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PROVIDING FINANCIAL SECURITY FOR RETIREES

Moderator: DONALD S. GRUBBS, JR. Panelists: M. DAVID R. BROWN, C. LAMBERT TROWBRIDGE, THEODORE J. KOWALCHUK

1. To what extent do the OASDI program and the Canada-Quebec Pension Plan meet the needs of retirees, both at the date of retirement and during the inflationary years that follow? What are the desirability and the prospects for change?

2. What is the role of personal savings in meeting the security needs of retirees? Is it declining? What is the outlook? Should steps be taken to enhance the role of personal savings?

3. To what extent do employee pension plans contribute to the needs of retirees at the time of retirement? What are the gaps in coverage? How do vesting provisions affect the role of pension plans? Are changes expected or desirable?

4. Should private pension plans be adjusted for inflation after retirement and, if so, how? Should a separate cost-of-living index be developed for retirees?

5. What is the supplemental role of thrift plans and other deferred profit-sharing plans?

6. Does the lack of portability affect the security of retirees? If so, what solutions are suggested?

MR. DONALD S. GRUBBS, JR.: This session covers the very broad topic of "Providing Financial Security for Retirees." We shall consider what the need of retirees are for financial security, whether those needs are being met, and the difficulties of employers and others serving the programs in trying to meet those needs. To meet those needs, traditionally we have looked for the support of a three-legged stool consisting of social security, employer pension plans, and individual savings. We shall examine all three legs of the stool.

MR. C. LAMBERT TROWBRIDGE: I hope to address my remarks to the U.S. portion of 1, and to most of program items 3 and 4. As to 2, 5, and 6 I have no special insight.

The OASDI program, in my opinion, goes a long, long way toward meeting the needs of retirees, both at the date of retirement and in an inflationary period thereafter. This will sound to you like a simple "yes" to the south of the border part of 1. Lest we get too euphoric, however, we need temper this answer, as follows:

a. OASDI was not intended to meet <u>all</u> the retirement needs of <u>anybody</u> - let alone <u>everybody</u>. Private pension plans, personal savings, and public welfare programs are the other three legs of what I consider the four legged stool of retirement income.

b. The role of the public welfare system we call SSI, for example, is to guarantee some level of income to those older people who have worked very little (at least for pay). These are not really retired persons in the usual sense; rather they are over 65 (or blind or disabled) and poor. OASDI must be viewed as a wage replacement system. It is not a system to generate income that has never previously existed.

c. U.S. Social Security provides no benefits as to earnings above the taxable wage base, and little for the earnings bracket immediately below, leaving these areas, quite appropriately, to private pension plans or personal savings.

d. Social Security in the U.S. is not quite universal, and not quite compulsory. The important groups outside are federal civil servants, and some groups of state and local government employees. For workers who have substantial amounts of non-covered service, the integration with governmental staff pension plans has not been well worked out. For many of these, OASDI benefits are too high. For others the OASDI benefit will be zero, despite some Social Security taxes paid. We need universal coverage, and we are beginning to need it badly.

e. OASDI is rather unique in that it fully adjusts for price inflation once a beneficiary is on the roles. We sometimes hear the argument, that the indexing of OASDI benefits should be on wages instead of prices, thereby passing on to retirees the gain in real wages enjoyed by those still at work. We haven't heard this argument so much since gains in real wage levels have tended to be negative. In years that prices rise faster than wages, there is at least some question as to whether the retiree may be doing too well, in comparison with those still at work.

As to prospects for OASDI change, many observers, including this one, agree with the bare majority on the 1979 Advisory Council on Social Security who recommend a gradual shift of the normal retirement age upward. I would like to see a start in this direction. I would also like to see more progress toward universal coverage. Let us now move on to item 3.

Employee pension plans contribute to the needs of retirees, but not always. Those who work for most of a career for a single employer of some stature are likely to retire under a pension plan designed to supplement OASDI such that the two together meet the designer's idea of what constitutes an adequate replacement of earnings before retirement. But at any point of time something like half of the total work force are not members or participants of private pension plans, or will enjoy very tiny benefits if they are. It is well to note why there are these "gaps" in coverage.

The first reason is that a substantial number of employers do not provide employee pension coverage, except through the employer contribution to social security. Remember that there is no requirement that an employer institute a pension plan, and many (especially new businesses or small ones) have chosen not to do so. Profit-sharing or thrift plans fill a part of the gap; but there remain a substantial number of uncovered workers. ERISA may have reduced the proportion of workers covered under deferred benefit pension plans, though this was not the intention.

As far as I am aware, the only movement toward expanding private pension coverage is the possibility of mandating private pension coverage at some minimum level. The preliminary report of the President's Commission on Pension Policy suggests that such a recommendation may be included with its final report.

As to the second, it must be recognized that pension coverage is often lost due to the high mobility of American labor. A worker who moves between employers will seldom enjoy as large a pension as the worker who stays with one employer. When pension benefits are typically based on some form of final average pay, the mobile worker often suffers some loss in pension even if every one of his several employers has a pension plan, and even if the worker stays long enough to meet the vesting requirements. More often one, or the other, or both of these two conditions is unmet, and the loss of coverage is substantial.

Vesting provisions ameliorate the loss of pension coverage to some extent; but full and immediate vesting is too much to expect. The current ERISA vesting requirements are as good as any. The worker who changes jobs, presumably because something about the new job is better, must expect to lose something. Quite often the most obvious loss is a reduced pension. I don't feel too concerned with the worker who moves at his own choice, but I am concerned about the worker who loses his coverage because he has been laid off.

Now let us go on to 4. Ideally, private pensions, like social security, should be adjusted for inflation after retirement. It is not easy for an employer to put in such a COL provision, even under what we hope are normal conditions - with inflation under 5 percent annually e.g. and with interest rates 3 or 4 percent higher. Under today's conditions of double-digit inflation, and investment earnings rates all too close to - if not actually lower than - the rate of inflation, many find a COL provision simply impractical.

The only ray of hope I see, short of getting inflation well under control, is the raising of the age of retirement. If Social Security takes the lead, I assume private plans would quickly follow, then the savings due to later retirement can be traded for some form of COL. Should all of this happen the whole pension movement will be stronger. It is fortunate that demographics and economic factors point toward a higher retirement age, and that an augmented ability to adjust pensions for after retirement inflation could be a most desirable by-product.

A separate cost-of-living index for retirees may have some merit, but I for one doubt it. Were one to be designed, I have no confidence as to whether it would show higher or lower inflation rates for retirees. Whichever it showed for 1980 might be the opposite way in 1985. We have more important things to worry about than fine arguments as to which groups suffer most from inflation. We will never answer this question with any degree of certainty, so I suggest, as one of our Canadian friends did on another panel yesterday, that actuaries put their attention on the important question of how private plans can be indexed at all, rather than on the best theoretical index.

MR. DAVID R. BROWN: The topics to be covered by this panel seem to me to go somewhat beyond the usual rather technical subjects more commonly discussed at actuarial meetings. To describe them as "philosophical" may be too pretentious but at the very least, we can agree that our purpose this morning is to take a fairly broad look at the present and prospective sources and levels of income for members of the retired population. My presentation will focus on the first three topics, that is the respective roles of social insurance programs, personal savings and employer-employee pension plans. Further, my comments will be founded entirely in a Canadian context, which is the only basis on which I can offer even impressions, let alone substitute some facts.

