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FOCUS 2000: OUTLOOK FOR EMPLOYEE BENEFITS

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- o Key societal trends (longer term focus)
  - -- Demographics
  - -- Regulation/legislation
  - -- Increased global pressure
- o What information is available now?
- o Expected trends in employer sponsored plans
  - -- Structure of benefit packages
  - -- Retirement plans -- cash and medical
  - -- Active employee benefits
  - -- Response to work/family issues
  - -- Health system issues
- o Role of the actuary

MR. C. S. (KIT) MOORE: This particular session will address the outlook for employee benefits and the changing role and challenges for the actuary in that area.

When we talk about projections into the future, we walk a fine line between conjecture and certainty. I'm reading a novel right now called *The Book of Evidence* by an Irish author, John Banville. I think he puts the issue very well when one of his characters says that he took up science, not necessarily actuarial science, but science, not to find certainty, but rather to make the lack of certainty more manageable. That's really what we're trying to do. One of our purposes in holding a session like this panel discussion is to look at the changing environment around us in an effort to help the actuary better manage that lack of certainty about future events.

Each of our four panelists will address the outlook for employee benefits from his or her own particular perspective. Following their initial presentations, we'll recap or elaborate on the comments that may be made on the role of the actuary and the changing role of the actuary.

Our first panelist is Anna Rappaport -- one of my favorite actuaries, and also a former associate of mine when I was at Mercer. Anna is well known to all of you as an active and enthusiastic contributor to her profession through organizations such as the SOA.

* Ms. Lockhart, not a member of the Society, is Director of Greater Phoenix Affordable Health Care Foundation in Phoenix, Arizona.

She has put a great deal of thought into this particular topic in recent years, and was one of the first people I thought of when we were putting the panel together.

Anna is going to discuss the influences she sees driving change in our world today, some of the specific changes she foresees in benefits, and the significance of those changes for employers and employees in North America.

MS. ANNA M. RAPPAPORT: We are going to try to take a very quick overview of the forces influencing employee benefits. We're going to start with setting the stage and talk about some of the major issues facing employers today, talk a little bit about the issues in labor force projections and the demographics, talk about work/family and its emergence as a corporate issue, the underlying drivers of regulation, look at a real actuarial issue -- the future of retirement -- and then say, "What does that mean for benefits and what does that mean for us as actuaries who are trying to work with employee benefit plans in a variety of roles?"

INTRODUCTION

As they enter the 1990s, many organizations are finding that they have undergone major change, must deal with a maturing work force who have different values, and/or are under major financial pressure. These organizations are often faced with employee benefit designs that no longer fit their needs because of the following: a need or desire to change culture; changing employee needs which are confusing or difficult; and/or need to reduce costs.

Plan designs can be changed abruptly, benefit by benefit, or alternatively, a comprehensive approach can be taken to review the entire compensation (or benefit) program. A thoughtful approach should begin by evaluating the environment in which benefits are operating. Such an evaluation will often lead to a change in the benefits package in response to the external business environment. We will be focusing on the environment and the benefit planning issues faced by many employers today in that context. Some ideas will be provided about benefits in the future and the directions that benefit planning is likely to take.

Key issues in the environment in 1990 are as follows: a changing work force, because of demographics and patterns of labor force participation; a different population composition, with the outlook for substantially more older persons in the future; a trend toward early retirement; accelerated regulatory change with benefits heavily tied to federal budget issues; globalization of business; cost pressure on all businesses; and mergers and acquisitions, which tend to replace long-term thinking with short-term thinking.

Two areas have been identified where the level and increase in benefit costs are putting financial pressure on many employers: active employee health benefits and retiree health benefits.

Health care costs are a key issue today. The concerns about retiree health most often relate to the future when this benefit will be treated like a pension for accounting purposes. In addition, some employers are rethinking retirement ages and benefits, and many employers are likely to do so in the future. Another major area of concern today

relates to work/family issues and how to design a benefit package to meet the needs of the family of the 1990s.

BENEFITS PLANNING ENVIRONMENT TODAY

SETTING THE STAGE: KEY ISSUES FACING EMPLOYERS

The major concerns facing employers when developing a benefit strategy include the following:

- Rapid escalation of medical care costs, with no effective way to stop such escalation despite of many types of cost containment programs.
- Proliferation of new laws and regulations, creating complexity, the need for frequent change, and expense in plan administration.
- Proposed changes in accounting rules for retiree medical benefits that will substantially reduce reported earnings per share.
- Health care benefit changes that have become a "big-ticket" item in highly visible labor negotiations. Competition on a worldwide basis has changed the situation. In a negotiated environment, unions have been faced with accepting labor costs that are competitive. The alternatives are lost business by their employer or having production moved to other areas. Union negotiations no longer are setting benefit trends.
- Increases in total benefit plan costs and the difficulty of predicting or controlling these costs.
- General level of benefit costs, and concern about value and appreciation by employees.
- Conflict between a paternalistic and protectionist philosophy and a philosophy whereby benefits are part of the total compensation package.
- Use of benefits to support the company's employee relations environment and culture.
- Use of benefits to portray a desired image of the company in the community.
- Recognition of changing demographics and that the integration of work and family issues are important to employee morale and productivity.

