessive degree of protection. Obviously, any further enhancement of disability coverage by the QPP would reduce the already limited scope for coverage in the private sector. The CPP could expand its disability benefits to be consistent with the QPP.

RETIREMENT NEEDS

I have saved the area of retirement needs to the last because it is currently under substantial review in Canada. A number of independent studies of this very broad and complex area are now being undertaken. A task force by the federal government, a Royal Commission in Ontario, a study by the Economic Council of Canada, studies by the province of Quebec, a study by the Financial Executives Institute and an independent actuarial review of the financing of the Federal Public Service Pension Plan are all in progress or just completed. All of them will be completed by early 1979.

At that time, the future direction of government pension programs will be known, including such considerations as:

1. The level of pension income to be provided by government programs. (Today C/QPP provides 25% of the average the YMPE in the year of retirement and the preceding 2 years or about 23% of final YMPE while Old Age Security ("OAS") adds another 17%, to produce total government sponsored pensions of 40% of the YMPE.)

2. The age at which government pensions will be offered on an unreduced basis. (Currently both C/QPP and OAS pensions commence at age 65.)

3. Whether an earnings test will have to be reintroduced. (Such a test existed in 1966 when the C/QPP came into effect. It was dropped in 1975 by the CPP and in 1977 by the QPP.)

4. The direction that the funding of the C/QPP will take in order to offset increasing benefit outflows attributable initially to a maturing of the plans and eventually to an increase in the population of beneficiaries relative to workers (contributors) as the result of the post-war baby boom. (The combined current contribution level of 3.6% from employees and employers is below the level entry age contribution of approximately 8% needed to support the plans notwithstanding the fact that a $12 billion dollar fund now exists.)

The pension debate that is occurring in Canada has stemmed from a number of factors, including:

1. The lack of 100% coverage of the work force by private sector plans while C/QPP essentially covers 100% of the work force.

2. The inability of the private sector to cope with the desirable feature of portable pensions, an automatic characteristic of universal pension programs like the C/QPP.

3. The unwillingness on the part of the private sector to commit itself to an open-ended financial liability in order to introduce fully indexed pensions. The pressure here comes not only from fully indexed C/QPP and OAS pensions but also from federal and provincial government pension programs where full indexing is also provided at what appears to be a bargain price - 1% of pay from the civil servant and a matching 1% from government.

4. Overly generous pensions, available to federal civil servants in particular, have created an "us" and "them" syndrome. Pensions of as much as 70% of final 6-year average pay available, unreduced, as early as age 55 (after a minimum of 30 years of service) and fully indexed to the cost of living have galled those in the private sector who cannot obtain similar arrangements for themselves, yet are paying the taxes that provide such generous arrangements to civil servants. A recent independent actuarial study indicated that the average employer cost of federal civil service pensions was about 9% greater than the average employer cost for private sector pension plans. The comparability of total compensation packages as between the private and public sectors is a key issue in Canada.

These are the major reasons for the hot debate on pensions that now ensues in Canada. Economic issues abound as well, and in fact, it will probably be economic factors that will determine the outcome of issues such as:

- Whether the C/QPP will be funded in advance or on a pay-as-you-go basis.

- The effect that a funded C/QPP would have on saving patterns, the manner in which such funds would be invested, or consumed, by the provincial governments who would have access to them and the overall impact that such a large pool of capital would have on the capital marketplace.

The impact of all of this on private pensions is enormous. Should the decision be reached that an enhanced C/QPP is the solution, a position endorsed by the Canadian Labour Congress, then there will be little room left for private pension programs except on earnings above the YMPE. It is also conceivable that the limit on covered earnings could be increased beyond the YMPE in its present conception, thereby reducing the role of the private pension system yet further. In fact, the Quebec study on pensions, just released to the public, recommends that the QPP increase pension levels from 25% of the YMPE average to 50% of the 1st ½ of the YMPE average and 25% of the next ½ of the YMPE average. Also employer contributions would no longer be restricted to the YMPE although employee contributions would continue to be made only on earnings up to the YMPE.

Research undertaken by me and an associate of mine, which will be included in a book to be published by the Financial Executives Research Foundation later this year, postulates that a pension of 75% of final pay up to the YMPE and 55% of final pay above the YMPE will be sufficient to match pre-retirement after-tax income, bearing in mind the saving patterns of workers prior to retirement. With 40% of earnings up to the YMPE coming from government sources, we are then left with 35% of final earnings up to the YMPE and 55% of final earnings above the YMPE to be provided by the private sector.