It seems that in both Canada and the U.S.A., we are in the throes of a reconsideration of the basic questions of what constitutes an adequate retirement income, how should it be provided and who should pay for it. In Canada, there has been a series of studies and investigations of all aspects of these questions by various levels of government and government-sponsored agencies. Most of these studies have now culminated in published reports and I will be drawing on some of the research contained in these reports during the course of my remarks.

I think it's useful to look first at the total income replacement picture, before getting into considerations of the relative roles being played by the different sources of income. Table 1 is taken from the 1979 study published by the Economic Council of Canada entitled <u>One in Three</u>. The message conveyed by this table is fairly simple: the total pre-tax income replacement ratios for the very lowest and very highest income groups could probably be described as "adequate" (if we leave aside such questions as how one survives on the income attributed to the first quintile group, whether pre- or post-retirement). The problem, if there is one, appears to afflict the central 60% of the income distribution, especially the lower end of this group. It is important to bear this distributional characteristic in mind when we come to look at the various sources of retirement income and some of the proposals for the future. It should also be said that the table represents a 1975 "snapshot" and therefore does not even describe adequately what the situation is going to be in the near future even if there are no changes in the existing retirement income arrangements. Secondly, the income replacement ratios given by the table are only for the initial period following retirement and do not reflect the problem of maintaining adequacy of real income in retirement against the effects of inflation.

Now bearing in mind these preliminary comments, let's take a look at Table 2, which is taken from the report of the Lazar task force report to the Canadian federal government on retirement income policy. Let's look first at what the figures in the table seem to be telling us and then I want to note some important qualifications.

The first message is that the sources of income vary dramatically according to income level, with government sources providing most of the income (93%) for the lowest-income elderly and becoming rapidly less significant as you move up the income scale while private sources move in the opposite direction from 7% for the lowest-income group up to 79% for the highest.

Another message worth noting is that the category described as "investment income" is more important at all income levels than the category described as "employer-sponsored pensions, annuities, etc."

Lastly, the pattern of "earnings from employment" is worth looking at. This category increases rapidly as one moves up the income scale. A number of inferences might be drawn from this. One is that highest income group includes a heavy representation from those who have recently attained age 65 and from self-employed owners and professionals. At the other end of the income scale, it seems likely on the basis of other evidence that a high proportion of the lowest-income group are elderly females with little or no possibility of employment for income and little or no previous history of attachment to the work force.

Now let's look at the significance of some of the limitations in the numbers in Table 2. Firstly, the numbers include only cash income from arm's-length sources. The exclusion of the value of owner-occupied housing and of intra-family transfers would seem to be quite significant, if only on the intuitive basis of personal experience and observation, and especially so for the middle-income groups. Secondly, the exclusion of supplementary provincial transfer programs undoubtedly is an important limitation on the validity of the figures for the lower income groups. No fewer than six of the ten provinces operate such programs. Total benefits paid in 1977 amounted to $192 million which is a relatively small figure in absolute terms (about 4% of the total paid in the same year under OAS/GIS) but significant nonetheless because of being wholly concentrated on the lowest income groups.

Probably the most damaging qualification one must register to the figures in Table 2 is that they indicate only the situation in 1975. This tends to overstate the significance of OAS/GIS and to understate the emerging role of employer-sponsored plans, "investment income" (which includes the proceeds of Registered Retirement Savings Plans) and the C/QPP. The relative immaturity of the C/QPP programs can be readily indicated without introducing statistical evidence. These plans were introduced in 1966 with a ten-year transitional period. This means that retirees who left the labor force before 1966 receive nothing from these programs and those who retired in 1966 through 1975 receive only partial benefits. With full benefits being granted to those retiring in 1976 and later, the relative importance of this source of retirement income to the aged population as a whole will rapidly increase over the next 20 to 30 years, even if no changes are made in the terms of the program.

The foregoing comments about the relative immaturity of the C/QPP program will be readily understood and accepted by most students and observers of the retirement income situation in Canada. What has been less well understood is the almost comparable immaturity of employer-sponsored plans and of Registered Retirement Savings Plans (RRSP's). My own perception is that although employer-sponsored plans have not been growing all that fast in terms of coverage of the population or the labor force, the benefits being delivered are becoming more and more adequate and the introduction of C/QPP has resulted in greater concentration of benefits in the "gap" between early retirement and age 65 and in replacing earnings above the level covered by C/QPP. As facts to substantiate these impressions, I offer the following consideration of pension payments by trusteed pension plans in Canada, derived from the bi-annual studies published by Statistics Canada. From

1968 to 1978, the annual amount paid out by these plans as pension benefits increased from $294 million in 1968 to $1,400 million in 1978, an annual compound rate of increase of 16.9%. If we deflate this increase for changes in the Consumer Price Index, we still get an annual compound rate of increase of 9.34%. Meanwhile, the GNP in constant dollars increased at an average annual compound rate of 4.46%, or less than half the rate at which pension payments from trusteed plans were increasing. Without refining the statistics further, I think the picture is clear enough: employer-sponsored pension plans in Canada have been a rapidly growing source of retirement income and a statistical snapshot of their role in 1975 almost certainly understates their importance now and in the near future.

I believe a comparable statement could be made about the role played by Registered Retirement Savings Plans which have literally exploded in the decade of the 1970's but statistical data for these plans is less easy to come by. However, the potential impact of these vehicles for retirement income security is obvious from a cursory review of the contribution input to such plans, which increased from $27.5 million in 1960 to $225 million in 1970 and $2,115 million in 1976. The proportion of tax filers claiming RRSP deductions increased from 2.7% in 1970 to 10.5% in 1976. These plans undoubtedly were of greatest importance initially to people in the upper income brackets but their increasing popularity will undoubtedly reflect their growing importance as a source of retirement income security to people in the middle and lower income brackets.

To what conclusions does this recital of the roles being played by the various components of retirement income lead us, either as to how satisfactory the present situation may be or what directions would be desirable for the various components in the future?

I think a balanced consideration of the situation must lead to the conclusion that we are by no means facing an emergency requiring drastic measures. The overall income replacement ratios, at the point of retirement at least, are surprisingly high, especially after we make a mental adjustment for the effects of home ownership and of provincial transfer programs. Moreover, the situation appears to be improving quite rapidly with the growing maturity of both C/QPP and private plans.

As to the desirability and prospects for change in the social insurance programs, it seems to me that the priority objective should be to assist the very old and especially the female elderly. One thing that has come through very clearly in most of the recent studies is that this is the forgotten group, both by the social insurance plans and the private plan designers. The remedy to their situation does not lie in expansion of the C/QPP, which presumably will only benefit the present and future employed population. Increasing the universal Old Age Security program would be more effective but not very efficient because it would entail increasing benefits for the whole of the elderly population and not just those who need them. Clearly the best approach would be through the Guaranteed Income Supplement or a similar income-tested program.