Business is increasingly global. Companies headquartered in different countries are buying companies in other countries, and many companies are distributing their manufacturing operations worldwide. Even service organizations are beginning to do the same thing, and computers will increase their opportunities for redistribution of work. As a result, costs must be competitive, particularly where their customers can buy in a worldwide market and where other companies can choose the most effective locations

for getting work done. The total compensation cost and types of benefits which American companies traditionally offer may be unacceptable in the future.

These issues force us to focus on corporate culture. Many employers are identifying a need to build a new culture and have benefit plans to support that culture. In some cases, their existing benefits imply a culture which is very paternalistic (an "entitlement" philosophy) and one in which benefits are generally provided without cost-sharing. The messages they convey do not include individual responsibility.

Today, those employers seeking to develop a new culture are often concerned not only about benefit costs, but also about motivating employees to improve productivity. Compensation systems are a key factor in such motivation. Those existing benefit plans which reflect an entitlement philosophy do not have much motivational impact. Incentive compensation plans can have a high level of motivational impact.

LABOR FORCE PROJECTIONS

Tables 1-7 provide new projections of the labor force to the year 2000. These projections were published by the Department of Labor in late 1989 and are an update of the projections which were discussed in the Workforce 2000 study. They show the following:

- Slower growth to the year 2000 than in recent years; growth is projected at 1.2% compared with 1.6% from 1980-88, and 2.6% in the 1970s.

- Female participation rates in the year 2000 of 85% at ages 35-44 years; these are 90% of the male rates.

- A small increase in male participation rates at the early retirement ages.

- Faster increases in the black, hispanic, and other labor forces than in the white labor force (Tables 8-11).

A second set of forces is also important. The challenges facing employers relate not only to the demographics of the labor force, but also to their skills. At present, there is a problem of matching skills needed with those available. This mismatch between needed skills and available capability of the labor force is expected to get worse.

The significant questions for the next decade are as follows:

- Will there be shortages of skilled workers? In what areas and occupations?

- Can female participation continue to grow? Is there a limit?

- Will the trend toward early retirement reverse?

- How will immigration fit into the picture?

At the present time, there is a curious dilemma. On the one hand, many employers are reducing staff and downsizing, while on the other, there is widespread prediction of

TABLE 1

Labor Force Participation Rates

Age	1970	1980	1988	2000 Projection
		Male		
16-19	56.1%	60.5%	56.9%	59.0%
20-24	83.3	85.9	85.0	86.5
25-34	96.4	95.2	94.3	94.1
35-44	96.9	95.5	94.5	94.3
45-54	94.3	91.2	90.9	90.5
55-64	83.0	72.1	67.0	68.1
65+	26.8	19.0	16.5	14.7
		Female		
16-19	44.0%	52.9%	53.6%	59.5%
20-24	57.7	68.9	72.7	77.9
25-34	45.0	65.5	72.7	82.4
35-44	51.1	65.5	75.2	84.9
45-54	54.4	59.9	69.0	76.5
55-64	43.0	41.3	43.5	49.0
65+	9.7	8.1	7.9	7.6

Source: Department of Labor, 1990 Statistical Abstract of the U.S. No. 625

TABLE 2

Labor Force Participation Rates
Ratio -- Female to Male
(Shown in percentages)

Age	1970	1980	1988	2000 Projection
16-19	78%	87%	94%	101%
20-24	69	80	86	90
25-34	47	69	77	88
35-44	53	69	80	90
45-54	58	66	76	85
55-64	52	57	65	72
65+	36	43	48	52

TABLE 3

Civilian Labor Force (millions)

Age	1970	1980	1988	2000 Projection
		Males		
16-19	4.0	5.0	4.2	4.4
20-24	5.7	8.6	7.6	6.9
25-34	11.3	17.0	19.7	16.6
35-44	10.5	11.8	16.1	20.2
45-54	10.4	9.9	10.6	16.4
55-64	7.1	7.2	6.8	7.8
65+	2.2	1.9	2.0	2.0
Total	51.2	61.4	67.0	74.3
		Females		
16-19	3.2	4.4	3.9	4.4
20-24	4.9	7.3	6.9	6.7
25-34	5.7	12.3	15.8	15.1
35-44	6.0	8.6	13.4	18.6
45-54	6.5	7.0	8.5	14.4
55-64	4.2	4.7	5.0	6.1
65+	1.1	1.2	1.3	1.4
Total	31.6	45.5	54.8	66.7
Total	82.8	106.9	121.8	141.0

Source: Department of Labor, 1990 Statistical Abstract of the U.S. No. 625

TABLE 4

Civilian Labor Force (millions)