My view is that the private sector will remain with a major role once this pension debate is over. A number of improvements in private sector pension plan provisions will need to occur, however. For example:

- Improved vesting.

- Means for dealing with portability, such as pre-retirement indexing after termination of employment or possibly a form of money purchase minimum.

- Some form of automatic post-retirement indexing, even if it is only on earnings up to the YMPE and is 1% or 2% below the actual increase in the cost of living.

- A continuation of 50% to 60% of the breadwinner's pension income to the surviving spouse.

If the private sector can realign present pension arrangements to accommodate these needed changes, then my view is that there will be no further government encroachment on the private pension sector. Costs will increase, but reduction in starting pensions, particularly on earnings up to the YMPE, which exceed "adequacy" levels, will help to keep cost increases down. Further, a recognition that employees must share in the cost of the provision of pensions will also serve to dampen cost increases. This is being achieved by some employers with non-contributory plans by introducing company-sponsored group Registered Retirement Savings Plans. Others have optional contributory plans in addition to compulsory non-contributory "floor" plans.

All in all, the private pension system will survive in Canada as long as needed alterations discussed earlier are viewed in a positive manner by the private sector and the need for innovative approaches by the insurance industry for the development of funding vehicles for common pension programs for small employee groups is met.

MR. CHRISTOPHER GARAND: Recently the mandatory retirement age was extended in the U. S. to 70 and intuitively I feel that there are cost implications relative to a shifting from Social Security to private insurance. Has there been any research and quantification of the cost implications of this on Social Security, worker's compensation, disability health plans, pensions and so forth?

MR. CHARLES B . H. WATSON: That is a broad question. Which one of the panelists wants to tackle it first?

MR. BIGGS: The magnitude of the impact of this new legislation will depend enormously on the decisions that employers make about what to do with their private plans. We can assume that the change in mandatory retirement provisions will encourage some people to continue in employment. If retirement plans generally are not changed, the likelihood is that some reduction will occur in employer retirement costs because most plans do not start the retirement benefit at the normal retirement date if the individual continues in employment. Also, a fairly substantial number of plans do not give additional credit for service beyond the normal retirement age and/or under final pay plans, they freeze the averaging of the salary at the normal retirement date even though the individual continues in employment. There was a carefully staged written dialogue between the Congress and the Department of Labor on what the consequences would be under ERISA of this extension of mandatory retirement age, and my understanding is that this established for the record an agreement that employers would not be required to credit post-65 service and that the pay averaging could be frozen at age 65. How long this will be viable, particularly in a negotiated situation becomes a very questionable thing.

MR. JOHN ROWLE: Will the change in mandatory retirement age from 65 to "whatever," be a precursor to a change in the Social Security retirement age from 65 upward?

MR. BIGGS: I guess the candid answer is "Damned if I know." Clearly, this is one of the proposals which has been made by some members of Congress, by various study commissions, and by various knowledgeable individuals as one of the solutions to the financing problems of Social Security. It seems to me there have been specific proposals for a gradual advance in the retirement type over a period of time, such as moving it up by 3 months every 3 years. As for the political realities of such a proposal, I cannot even speculate.

MR. CHARLES L. TROWBRIDGE: There are some straws in the wind that might put the retirement age of Social Security upwards, but they are not related to the raising of the mandatory retirement age in the private sector. They are two separate issues, from two different sources. There are certain demographic influences and other factors that might lead to thinking that eventually normal retirement age under Social Security will be higher. There are also some political influences, mostly related to discrimination issues, that are getting us off of mandatory retirement at 65. These are not the same thing and so the change in the mandatory retirement age under private plans is not really a precursor of higher retirement ages under Social Security, but they may come anyway for other reasons.

MR. WATSON: That is certainly a possibility, but if you look around the world, the pressures we see are still being exercised towards reducing retirement ages. I grant you that the argument about demography is raging in some of these countries, but there is not evidence anywhere in the world, yet, that governments are trying to raise Social Security retirement ages.

MR. COOPER: The Scandinavian countries and some other European countries set their Social Security retirement ages at 67 and 68.

MR. WATSON: That is right, but they have been reducing retirement ages. They started off with a higher age but the trend in Scandinavia has been to inch the age down--so far.