As for personal savings, the program topic asks whether their role is declining, what is the outlook and should steps be taken to enhance their role. From the figures I have already quoted for Registered Retirement Savings Plans, the role being played by tax-sheltered personal savings is certainly

not declining - it is increasing very rapidly. The only "steps" which seem appropriate are to make sure that the statutory limits on tax-deductible contributions are kept current, either through indexing or frequent review.

For employer-sponsored plans, the reference in the discussion topic to "gaps in coverage" disturbs me a little. The traditional conception of these plans is that they are voluntary arrangements which by definition can only reach the employed sector of the population. We can hardly expect employer-sponsored plans to solve the retirement income problems of those who do not enter the labor force or who do not spend very much of their active lifetimes in the labor force. Likewise, the role of employer-sponsored plans is bound to be quite limited for low-income earners, who already have very high prospective income replacement ratios from the social insurance programs. One hears in both Canada and the U.S. of proposals for compulsory private pension plan coverage. Such proposals seem quite unacceptable to me. If the situation requires action for the whole of the working population, then the appropriate and most efficient vehicle is a social insurance program and not the mandating of an inadequate and/or unsuitable "private" plan for every gas station and coffee shop in the country. If the concern is that social insurance programs don't generate savings in the way that private plans do, then let's address the problem of how to generate more savings in the country and not mix it up with retirement income policy. In any case, the present contribution of savings for retirement purposes to the total savings picture is already very substantial, in this country at least. According to the Lazar report, the average percentage of gross savings in the years 1972-1976 attributable to retirement plans was 23%.

Vesting provisions in private plans undoubtedly affect the degree of effectiveness with which they play a role in the total provision of retirement income. Vesting provisions in Canadian plans improved considerably in the late 1960's as a result of the pension benefits legislation and one result of the current round of studies is almost certain to be a more stringent statutory vesting standard. The province of Saskatchewan has already broken ranks with the other provinces and has introduced a new standard to be effective July 1, 1981. The new standard will be age plus service totalling at least 45 years, subject to a one year service requirement. The previous standard (and the one which still prevails in other jurisdictions) was age 45 and 10 years' service. The Saskatchewan legislative changes have some other interesting features, including a minimum employer-provided vested benefit in contributory plans and some relaxation of the locking-in of employee contributions on termination of employment. The 1978 report of COFIRENTES +, a study commissioned by the Quebec government, recommended a revised vesting standard of age plus service totalling 35 years, with full locking-in of employee contributions and central administration of vested benefits by a government agency, with some indexing during the deferred period, to be financed by "excess" interest earnings.

I want to try to stay within my allotted time but I really can't finish without saying something about post-retirement inflation adjustments. I think the question of whether such adjustments should be made has been answered in the marketplace - most large plan sponsors are now making such adjustments on a fairly regular basis. The most recent survey of the federal government's Plan Research Bureau showed that more than 60% of the employers surveyed had made at least one such adjustment in the past two years. The survey covers 172 private sector establishments, widely diversified by indus-

try and geography and with an average of 1,576 employees. The adjustments granted were nearly all of an ad hoc nature and the formulas used to calculate the pension increases varied widely. However, an increasing number of employers have, for all practical purposes, established regular patterns for these ad hoc adjustments. Despite these developments, I think there is more than a remote possibility that one or another level of government is going to get into the act, either by requiring private plans to adjust pensions-in-pay in line with investment earnings on assets matched to pensioner liabilities (this was recommended by COFIRENTES +) or by offering to reinsure the indexing risk and requiring that plans deliver indexed benefits.

As for the development of a separate cost-of-living index for retirees, this makes some sense in theory since the consumption pattern of retirees as a group will clearly differ from the pattern for the population as a whole. However, there are also very significant individual variations within the retiree group. A perfect solution would require a different index for each one. Perhaps the use of a whole-population index, while imperfect for any individual, is not such a bad measure for the retired group as a whole. A more useful exercise might be to improve the existing Consumer Price Index, which has been extensively criticized on technical grounds by some economists.

TABLE 1

AVERAGE INCOME BEFORE TAX OF
PERSONS AGED 65 TO 74 YEARS
BEFORE AND AFTER RETIREMENT,
BY INCOME QUINTILE, CANADA, 1975

	Average income (Constant 1975 dollars)		
	Pre-retirement (1)	Post-retirement (2)	Ratio of (2) to (1)
Income quintile:			
First, lower-income	2,162	2,083	96.3%
Second	5,282	3,877	73.4
Third	8,234	6,301	76.5
Fourth	11,799	9,946	84.3
Fifth	21,939	20,233	92.2

Source: Statistics Canada, Income Distribution by Age in Canada. This table appears as Table 2-5 in One in Three, Economic Council of Canada, 1979.

TABLE 2

AVERAGE INCOME AND SOURCES

OF INCOME OF ELDERLY FAMILY UNITS, 1975

	Less than $2,500	$2,500 - $3,999	$4,000- $5,999	$6,000 - $8,999	More than $9,000	All Income Classes
Percentage of total units in class	20	40	18	13	10	100
Average income per unit in class	$1,759	$2,998	$5,026	$7,524	$14,643	$4,807
Sources of Income and Percentage Distribution by Income Class						
Earnings from employment	-	1	5	10	25	11
Investment income	5	8	18	24	37	21
Employer-sponsored pensions, annuities etc.	2	5	11	19	17	12
OAS/GIS	87	78	57	37	16	48
C/QPP	2	3	5	5	3	4
Other gov't transfers	4	4	5	5	2	4
	100	100	100	100	100	100

Notes:

1. "Elderly Family Income Units" are those individuals and couples where both spouses were age 65 or over.
2. Data excludes value of imputed rent associated with owner-occupied housing, intra-family tranfers, subsidized services, and supplementary provincial transfer programs.
3. Number may not add due to rounding.

Source: Survey of Consumer Finance, 1975, Statistics Canada, 1976. This table appears as Table II-3, Vol. 1, p. 11 in The Retirement Income System in Canada: Problems and Alternative Policies for Reform, which is the 1979 report of the (Lazar) Task Force on Retirement Income Policy of the Canadian government.

MR. THEODORE J. KOWALCHUK III: It is common knowledge that the average life expectancy of Americans is increasing. A male who reaches the age of 65 currently has an additional life expectancy of approximately 15 years, while a female attaining age 65 has an additional life expectancy of approximately 18 years. Longer life expectancies and the eroding effect of inflation on fixed pension amounts have focused attention on the adequacy of retired income.

There are four primary sources of income for our senior citizens. These are: social security, private or public pension plans, personal savings (including investment earnings), and part-time or full-time employment. Unfortunately some of our senior citizens do not have sufficient income and must accept some form of social assistance or charity.

The retirement income needs of retired individuals vary with individual circumstances. However, an estimate of current post-retirement income needs for a married couple to maintain the standard of living before retirement is as follows:

(1) Annual Gross Income Before Retirement	(2) Approximate Reduction in Annual Income Taxes, Work Related Expenses and Savings as a Result of Retirement	(3) Approximate Equivalent Postretirement Income Needed to Maintain Preretirement Standard of Living	
		Dollars*	%**
$ 6,500	$ 900	$ 5,600	86%
10,000	2,200	7,800	78%
15,000	4,300	10,700	71%
20,000	6,800	13,200	66%
30,000	11,900	18,100	60%
50,000	22,600	27,400	55%

* col. (1) - col. (2)
** col. (3) Dollars ÷ col. (1)

For single persons the approximate equivalent postretirement income needed to maintain the preretirement standard of living would be approximately 5% less (of preretirement gross income).