	1970	1980	1988	2000 Projection
Males	51.2	61.4	67.0	74.3
Females	31.6	45.5	54.8	66.7
Total	82.8	106.9	121.8	141.0
White	73.6	93.6	104.8	119.0
Black	9.2	10.9	13.2	16.5
Other	*	2.4	3.8	5.5
Hispanic	N/A	6.1	6.6	8.5
Percentage of Total				
Males	62%	57%	55%	53%
Females	38	43	45	47
White	89	88	86	84
Black	11	10	11	12
Other	*	2	3	4
Hispanic	0	6	5	6
Annual Growth Rates of Labor Force				
Males		1.8%	1.1%	0.9%
Females		3.7	2.4	1.7
Total		2.6%	1.6%	1.2%

* Included with black in 1970

Note: Hispanic includes a combination of white and black

TABLE 5

Civilian Labor Force
Percentage Distribution by Age and Sex

Age	1970	1980	1988	2000 Projection
		Males		
16-19	4.8%	4.7%	3.4%	3.1%
20-24	6.9	8.0	6.2	4.9
25-34	13.6	15.9	16.2	11.8
35-44	12.7	11.0	13.2	14.3
45-54	12.6	9.3	8.7	11.6
55-64	8.6	6.7	5.6	5.5
65+	2.7	1.8	1.6	1.4
Total	61.8%	57.4%	55.0%	52.7%
		Females		
16-19	3.9%	4.1%	3.2%	3.1%
20-24	5.9	6.8	5.7	4.8
25-34	6.9	11.5	13.0	10.7
35-44	7.2	8.0	11.0	13.2
45-54	7.9	6.5	7.0	10.2
55-64	5.1	4.4	4.1	4.3
65+	1.3	1.1	1.1	1.0
Total	38.2%	42.6%	45.0%	47.3%
Total	100.0%	100.0%	100.0%	100.0%

TABLE 6

Civilian Labor Force
Growth Rates by Age and Sex

Age	1970-80	1980-88	1988-2000 Projection
Males			
16-19	2.3%	-2.2%	0.4%
20-24	4.2	-1.5	-0.8
25-34	4.2	1.9	-1.4
35-44	1.2	4.0	1.9
45-54	-0.5	0.9	3.7
55-64	0.1	-0.7	1.1
65+	-1.5	0.6	0.0
Total	1.8%	1.1%	0.9%
Females			
16-19	3.2%	-1.5%	1.0%
20-24	4.1	-0.7	-0.2
25-34	8.0	3.2	-0.4
35-44	3.7	5.7	2.8
45-54	0.7	2.5	4.5
55-64	1.1	0.8	1.7
65+	0.9	1.0	0.6
Total	3.7%	2.4%	1.7%
Total	2.6%	1.6%	1.2%

TABLE 7

Labor Force Participation Rates for Wives -- Husband Present
By Age of Youngest Child

	1975	1980	1985	1988
No children under 18	44.0%	46.0%	48.2%	49.1%
With children under 3	32.6	41.5	50.7	54.8
With children 3-5	42.2	51.7	58.6	61.4
With children 6-13	51.8	62.6	68.1	72.3
With children 14-17	53.8	60.5	67.0	72.9
Total wives	44.5%	50.2%	54.3%	56.7%

Source: Department of Labor, 1990 Statistical Abstract of the U.S. No. 637

TABLE 8

Projections of Total Population by Race -- 1989-2025
Percent Distribution -- Middle Series

Year	White	Black	Other
1989	84.3%	12.4%	3.4%
1995	83.3	12.8	3.9
2000	82.6	13.1	4.3
2005	81.8	13.4	4.8
2010	81.0	13.7	5.2
2015	80.3	14.0	5.7
2020	79.6	14.3	6.1
2025	78.6	14.6	6.5

Source: Bureau of the Census, 1990 Statistical Abstract of the U.S. No. 16

TABLE 9

Projected Components of Population Change
Rate Per 1,000 Mid-year by Race

Year	Net Growth Rate	Natural Increase			Net Civilian Immigration
		Total	Birth Rate	Death Rate	
White					
1989	7.0	5.3	14.3	8.9	1.7
1990	6.7	5.1	14.0	9.0	1.6
1995	5.0	3.6	12.7	9.1	1.4
2000	3.8	2.5	11.7	9.2	1.2
2005	3.3	2.1	11.5	9.4	1.2
2010	2.9	1.8	11.5	9.8	1.2
Black					
1989	14.0	12.1	20.3	8.2	1.9
1990	13.7	11.8	19.9	8.1	1.9
1995	11.9	10.2	18.1	7.9	1.7
2000	10.8	9.2	17.0	7.7	1.5
2005	10.1	8.6	16.3	7.7	1.5
2010	9.2	7.8	15.9	8.0	1.4
Other					
1989	34.7	13.7	18.2	4.5	21.0
1990	33.8	13.5	18.0	4.5	20.3
1995	29.4	12.2	17.0	4.7	17.2
2000	26.3	11.4	16.4	5.0	14.9
2005	23.9	10.8	16.0	5.2	13.1
2010	21.6	9.9	15.6	5.7	11.7