Social security benefits generally meet only a small percentage of the income needs of retired individuals. One estimate indicates that the portion of benefits paid by social security is slightly greater than half of the total benefits paid under all private and public retirement plans. However, the American people are becoming increasingly concerned about the ability of the social security system to provide the benefits promised because of the essentially pay-as-you-go financing. Furthermore, in a few decades there may be one retired social security recipient for every worker in the U.S.

As the population of our senior citizens expands there will be considerable pressure on Congress and the President of the U.S. to continue to promise ever-expanding social security benefits. However, there will be mounting resistance by employers and employees to significant increases in social security taxes.

The President's Commission on Pension Policy has recommended in a preliminary report that serious consideration be given to the establishment of a universal minimum advance-funded pension system. This recommendation has considerable merit and I shall discuss this further later.

Private pension and profit sharing plans have grown rapidly since World War II and provide a significant portion of the retirement income needs of many retired individuals. Approximately 80% of the workers in the United States are covered under private or public retirement plans other than social security.

Congress and the Administration should continue to stimulate the development of the private pension system, especially among smaller employers, through tax incentives. Furthermore, a strong effort should be made to eliminate much of the red tape and uncertainty that has led to numerous plan terminations among smaller employers. Since the IRS is primarily concerned with revenue considerations, it would be desirable to shift full responsibility for regulation of pension plans to a more socially minded governmental "Pension Commission" (perhaps the Pension Benefit Guaranty Corporation).

One area in the private plan sector that requires further study relates to vesting of accrued benefits. American employees are highly mobile and many have little or no vesting at present. From a public policy standpoint I question the desirability of the 10 year "cliff" vesting schedule, which is prevalent in plans of large employers. A small employer generally cannot safely adopt a 10 year cliff vesting schedule and it might be argued that larger employers have a pension cost advantage with respect to vesting.

I do not advocate very rapid vesting because employers would resist adopting generous pension plans that provide high vested benefits after short service. In my opinion the "4-40" vesting schedule represents a reasonable compromise that should be the vesting standard adopted, and perhaps the minimum schedule required by law, for large as well as small employers.

A serious problem of retirees receiving fixed pension benefits is the erosion of the real value of such benefits because of inflation. If inflation continues in the future at an annual rate of 10%, the real value of a fixed pension will drop to 39% in 10 years, 24% in 15 years and 15% in 20 years. Employees and union leaders are becoming increasingly concerned about this problem.

Many employers have attempted to deal with this problem in the following ways:

- Adoption of ad hoc pension increases for retired employees and beneficiaries.
- Periodic updates in the compensation bases for service to date under career average pay plans.
- Some career average pay plans are being changed to final average pay plans.
- In some final average pay plans the period over which the average compensation is measured is being shortened from five years to three years.

However, the above measures are not adequate and generally will not provide a sufficient safeguard to pensioners that their pension benefits will not be severely eroded with inflation. There is a strong social need for pensions which increase with increases in the cost of living. However, the costs of incorporating such a benefit feature could be staggering. For a new plan, e.g. for a small employer, the additional costs could be approximately 27% if cost of living increases are limited to 3% per annum, and 53% if limited to 5% per annum.

We made some calculations to project the increase in cost for one of our larger clients if the client were to adopt postretirement cost of living increases. If cost of living increases were limited to 3% per annum, the estimated costs would increase by 47%; if the increases were limited to 5%, the costs would increase by 91%!

It appears unlikely that our federal government will be able to completely curtail inflation, but hopefully we shall elect responsible individuals who can bring the inflation rate to some manageable level. Some inflation - and perhaps a relatively high rate - is likely to be with us for some time. Employers, unions and their advisors must squarely face this problem and develop appropriate solutions. Some tradeoffs - perhaps lower initial pension amounts and possibly smaller current pay raises - to the high additional pensions may be necessary.

Some practical solutions to limit the costs of adopting automatic postretirement cost of living increases include:

- incorporating a limit, e.g., 3%, or 5% per annum on the cost of living benefit increase for any year.
- Adopting automatic benefit increases equal to a percentage, e.g. 50% or 66-2/3% of the current year's increase in cost of living, perhaps with an overall cap of, say, 7%.
- The commencement date of the cost of living increases could be deferred, at least initially, to some age such as 70 (or 5 years after retirement).

An alternative solution that may be appropriate for some retirees would be to offer a pension option providing for a pension increasing at, say 5% per annum (regardless of changes in the cost of living). The initial pension amount would be actuarially reduced (but might be slightly subsidized by the employer). In the event of death before, say, 10 or 15 years after commencement of the pension, a death benefit could be payable. Experimentation along these lines might be a logical initial solution to the inflation problem.

It should be remembered that the wife of a male retiree is likely to be approximately four years younger than her husband and will probably survive him by about seven years. Since she will need almost as much income after his death as they needed before his death, the optimum normal benefit form, from a social standpoint, may be a 100% joint and survivor pension which is adjusted annually to reflect increases in cost of living.

The present social security system, together with private and other public pension plans, is not likely to fully satisfy - nor should they necessarily - the retirement income needs of all retirees or even a high percentage of retirees. Americans should have the foresight to save and this is extremely desirable for social and economic reasons. However, it has become extremely difficult for Americans to save because of high governmental spending and taxes. Inflation has reduced the incentive to save.

Personal savings of Americans should be strongly encouraged through tax incentives. The IRA vehicle was a step in the right direction. However, participants in an employer retirement plan are not able to establish IRA's (except in the case of a rollover), even though they may not vest in the employer's retirement plan. This is undesirable and we should support legislation that will permit tax-deductible contributions of, say, $1,000, and preferably much larger amounts, to an individual's own tax-deferred pension account.

I believe the key to adequate retirement income for most Americans involves a combination of (1) soundly financed social security benefits which do not exceed the ability and willingness of younger Americans to support by payroll taxes, (2) soundly designed and financed employer and public retirement plans which reflect the need for reasonable initial pensions which increase with increases in cost of living, and (3) a meaningful amount of personal savings.

One problem is that many Americans find it difficult to save for the reasons outlined above. Some individuals have little inclination to save (assuming they earn more than a subsistence income) and simply will not voluntarily save. Another serious problem is that some employees are not yet covered under an employer sponsored pension plan and may never vest in a meaningful retirement benefit. Others may cash in their vested benefit on termination of employment and dissipate the funds before retirement. There will always be some gaps in coverage.

A solution that I recommend be considered by the President's Commission on Pension Policy and the federal government is a mandatory employer thrift plan with the usual tax incentives. Each employee would be required to contribute 2% of compensation on a payroll deduction basis toward his retirement, or earlier disability or death. The employer would be required to contribute 1/2% of compensation toward the employee's account and the employee would be fully vested. The assets could be invested in special short term or long term government securities and other investment alternatives could be elected. Employees would be permitted to contribute larger amounts up to 6% of compensation and employer contributions would be equal to 1/4 of employee contributions. Employers could voluntarily match employee contributions using a higher ratio than 1/4, and such excess matching could vest on a graduated basis.

I believe that a mandatory advance funded thrift plan approach, with appropriate tax incentives, would be popular with employees and would not be unduly burdensome for employers. In addition, it may ultimately reduce some of the pressure for continual increases in the present social security system. Various guarantees of principal and perhaps minimum interest earnings could be provided under law by the Pension Benefit Guaranty Corporation.

MR. GRUBBS: The elderly in the United States have been described as a two-class society. Many in the elderly population have an adequate income, provided by these various sources that have been discussed. However, statistics indicate that there are a larger number who do not have an adequate income. The median individual who is retired over age 65 has roughly about half as much income as the median worker between 55 and 65. Social Security provides a floor of protection. Last year the median worker earned about $12,000, and Social Security projects that this worker will receive a pension of about 42%, or around $5,000 in today's dollars. This serves the vital function of enabling the retired worker to survive, but, if there is no other source of income, it does not provide an adequate retirement income.

Dave's presentation indicated that personal savings can be a significant source of income for many people, primarily higher income earners. Statistics indicate that this is true in the U.S. also. For example, we do have tax incentives to save for many people who are eligible for IRA's. Among families whose adjusted gross income exceeds $50,000 and who are eligible for an IRA, 52% of them have IRA's. However when we get down to the level of the median worker, for families with incomes from $10,000 to $15,000, of those eligible for IRA's only 3% have IRA's. No matter what tax incentives are given, the average worker earning $12,000 a year is having trouble buying the groceries; he intends to save tomorrow, he is not able to do it today, and tomorrow he won't be able either.

Regarding pension plans, we have discussed the coverage problem briefly. About 35,000,000 workers in the United States are not covered under any pension plan. Of those who are covered, many will never receive a benefit, or perhaps will receive a very small benefit from the last employer, because they will change employment before they are vested. The individual who changes jobs every 5 years is going to have as much need for a pension when he reaches 65 as the one who stays with one employer for 40 years, but it is unlikely that he will get it. It seems clear to me that, if we are going to provide adequate retirement incomes, we must solve the coverage problems and we must solve the vesting problem.

Regarding cost-of-living increases under pension plans, we have seen both that they are needed and that there are problems in providing for those needs. How many of you have ever seen a private pension plan that says that we are going to cut the pension by 7% every year after retirement? If you had such a plan it would be clearly recognized as inadequate. As a practical matter, that is what almost all plans are doing; it is not just 7% every year, sometimes it is more and sometimes it is less. But I think that we should realize that this is inadequate. I am not saying that we can necessarily afford to solve the problem. Solving the problem is tough. But we are closing our eyes if we say it is not a problem.

Ted mentioned thrift and savings plans as a solution, and these have been very helpful for many people. The participation rates have been high among employers who have offered them. One problem with most defined contribution plans in the United States as a vehicle for providing retirement income is that ordinarily they provide their benefits in lump sum distributions that are dissipated, rather than as pensions to meet retirement needs.

The program outline includes portability. We must distinguish portability from vesting. Vesting is a nonforfeitable right to an accrued pension; portability is some ability to carry it with you when you go from job to job. Portability may allow the participant to transfer his vested pension either to another pension plan or into some kind of central clearinghouse. Does it really matter whether someone gets four little vested pensions from four sources or gets one big one from one source? In many cases it doesn't matter at all, but there are situations where it does matter. Two kinds of situations are quite important. One involves the lump sum distribution problem. Employers have found it is not feasible to administer small vested pensions, and therefore they pay them off in lump sum distributions.

I am sympathetic with the needs of the employers; indeed it is expensive to administer small vested pensions. But if there were some sort of portability - a clearinghouse into which the employer could pay the lump sum distribution instead of paying it to the employee - that could preserve the pension. Second, the lump sum distribution problem discourages earlier vesting, either voluntarily or mandatorily. An employer who might be interested in having earlier vesting says, "If I change to earlier vesting it is just going to result in little amounts that I am going to pay off in a lump sum, and that is not really going to help meet retirement needs." If we had a portable pension system, I think that at least some employers would find it desirable to allow earlier vesting voluntarily because it would provide pensions.

Congressman Claude Pepper has promised to introduce a bill which will have four provisions to help solve the problem of inadequate income for the aged. First would be a section dealing with providing employment opportunities for the elderly. Second would be tax incentives for individual savings. Third would be to change ERISA's minimum vesting requirement from 10-year 100% vesting (or one of the two equivalent formulas) to 5-year 100% vesting. I would regard that as a significant step forward. I disagree with those who prefer some kind of graded vesting schedule. Graded vesting is difficult to administer and difficult to communicate; it involves buy-back provisions for the person who terminates with partial vesting and comes back. Based upon my earlier studies, I indicated to the House Select Committee on Aging that, for the large majority of plans, going from the present standards to 5-year full vesting would increase plan costs in a range from 0% to 7% of present plan costs. As a percentage of pay, for most plans it would increase plan costs between 0% and 0.2% of pay. The largest percentage increases would be for the very high turnover employers who now have very low pension costs as a percent of pay. I also told the Committee that, if we go to full vesting after 5 years, this would substantially reduce the potential for discrimination which can result from turnover. Therefore, if we go to full vesting after 5 years, we should delete section 411(d)(1)(B) of the Internal Revenue Code, which allows IRS to require more rapid vesting in cases where it suspects *there will be an accrual of benefits or forfeitures tending to discriminate* in favor of the highly compensated. This would end the uncertainty and confusion caused by the positions of the Internal Revenue Service. Most employers can live with certainty better than with uncertainty, even if it is not with the certainty that they would most prefer.

Fourth, Congressman Pepper's bill would establish a federal portable pension system. I expect that the bill will provide for the investment of that fund in private sector securities and that the investment will be managed by private investment managers under the supervision of PBGC, just as PBGC now invests terminated plan assets. I expect that administrative functions, such as individual recordkeeping, will be in the Social Security Administration. If we go to 5-year vesting, it is most important to have a **portable** system to preserve those small vested pensions so the employer would not have the burden of retaining them.