Source: Bureau of the Census, 1990 Statistical Abstract of the U.S. No. 17

TABLE 10

Projected Components of Population Change
Relative Rate Per 1,000 Mid-year by Race

Year	Net Growth Rate	Natural Increase			Net Civilian Immigration
		Total	Birth Rate	Death Rate	
Black as Percentage of White					
1989	200%	228%	142%	92%	112%
1990	204	231	142	90	119
1995	238	283	143	87	121
2000	284	368	145	84	125
2005	306	410	142	82	125
2010	317	433	138	82	117
Other as Percentage of White					
1989	496%	258%	127%	51%	1235%
1990	504	265	129	50	1269
1995	588	339	134	52	1229
2000	692	456	140	54	1242
2005	724	514	139	55	1092
2010	745	550	136	58	975

TABLE 11

Years of School Completed by Race and Hispanic Origin -- 1988
Percent of Persons Age 25 and Over Completing

	Total	White	Black	Hispanic
Elementary School				
0-4 years	2.4%	2.0%	4.8%	12.2%
5-7 years	4.4	3.9	7.7	15.7
8 years	5.2	5.3	5.5	6.9
High School				
1-3 years	11.7%	11.1%	18.6%	14.2%
4 years	38.9	39.5	37.1	28.3
College				
1-3 years	17.0%	17.2%	15.0%	12.6%
4 years or more	20.3	20.9	11.3	10.0

shortages of skilled labor. The shortages are very real for certain occupations, including nurses.

KEY DEMOGRAPHIC ISSUES

These labor force changes are driven, to a large extent, by demographic forces. The two-worker family, of course, remains important. Another key issue is population aging. Table 12 shows the increasing proportion of elderly expected, particularly after 2015. How are we going to support the Baby Boom generation as they live longer? At present, the Baby Boomers are in middle age and the work force reflects this.

Also driving the future are low total population fertility rates, but higher fertility rates among blacks and hispanics than among the total population. Table 9 shows growth of the population by white, black, and other.

WORK/FAMILY ISSUES

The combination of the labor force and demographic issues is such that addressing work/family issues has become a major human resources concern in some companies and a "legitimate corporate" objective in many companies. This issue is tied to competition for people and concern about maintaining the labor force.

Image with regard to family matters is also an issue. Once an issue has got a lot of public attention, many companies want to appear progressive and will work to create a public appearance of concern even if they do not feel an area is of great business importance. The reasons for focusing on image may vary and may not be well defined, but they can include implications for recruiting, effect on investors, and possible influence on customers.

Activities to address the work/family concerns of employees are often centered around work schedules and employee benefits. Response includes offering more flexibility in both leave policies and work schedules, choice in benefit plans, and some support for dependent care.

FUTURE OF RETIREMENT

The aging population and labor force composition data point to the question: Will the trend to earlier retirement continue? There are many possible work/retirement patterns, including new options for older persons and gradual retirement. While more people have been retiring earlier, there has been a significant amount of legislation protecting the rights of people to continue working, to continue earning benefit accruals in pension plans, and providing for higher Social Security benefits for those who retire later. Retirement ages and patterns are a key area of uncertainty.

We've also had business with a lot of early retirement window programs encouraging people to leave early. Tied to this major area of uncertainty is this potential for shortages and the high cost of retiree health and medical benefits for older persons.

LEGISLATIVE ISSUES

A major shift has occurred in federal policy as it affects employee benefit plans. At the time ERISA was passed (1974), the major focus was on employee protection with a

TABLE 12

Actual and Projected Growth of Older Population

Year	Total All Ages	Ages 55-64	Ages 65-74	Ages 75-84	Ages 85+
1900	76,303	4,009	2,189	772	123
1920	105,711	6,532	3,464	1,259	210
1940	131,669	10,572	6,375	2,278	365
1960	179,323	15,572	10,997	4,633	929
1980	226,505	21,700	15,578	7,727	2,240
2000 proj	267,955	23,767	17,677	12,318	4,926
2020 proj	296,597	40,298	29,855	14,486	7,081
2040 proj	308,559	34,717	29,272	24,882	12,834
Percentage of Total in Age Group					
1900		5.3%	2.9%	1.0%	0.2%
1920		6.2	3.3	1.2	0.2
1940		8.0	4.8	1.7	0.3
1960		8.7	6.1	2.6	0.5
1980		9.6	6.9	3.4	1.0
2000 proj		8.9	6.6	4.6	1.8
2020 proj		13.6	10.1	4.9	2.4
2040 proj		11.3	9.5	8.1	4.2
Percentage of Age 65 Population in Age Group					
1900			71.0%	25.0%	4.0%
1920			70.2	25.5	4.3
1940			70.7	25.3	4.0
1960			66.4	28.0	5.6
1980			61.0	30.2	8.8
2000 proj			50.6	35.3	14.1
2020 proj			58.1	28.2	13.8
2040 proj			43.7	37.1	19.2
Percentage Increase Over Prior 20-Year Period					
1920	38.5%	62.9%	58.2%	63.1%	70.7%
1940	24.6	61.8	84.0	80.9	73.8
1960	36.2	47.3	72.5	103.4	154.5
1980	26.3	39.4	41.7	66.8	141.1
2000 proj	18.3	9.5	13.5	59.4	119.9
2020 proj	10.7	69.6	68.9	17.6	43.7
2040 proj	4.0	-13.8	-2.0	71.8	81.2

Source: *America in Transition: An Aging Society*, Special Committee on Aging, U.S. Senate, Washington, D.C., 1984-1985 edition.

secondary focus on ensuring that tax-advantaged benefits were not abused in favor of highly compensated employees. During the last few years, however, the emphasis has shifted to deficit management. The major concern is that there are large "tax expenditures" for benefits, and Congress is focusing on reducing and managing these tax expenditures. There are still concerns related to financial security, but they are second to tax expenditures.

The general public policy environment in the U.S. of frequent change driven by deficit management leads to a high level of uncertainty. Similar issues are driving frequent change in the U.K., Canada, Australia, and New Zealand. In Australia and New Zealand, change has been much more radical than in the U.S.

As a result of this change in the public policy environment, and as a result of a reluctance to modify tax rates, a relatively long list of benefit issues gets considered in each year's budget legislation, with continual turmoil, change, and uncertainty being the result. The general regulatory situation for benefits is discussed here in by type of plan, including some of the major potential areas for change.

RETIREMENT AND CAPITAL ACCUMULATION PLANS

Under the Tax Reform Act of 1986, there were major changes in requirements for retirement and capital accumulation plans which became effective on a phased basis from 1987-89. Due to delays in publishing regulations, there were some special IRS rulings which effectively granted some extensions for compliance. The most important provisions are as follows:

- Coverage tests -- Much stricter new coverage tests apply. Some employers found that entirely new structures were required for retirement plans.

- New integration rules -- Under these rules, plans which have benefits designed to work together with Social Security must meet new rules designed to generally reduce discrimination in favor of the highly paid. Regulations were issued in proposed form in November 1988 and modified by additional rules issues in 1989 and 1990.

- Lower IRC Section 415 limits -- The maximum benefit available under qualified plans was markedly reduced. This was the third reduction in the decade, and meant that many highly compensated employees would get substantial portions of their benefits from nonqualified plans.

- New vesting standards -- Effective January 1, 1989, benefits must vest in five years or on a graded schedule which runs from three to seven years.

- Minimum participation rules -- A plan must cover at least 50 people or 40% of the entire group.

- Stricter nondiscrimination testing of 401(k) plan contributions -- This issue must be considered together with the coverage test issues, and in some cases, more people needed to be offered 401(k) plan coverage. The bottom line for many

highly compensated employees was that they were forced to reduce the amount they could save on a tax-deferred basis.

All of the tests need to be reviewed in light of the current work force and any projected changes.

OUTLOOK FOR CHANGE

It is quite likely that there will be further change. Some of the potential issues are as follows:

- Plan terminations -- There is a serious move to restrict the right of employers to receive a reversion on plan termination. This might be done by requiring that all assets be distributed to participants, by requiring that cost-of-living increases be included in benefits, and by other means. Excise taxes have already been imposed on reversions and these could be increased further. Legislation was almost passed in 1989 and this will continue to be a hot issue. In mid-1990, legislation was introduced to increase the excise tax on reversions to 30%, and the General Accounting Office (GAO) has proposed increasing it to 39%. Legislation may well pass on this issue.

- Taxation of investment return on plan assets -- A proposal was made in 1989 to tax gains on investments held for a short time. This proposal and others are likely to be seriously considered in the years ahead. Over the last few years, Australia and New Zealand have changed the way that employee benefits are taxed in their countries. It is unclear what the outlook is, but if legislation passes, it will increase the cost of pension benefits.

- Control of pension plans -- A proposal was introduced in 1989 to require joint employee and management control of pension plans. This is expected to remain on the legislative agenda for the next few years. There has been considerable publicity recently about retirement security in general, and much public focus on the potential retirement security of the Baby Boomers. There is strong opposition to these proposals, but there is likely to be continued support for them in some circles.

- Limits on benefits to be provided under tax advantaged plans -- Over the last decade, the maximum benefit limits (Section 415 limits) have been reduced three times. Proposals have been made to dramatically further reduce these limits. The limits on deferrals in 401(k) plans have also been reduced. As long as the deficit situation continues, further reduction in limits must be viewed as a likely occurrence over the next few years.

- Excise taxes -- A variety of excise taxes have been introduced in the last few years. They include taxes on early distributions from pension and savings plans, taxes on reversions, and taxes on high benefits. It appears quite likely that further excise taxes may be introduced, although the specifics are unknown.