Mr. Pepper's bill would create improvements, but it would still leave a significant gap. It would do nothing for those not now covered under pen**sion plans**. The only way to solve that problem is the proposal to have mandatory universal pensions, to require that every employer provide a pension for every employee. It is not a new proposal. The President's Commission on Pension Policy got the idea by reading the Transactions of the Society of Actuaries for its 1972 Spring Meeting. The same idea appeared earlier in The Actuary for May, 1970. Every employer would have to provide some pension in addition to the present pay-as-you-go social security system. They could preserve the very desirable flexibilities that we have in the system today. An employer could meet its obligation by a defined benefit plan or by a defined contribution plan, or could just contribute to an IRA for everyone. If the employer chose the defined contribution route, my proposal would require a minimum level of contributions of 3% of pay, with a phase in increasing from 1% the first year grading up to 3% the third year and thereafter, to ease the transition problem. If the employer chose instead to meet the obligations through a defined benefit plan, as most larger employers are already doing, I propose that the present value of the accrued benefit should at least equal what would have resulted from 3% contributions under a defined contribution plan with some stated rate of interest. To fully fill the gap in pension needs, there must be 100% immediate vesting with respect to the minimum mandatory pensions. The only way we are going to get this gap filled for everyone is to make sure that they get a pension for every year of service. Isn't this going to create great problems administratively? It need not. With a portable pension system, employers could meet their obligation on termination of employment by transferring these little amounts - these lump sum distributions - into the federal portable system which can administer them. The small employer that wants to avoid the administrative problems of setting up a plan could meet its entire obligation simply by making payments directly into the portability system. In addition, the large employer that wants to maintain age 25 and 1 year as eligibility requirements could meet its obligation for the people not eligible for the private plan by making payments for those individuals directly into the federal portable pension system. Making payments of 3% of pay directly to the portabilty system would be an administrative task that is equivalent to paying your Social Security tax, not an overwhelming administrative burden. This proposal would significantly aid in assuring every worker gets an adequate retirement income.

The basic question before us is allocation of resources. How much of the resources of the nation are going to be allocated **to different groups? In the past we have had productivity gains, and we hope that we will have them in the future. In the past a significant portion of the productivity gains have been used to raise the wages of the average**

worker. In the future a greater proportion of those productivity gains need to be used to meet the needs of the retired sector of the population, who are way behind the active workers. Well, let's go on to your comments and discussion. Trow, you mentioned that you were more sympathetic to laid off workers then people who just quit. Do you have any thought as to how laid off workers might be treated differently, and secondly, would you have any more sympathy for the employee who quit because of what he considered intolerable working conditions?

MR. TROWBRIDGE: I think that mobility of labor comes from lots of different things. But the kind of mobility of labor that I am not particular sympathetic with, as I implied before, is the man who is continually trying to find a better deal and who considers that every job change is a step upward. What he finds, when he does that, is that some of these job changes that seemed to be a step upward, have some kind of hidden losses and that they are not quite as much a step upward as he thought they were, and loss of pension coverage is one of those. Maybe my philosophical bent is different from some of yours, but as far as these people who are continually job hoppers on the idea of getting upward mobility, I don't have all that much sympathy for them. On the other hand, somebody who loses a job or who quits their job because it is intolerable and, therefore, loses a vested pension benefit as I implied, I have more sympathy with. There are people who change jobs, not because they want to but because they have to. One answer to those is to improve the vesting, make the vesting requirements subject to why you quit. I know administratively how hard that is, but I guess philosophically I would be in favor of more broad vesting for some kinds of quits than others. I am not suggesting that as a practical possibility because we all know that people are laid-off for unemployment compensation purposes by agreement with the employer in order to get compensation benefits. And you get the same kind of thing going on here, I don't think that it is a practical solution but, philosophically, I am still where I was before.

MS. ANNA M. RAPPAPORT: I think that it is important that all of us recognize, and we had some discussion about raising retirement ages, that raising retirement ages is a vital matter, and it is one that we should be promoting more, because if you look at the demographics going forward if we don't raise retirement ages, this allocation of resources, which John talked about, is going to get a lot worse. I also am very alarmed by the total growth in transfer payments. I think that we need to focus on what we can afford and what that implies for our Social patterns. We tend to talk about issues relating to the retirement system as if the social pattern that we have today, that is that people generally retire at 62 to 65 if they have been in the labor force for a significant period of years, is the way that it is going to be. Ted mentioned a statistic from 1900, he said that 2/3 of the men over age 65 were in the labor force at ages beyond 65 in 1900. Those people were probably in worse health than people over 65 today. They were probably less capable of working. There is no reason why we have to have a life cycle pattern that says that one is "entitled to retire at these certain ages". There has been some discussion as to other life cycle alternatives for the possibility of different spreading of leisure and work through life. Where that will take us and what that will do, I don't know. I would much prefer not to assume that the current social patterns are going to continue. If we look at other social patterns over the last 25 or 30 years, there certainly have been changes and I think changes may be necessary for a good solution for our society. As actuaries we need to study these issues more. Retirement ages today are not based on anything scientific. They

are based on history, political and labor negotiation compromise. In fact here we have a social system that is designed to meet a certain pattern of people retiring, but the system also creates the pattern. We should remember that the pattern does not come from nature but that the pattern comes partly form the system. One other point on this question of survivor benefits and women, and then tie back to something that Don said. It is certainly true that if you study and I think this point is true in both countries, who is in the worst trouble among the aged it is the aged women, there is a larger population of aged women. There are a lot of proposals for doing things like improving survivor benefits to help. If we look again at our social patterns, our social patterns are changing. Any system which is tied to the definition of married and family status over the long term, is not going to work out very well, at least for a significant percentage of people. I therefore see that the only way we are going to build a system that is going to work well for almost all of our population, is to focus on individual entitlement, and to create individual entitlement over a period of a lifetime for that person, whether they are attached to the labor force or not, which gets us to something like earning sharing, which means that we need a different way of looking at survivor rights. As actuaries we could pay some attention to figuring out how to make that work. Because if we don't do that, we might reduce the problem for this segment of the group, and end up with discovering that we have another segment of the group that we did not do anything for at all.

MR. TROWBRIDGE: I just like to make the point that the earning sharing concept which did come out of several things lately but most recently out of the 1979 Advisory Council, is one that certainly deserves a lot of study. Most actuaries are not very familiar with it. I am not as familiar with it as I would like to be myself. But the whole concept as to how we can handle the changing marital status pattern - whether earning sharing is the best route - and, if you buy the principal how you actually implement it without a lot of other things that would go poorly, is really worth a lot of study. And although it is being given a lot of study now, it certainly has not been resolved. Actuaries that want to get familiar with a tough problem, that is one that really is worth spending some time on.

MR. BROWN: The earning sharing idea has been under consideration by the Canada Pension Plan for some time. I am not close enough as to how those things get changed as to know where it stands at the moment. But it certainly has a lot of support in some areas. I think that we have a somewhat different situation with having an old age security plan which is a demigrant system which covers everybody with the same amount of benefit. When I, in my earlier remarks, suggested that the most efficient solution of the immediate problem was an income tested program, I was obviously just talking about the existing age. That isn't really going to do anything about avoiding the continuation of the problem or for a need for a continuing income related system. I agree with Anna's comments that we have to be careful in solving some of these things; to look not only at some of the problems of the existing people but where we are headed in another 25 or 50 years.

MR. HOWARD L. KANE: It appears that the three legged stool which became a four legged stool has now become a five legged stool as Ted added on the part-time employment. And we no doubt could add other legs to this. I would first like to comment on Ted's remarks on the four-forty vesting. It is true that if we have a uniform portability run by the government, it may alleviate some of the administrative burden, but, until that time comes to have 4-40 from experience, it is an administrative nightmare in that many many small pensions are being accumulated for very short time employees. It seems that the longer term employees should be those rewarded. The one thing that was not brought out which surprises me somewhat, basically we have all been contributing to an IRA for sometime and will be paying $2,000 next year to an IRA. That is called Social Security. I wonder what the thoughts are, and this has been expressed many years ago on a paper in the transactions by Ray Peterson when Social Security taxes were far-far lower, as to having Social Security payments be tax deductible in the year in which they are paid and then having the benefits be taxed.