- Portability -- The pension policy concerns coming from a labor orientation viewpoint have focused on portability as a priority over the last few years. Legislation has been introduced several times which addresses some portability related issues. The Tax Reform Act included five-year vesting, improving portability, and benefits for multiple careers. In Canada, vesting is mandated earlier, and there is also mandatory indexing of benefits. Legislation adopted in Canada is often later adopted in the U.S. This issue will remain on some agendas, but there is no outlook for short-term change.

- Limitations on lump sum distributions -- Benefits in savings programs are generally paid as lump sums. Benefits in defined benefit plans are sometimes paid that way. Research has shown that such benefits are often spent rather than saved for retirement. Proposals previously considered would have mandated rollover of lump sums into another retirement plan or individual retirement account. These proposals were not passed, but 10-year averaging for determination of taxation was discontinued and excise taxes were imposed. Distribution rules tightened for some types of plans. There is a clear philosophy held by some that tax-protected retirement funds should be restricted to use for retirement. It is quite likely that there will be further restrictions on use of lump sums.

HEALTH ISSUES AND RETIREE MEDICAL

The Tax Reform Act of 1986 included a sweeping new approach to discrimination in employer-sponsored health and welfare plans through Section 89. This legislation was repealed late in 1989, nearly a year after its effective date because of public outcry about its complexity.

As indicated above, it is likely that benefit-related issues will continue to be tied to the process of "deficit reduction and budget reconciliation" in Washington. There is a strong reluctance to add "new taxes" at the same time that current revenues do not support current expenditures. However, reducing the amount of benefits which are tax protected does not appear to be considered a "tax" by those who make tax policy. As a result, further taxation of benefits may be expected, probably with incremental changes made at various points in time. Benefits are quite likely to be an annual target. It is unclear in the absence of Section 89 whether there will be an attempt made in the next year or two to tax welfare benefits, at least for highly compensated employees. One school of thought would say that this is very likely in the current climate. The opposite view is that Section 89 caused so much turmoil that Congress will stay firmly away from this issue.

A significant national issue related to health care is the uninsured -- those who do not have health benefit protection. It is estimated that 37 million Americans have no health insurance protection and many more are uninsured. States are examining solutions. It appears unlikely that the federal government will do anything dramatic over the next three to five years. Massachusetts has enacted legislation which would require employers not offering benefits to pay a tax. This legislation is scheduled to go into effect in 1992, but there have been proposals to delay implementation because the cost estimates are rising. Chrysler is supporting a national approach to health benefits. This issue needs to be monitored.

FOCUS 2000: OUTLOOK FOR EMPLOYEE BENEFITS

Under Section 125 of the Internal Revenue Code, various trades are permitted between cash and nontaxable benefits. This code section is used as the basis for flexible spending accounts and pretax health benefit premiums. It appears very possible that there will be new limitations on the use of pretax dollars for health benefits in flexible benefit plans and for savings of employee money. Spending accounts may be eliminated, at least for highly compensated employees (as defined in federal law).

PRIORITY PROBLEMS FOR EMPLOYERS: RISING MEDICAL CARE COSTS

Increasing health care costs have plagued employers for the past 15 years. During the latter half of the 1970s and the first half of the 1980s, employer health costs increased at double digit rates. During the years between 1985 and 1987, health care costs moderated somewhat as the health care cost-containment programs implemented by both the government and the private sector began to take effect. But in 1988, employer health care costs began to skyrocket again. According to one source, total annual health plan costs per employee increased more than 18% in both 1988 and 1989.

It appears that the growth of health care costs has not been permanently contained by the effort of government and business. In fact some would argue that whatever savings the government has achieved through its diagnosis-related groups (DRG) program has merely been shifted to the private sector. Consequently, employers may now be experiencing cost increases that are the result of government actions that became effective in the mid-1980s.

It appears as though virtually all employers will continue to be faced with increasing health care costs. The 1990s will be a decade of change and challenge. The major issues (depending on one's point of view) are as follows:

- Thirty-seven million Americans have no health insurance protection and may not be getting adequate health care.
- The system is too expensive -- 12% of GNP is a much higher cost than most other nations; costs are rising faster than general inflation so that percentage is increasing annually and is projected by the federal government to increase to 15% by the year 2000.
- The employer's share of the cost is becoming an intolerable burden and more cost is being shifted to employees.
- A new method of paying physicians is being implemented for Medicare patients.
- Consumers have a very difficult time evaluating good versus bad care and accessing the system wisely.
- There are no generally agreed on standards for measuring quality of care; there is concern about the scientific basis for some generally accepted standards of practice.
- Research has shown that some care is unnecessary care, particularly surgery.

- The tort liability system and medical malpractice litigation is encouraging the practice of defensive medicine, thereby adding billions to the cost of medical care.

- Changes in our social structure have led to a situation where what were once family and personal problems are now being treated as medical conditions, with a big increase in teenage psychiatric care.

These issues have caused employers to put health care issues at the top of their list once again.