MR. GRUBBS: The President's Commission has tentatively endorsed that position on the taxation.

MR. PRESTON C. BASSET: To have early vesting at the young ages is rather futile. If you will make some studies of the value of the pension by the time the person reaches 65, and we hope 68 or 70 later on, the value of the pension you accumulate between 20 and 25 or even up to age 35 turns out to be something in the neighborhood of 1% or 2% of your final pay. To me it is ridiculous to worry about early vesting at the young ages. I would much rather see emphasis be put on early, if not immediate vesting, maybe 1 year for employees age 45 and over. I think that we could do a service if we would illustrate the benefit cost of early vesting by the age of vesting in the kind of economy that we have today. I think that we could convince the people that early vesting is not the answer; it is when the early vesting occurs. And if you have early vesting after age 45 it becomes meaningful. The fact that you quote costs from 0 to .2% of the amount of payroll is very illustrative of the fact that benefits are not worth much either.

MR. GRUBBS: That is a good point to indicate quite correctly that the value of vesting or vested benefits for younger workers is quite small. Therefore the Pepper approach would be of only minimal help certainly in an inflationary age. If, however, it is coupled with my proposal for universal pensions, that would increase the value of the vested pension at the earlier years, and that is, in part, why I have gotten some objections to the proposal that the value of vested pension benefit at the younger ages are a good bit less than 3% and this would raise the cost of those pensions to 3%. If we preserve those pensions on a money purchase basis then converting value, if we have an inflationary age, the interest rates will be high also if the past patterns of interest rates go along with inflation. So that will help at least - not completely solve, but help - keep those vested pensions up with the inflation.

MR. BASSETT: As you know, Don, the problem is that if we have the inflation in the investment return, we will have it in the salaries as well. So unfortunately you don't gain by that system. I still contend that even under a 3% mandatory defined contribution plan, that the benefit that you accumulate up to or before age 35 will be very very small by the time a person reaches 65 or 68.

MR. KOWALCHUK: Just as some of the people in congress are considering maybe full 5 year vesting might solve some of the practical problems that Howard Kane mentioned and Press mentioned. However, it would seem to me that under a defined contribution plan some meaningful accumulation of accrued benefit could be generated with respect to a younger person. I still believe that 10 year cliff vesting is a bit too onerous even for a younger person. I am impressed with the argument with respect to the practical problems of administering a very small defined benefit, accrued vested benefit, for a young person. Under a defined contribution plan, some meaningful benefit could be accumulated after 5 to 10 years of service, and you could project that from say age 35 or 40 to normal retirement age, I think that there would be a fairly significant benefit and that probably should not just be thrown away.

MR. RALPH E. EDWARDS: I want to echo what Press Bassett said. One thing that we overlook is that fact that there are a great many women outside the labor force from ages 20 to 45, and if we had the type of programs where benefits did not begin to accumulate until some such age as 40, then those women could come back into the labor force and have retirement benefits that would be much more comparable to men in the same salary brackets, which is not true today. I think for instance of so many plans where the president, on a final salary basis, is getting credit for the year 18 to 19 when he served as a mail boy and yet his pension credit is based on his present salary as president. I would also point out that the idea of the short term vesting has one problem of giving you an affect of, not a final salary plan but, an average salary plan.

MR. GRUBBS: I would like to point out another possible problem, that is if we have higher requirements with respect to older workers than we have for younger workers, this may discourage the employment of older workers, and that is a potential problem.

Dave, I have a question for you. Do I understand correctly that the Social Insurance Program provides generally higher replacement ratios so you have less of a problem of what I have called a two class society than the United States?

MR. BROWN: I am not sure about the comparative level. All I was saying was that the replacement ratios appear to be higher in Canada than most of us thought before this research appeared. And it seems odd to me that the studies in which the research appeared drew quite different conclusions as from what I draw from it. They seem to think that some drastic measures are necessary and I don't think that they are.

MR. GRUBBS: You managed to get locked in vesting up there in Canada both with respect to employee and employer vested benefits which we haven't done in the United States. Did you meet resistance to it, or why were you successful there?

MR. BROWN: I can tell you that it is extremely unpopular, but that with the very feeble vesting standard that we have in our law, that is, age 45 and 10 years service, that relatively few employees are affected by the statutory locking in, and those that are affected, are at an age where they probably don't mind it so much. Your younger employees would certainly object to it very much.

MR. GRUBBS: Ted, with regard to your proposals for a minimum thrift plan, would it involve locked-in vesting of either the employee or the employer vested benefits, and would it allow lump sum distributions as distinguished from annuity payments?

MR. KOWALCHUK: Certainly the employees contributions would be always fully vested and the employers matching contribution on a 1 to 4 basis would be fully vested. My proposal is very general at this point but I think that there could be some graduated vesting or some delayed 100% cliff vesting on any additional contribution that the employer might voluntarily make above the minimum matching. At retirement there should be a full range of options that would be available, for example, 100% or 50% Joint and Survivor and cost-of-living feature would be very desirable. As far as benefit payouts, benefits would not be payable in the event of termination of employment. The money must be used for retirement, that is, normal or early or deferred retirement or disability retirement or death. But the employee would get the money back under those circumstances.

MR. GRUBBS: We have clients with very liberal defined benefit programs right now who are providing long service employees with benefits which, together with Social Security, are replacing their full income. Would they be required to add one of these thrift plans too?

MR. KOWALCHUK: I would say so. They might want to modify some of their other programs, perhaps. I might add that this is an attempt to solve the portability problem to some extent, and I might comment on portability again later on.

MR. ROBERT CAMPBELL: Regarding the cost of living adjustments, it may be helpful to us in deciding among ad hoc increases, fully indexed cost-of-living increases, or cost-of-living increases with a cap, to investigate the extent to which continued high inflation is an insurable event. Certainly one individual has little control over inflation, but the insulation of a substantial segment of the population from the effects of the inflation can act to reduce the effectiveness of society's efforts to control it. I would be interested in the panel's views on this.

MR. TROWBRIDGE: A lot of us have felt, and still feel, that cost-of-living is not insurable, at least in the private sector. I am not at all sure that it is insurable in the social insurance sector although they are trying to do it. The way that it appears to be insurable is through the route of government issuing some kind of index bond or the index where the income from the bond is indexed to Social Security, and I guess that has been tried a time or two. So far our government has not seen fit to do it and nor have most others. That concept is that you can make it insured if you can have a fixed government bond that provides a real income of 3% and, therefore, the income is actually 3% plus the cost of inflation. You could come close to insuring it on anything that was actually funded that way. But I am not sure that is a practical concept.