BENEFIT TRENDS OF THE 1980S

During the 1980s, companies found that benefit related issues were having a major impact on the bottom line. There were several areas where this was true, including the following: pension plan terminations, where the reversions were key items in financing a change of control; employee stock ownership plans (ESOPs), which in some cases were substantial tools for corporate finance; health costs, which increased rapidly so that the health care plan was a major burden; and proposed FASB rules for retiree medical accounting.

As a result of these issues, benefits gained much greater prominence with employers and with senior financial management.

During the 1980s, employers were modifying their benefit plans to do the following:

- Reduce employer risk and shift risk to employees. Risk reduction is seen primarily in changes to both cash retirement benefits and medical plans.

- Increase employee responsibility for both retirement and health. Increased employee responsibility has been implemented through greater cost-sharing, shifting of risk, and introduction of choice. Benefits built on an entitlement philosophy have been shifted to benefits which are more reflective of a compensation philosophy.

- Introduce a variety of cost-containment measures. These include cost-sharing, utilization management, and negotiated provider arrangements.

- Assume a more activist role in health care cost containment. Negotiated provider arrangements and utilization management are key in these efforts.

- Increase choice in benefit plans. More choice is found in defined contribution plans with a range of savings available and in welfare benefits which allow a choice of health plans or opting out and a range of different levels of life insurance.

- Increase in defined contribution plans and their role in retirement benefits. The increased use of defined contribution plan implements reduced employer risk and

increased employee responsibility. These plans provide better benefits than defined benefit plans for employees who shift jobs several times over their careers.

During the 1990s, the following benefit trends are predicted:

- Reduced employee choice of health care providers. Employer plans are likely to provide better reimbursement for those employees who select providers participating in PPOs or HMOs. Reimbursement where there is free choice may be reduced considerably in some plans.

- More cost-sharing and choice of type of health plan and indemnity plan level. Employees are likely to be asked to pay a greater share of their health care costs, and to be given a choice of different types of plans, but with restrictions in provider choice embedded in most of the options.

- More risk for employees. This is a continuation of the trends of the 1980s. Employers will increasingly seek predictable and manageable levels of cost.

- Increased focus on retiree health. As the population changes and new accounting rules are implemented, this will be extremely important for many organizations. Plans are likely to be much more limited.

- Possibility of taxation of benefit plans. This is in response to federal policy issues and the budget deficit.

- More nondiscrimination rules for benefits. Increased nondiscrimination rules will work together with taxation in limiting tax expenditures for benefits and ensuring that tax expenditures are distributed fairly.

- More mandated benefits. Public policy has focused not on increasing public benefits, but rather on requiring more from the private sector. More of the same is expected.

- More results orientation in the compensation package so that employees win when the company does well. Companies will want to be sure that employees have the same interest as the company.

- Reorganization of the compensation package. It is expected that money will shift from entitlement-oriented benefits to results-oriented compensation.

The 1990s will be a period of challenge for benefit planners and actuaries as they have to respond to difficult business situations with solutions which make sense in the current business environment. They will need to focus on the external environment and how it will impact the organizations they are serving. It will be important not to assume general solutions, but to work with each organization on understanding how it sees its business evolving.

We see two kinds of roles for actuaries: a sort of a broad role where they're designers of benefits and working on business strategy, and a more narrow cost analysis role. I think the organizations we serve are going to need that broad role, and I encourage us to take it because otherwise we may be trapped and find that others are doing the conceptualization and thinking. We're going to be participating in teams of people that are multidisciplinary and we're going to find that retiree health is just as big a ticket item for many of us as pensions.

MR. MOORE: Our second panelist is Paul McCrossan who many of you know as one of the first actuaries elected to government, and the first elected to the Canadian House of Commons where he served three terms between 1978 and 1988. While he was there, he was very successful in helping us raise the profile of the actuary and the profile of actuarial issues in government legislation.

Paul is going to address these benefit issues from the viewpoint of a former legislator, and as the President-Elect of the Canadian Institute of Actuaries. He's also going to issue a bit of a challenge to actuaries, which is long overdue in my view, and he's going to make some positive suggestions about how we can take actions to deal with our changing benefits environment.

MR. W. PAUL MCCROSSAN: I thought I might start off with a true story that just occurred, because one of the themes I was going to dwell on is what the actuary might be able to do to influence the future. As I was leaving Pleasure Island to come to a meeting of our panel to plan the session, I encountered a young couple who were just crossing onto the island as I was leaving. The young woman pointed up at the marquee, which most of you probably noticed, which said "Home of the Actuaries." And she turned to her boyfriend and said, "What does that mean?" And he said, "I don't know. It must be some new horror movie." Well, my immediate thought was, we're going to influence the future and we've got all the profile of the gorgon raiders. My second thought was a little more sober, and that was, what if the young man actually knew actuaries and thought that it was the ultimate horror movie?

In her presentation, Anna referred to the cost pressures being placed on employers as programs matured, as the population ages, and as government requirements increased. The same pressures are felt in Canada.