MR. BROWN: Any employer who has a pension plan now, a defined benefit plan that bases the retirement benefit on calculations that is tied to average earnings in the time just before retirement, and that includes a lot of employers, is already insuring inflation to some degree. The difficulty that we are up against, and the employer with his final pay plan is up against it too, is that inflation is terribly difficult to predict. I don't think anyone has a good shot on it. And the reason why the usual solution in private sector plans is the ad hoc one, is that the private final pay plans grew up in an era when there was less inflation. I am not sure that they are spreading very much, or that many new employers are taking them on these days, because the nature of the blank check is there. Those that have already gotten themselves into that position are not anxious to widen their exposure by undertaking, essentially, after retirement what they are doing before retirement. In principal I don't think that you can say that it is not insurable, but that the cost is highly unpredictable, and that is the difficulty.

MR. KOWALCHUK: I basically agree with the comments that Dave made, that it is insurable, but it is very difficult to predict and project the costs. It is a risk that is very difficult, especially in the case of the smaller employer, because he may very well be out of business long before the final pension payment is made. So he would have to have his benefits fully funded if the IRS permits, certainly by the time the plan is terminated, and there would definitely be some need here for re-insurance. I don't know whether any insurance company feels they could provide insurance for this risk, and we probably would have to somehow get the federal government involved with some sort of a Pension Benefit Guarantee type of guarantee.

MR. GRUBBS: I think that although unlimited cost-of-living increases are uninsurable, cost-of-living increases with a cap are quite insurable. It doesn't mean that they are not expensive. They are expensive, but I have assisted employers in putting in COL adjustments with a 4% or 5% cap. We can tell them how much more that is going to cost. It is expensive but the costs are not unpredictable. Secondly, Trow, your book indicates that the more inflation that we have, the less expensive pensions are, which would indicate that employers are already taking advantage of inflation. That is, let's assume that in a non-inflationary age the true investment return is 2%. If we have 6% inflation we can get returns of 8%, for example. The cost of a level annuity beginning at age 65 of 2% equals the cost of an annuity increasing 6% if we can earn or assume 8% roughly. Would you agree with that Trow?

MR. TROWBRIDGE: Well, if I understood you exactly, I think it can be demonstrated that if you got a kind of stable situation where the wages are going up at such and such a speed, where the interest rate is at such and such a rate, somewhat higher than the increase in wages, and prices are going up at such and such speed, if everything is added to by, say 2%, interest rates have a 2% jump, wage rates have a 2% jump, and the cost of living has a 2% jump, then actuarially the cost, as a percent of payroll, would not be affected at all and you can give that 2% to retired people. But now that is a lot of if's. This is based on the assumption that the differential between interest and wage rates and the differential between interest rate and the cost-of-living rates, to say nothing of the differential between wage and cost-of-living, all goes together. And in today's times that just isn't so. This business of having wage increases at a faster rate than investment earnings, or even particularly, price increases faster

than invested earnings, turns the whole thing upside down. My book does say that but it also is based on real tough conditions which the real world just doesn't have.

MR. GERALD CLYDE: Looking over the last 15 or 20 years starting back when we had very low interest rates and the development of pension plans since then, the pension plans employers, the unions, have been going through a sort of golden age. They would negotiate a certain plan on a certain basis, the interest rates would not rise. Because pension and pay are fixed, they are not indexed, so cost declined. This allows unions negotiating a greater increase in pension benefits and employers to pay them out of their savings. This has been going on for quite some time. Everybody is happy except maybe the pensioners who find themselves on fixed incomes that are not indexed and are now going down. Now we are in the situation where everybody is upset by the high rates of inflation and we only wish that perhaps governments could do something to bring it down so that pensioners would have an adequate pension. Well what would happen if this occurred in the near future and if government actually pulled off this miracle of bringing down the rates of inflation? If accompanied by a drop in the rates of interest, the effective costs of these flat pensions would go up considerably, pension plans would go bankrupt. But who cares if all pensions terminate as long as pensioners are receiving adequate benefits. The point I am making is, if the pensions had been indexed according to some scheme, well there are any number of indexing schemes, but let us take one, suppose that the pensions were indexed according to investment earnings, say, all earnings in excess of 3% were applied to increase pensions. That is not as good as cost-of-living indexing, but it would be a lot better for the pensioners than no indexing at all. And as far as time costs go, they would be far more predictable. You would not have to make any assumptions, regarding inflation. You wouldn't even have to make assumptions regarding investment earnings. You would know exactly. Actuaries effectively would be out of business as far as predicting the future after retirement. And future costs would be stable whether inflation went up or down. It wouldn't affect the costs of the plans and the pensioners would receive a fair amount of protection against the inflation. All I am arguing is that, effectively, to a large extent, far from inflation not being insurable in pensions, that really the reverse is true as long as it is reasonably controlled. I am not sure that you could actually insure cost-of-living index increases. That is more difficult since they don't really go along with investment earnings, but if you provide assistance where pensions were increased by some excess interest earnings, it is far more predictable, far more insurable, than no index pension, and it is far better for the employees than for the pensioners.

MR. GRUBBS: You are suggesting that those of us who were advocating variable annuities in the 50's and 60's were right. We were just wrong about the investment medium. We should have used fixed dollar securities rather than equities.

MR. A. HAEWORTH ROBERTSON: This subject of index retirement bonds was brought up this morning, and I believe that it was said that we didn't have retirement bonds. I would like to suggest that the United States has issued six trillion dollars of index retirement bonds from which the Social Security system says it will pay benefits upon retirement based on average earnings which will be indexed, to the time of receipt of benefits, based upon changes

in average wages that have occurred from the time the wages were earned until the time the benefit computation is made, and that a Social Security system says that benefits, once they commence, will be adjusted fully and automatically for changes in the cost-of-living, is tantamount to issuing indexed retirement bonds, indexed in some cases according to changes in wages and in other cases according with changes in the cost-of-living. And that if we would look at the 35,000,000 people receiving Social Security benefits and the other 100 million or more who at some time in their career have worked and who think they have earned benefits based on service to date under Social Security and we attached a value to that, that we would find that we have, in fact, issued, but without printing the paper, about 6 trillion dollars worth of index retirement bonds.

MR. TROWBRIDGE: I think that argument follows as far as Social Security is concerned, but it follows even more directly on the military and civil service pensions where the government has, in effect, promised the benefits that index bonds would provide without providing the index bonds. The only point of the indexed bonds that I was making was to make it possible for the private sector to do it. The government sector in one way or another has been doing it for awhile.

MR. GRUBBS: I think Finland and Israel both did that at one point. Do you know why they stopped?

MR. BROWN: I think the rate of inflation in Israel is about 100% - isn't it?

MR. KOWALCHUK: Several people, including myself, indicated the need for more rapid vesting, even for younger people, but there is a problem with respect to some larger plans because the vested benefit would be a rather small insignificant amount. Perhaps we ought to explore, and the government should explore, coming out with a more rapid vesting schedule but one which would be very simple to administer and which would help solve the problem of portability that would discourage lump sum payments. Perhaps we ought to mandate some sort of reasonably rapid vesting, on a graduated basis, of a small benefit which would be independent of the actual plan adopted by the employer, where you would have a fixed schedule based on service and perhaps earnings. One option would be for the employee to take this benefit and have the employer tranfer a certain amount of money, say to the Social System, and the employee would have some small portable benefit he would take along with him. We have got to consider the practical problems of these small benefits; there might be some solutions along this general track.