I'm sure all of you have at one time or another focused on the future and particularly on the operations of government and asked: Why are they creating these new laws and regulations? What do the changes imply for my future? How on earth can we cope? My premise is that you, as actuaries, will be heavily impacted in the future by legislative and regulatory changes, and that this will directly affect the design and delivery of employee benefit programs.

The practical experience I bring to the table is strictly Canadian, both as a former legislator and as President-Elect of the Canadian Institute of Actuaries. Let me state that I believe both that the problems faced in Canada are similar in cause to those being faced here in the U.S. and in industrialized societies worldwide, and that these problems

will lead to similar legislative stresses in most of the industrialized world, but most particularly in the "new world."

It is often stated that to become a successful lawyer, you need to prepare your opponent's brief. That is, you need to understand your opponent's point of view given his options and the facts as he sees them. I suggest that the same is true in understanding, anticipating, influencing, and coping with future governmental initiatives. Although the mix of public and private delivery of benefits differs between Canada and the U.S., given the expected future demographic trends in both countries, the broad policy responses may be expected to be somewhat similar.

Let me set the stage. First, both countries are running near-record deficits and have been doing so throughout the longest economic postwar expansion. Debt service is becoming a major portion of government expenditures. The entitlement generation -- that's most of us in the room, the postwar Baby Boomers -- increasingly resist tax increases. We don't feel personally responsible for the deficits because we intuitively believe that they result from "pork barrel politics" or government waste. On the other hand, expense cutting is also fiercely resisted. Every government expenditure has its constituency, and these constituencies become increasingly rapidly mobilized to resist any threat to their ideals or to their programs. This emergence of the single-issue voter has fundamentally altered our political systems. Finally, there are increasing pressures to expand future program expenditures, for example, to protect the environment, to provide affordable child care, or to improve the lot of the poorest of the poor.

To a large extent, the economic success of the new world as compared with Europe was based on its demographics as well as the ready availability of land. We were young countries with relatively small retired populations and relatively large youthful labor forces supplemented regularly by immigration. We had immature social systems. That is now about to change rapidly, and the pressures on our society will also steadily increase.

Consider programs to support the elderly in North America, the most rapidly increasing type of governmental and corporate employee benefits. In Canada, these consist primarily of retirement income programs, and as Anna said, medical care programs. My choice of the second as a retirement program might surprise you, since most people don't think of medical care as a program of income transfers in which active workers finance retired employees' medical care. When you consider that people older than 65 years consume five times the per capita medical care costs that younger people do, and when you consider the shift in age that is coming in the future, it is obvious that medical care will become an increasingly hot topic, whether provided by government as in Canada or by a mix of government and corporate "socialism" as in the U.S.

Let me first dwell on retirement income plans, starting with the government sector. In Canada, our Canada Pension Plan provides an indexed retirement benefit of about 25% of the inflation-updated Average Industrial Wage. Costs for this benefit, which are currently paid by a payroll tax, are projected to rise from the level they were established at, which held until 1985, of 3.6% of payroll to around 7.5% of payroll by 2010 and are projected to rise to about 14% of payroll by 2030. In addition, we have a universal Old

Age Security (OAS) system which pays a flat benefit of about 15% of the Average Industrial Wage. The OAS is financed on a pay-as-you-go basis from general government revenues and can be expected to mature at the equivalent of about a 10% wage tax by the year 2030.

Turning to medical care costs, Canadian medical care costs, which run a little lower than in the U.S., are about 8.5% of the GNP. Providing the same level of services as the population ages could see costs double expressed in terms of active workers' wages. Therefore, at the government level alone in Canada, the combined cost for income transfers from workers to support the retired population will equal or surpass the current total income tax take of the government before any other program which directly benefits the workers themselves is considered, let alone interest servicing of the then accumulated government debt.

The conclusion is fairly inescapable. We, in Canada, are simply not going to fulfil our implied promises to future retirees because future workers will not accept these levels of taxation. The question is what do to about it and how can the changes be phased in.

There are essentially two political options. The first is the "steady as she goes" alternative -- just keep promising what you know you can't deliver because first, something may turn up. Second, the crunch will occur long after you've left politics. Or third, democracies seem to have to face an immediate crisis before a public consensus is reached necessary to take difficult political action. As an aside, I might point out that the governmental responses in North America to the fossil fuel energy consumption, global warming, and pollution issues clearly fall into the "steady as she goes" alternative. Politicians feel that voters won't opt for higher energy prices, decreased energy uses, or changes in lifestyle unless they're forced to. I think we can see the analogy when we see what's happened with the budget discussions here in the U.S. recently.

The second option is the "bite the bullet" alternative -- start the political changes now to cope with the future changes. My personal assessment is that in Canada, we're at the stage of "sucking" or "nibbling" at the bullet.

In her presentation, Anna referred to taxation as a future issue, and I suggest that this issue is going to be focused in on tax expenditures. We are going to hear more and more in the public press and in the government about the issue of tax expenditures. Pretty well everyone understands and accepts the concept of "program expenditures." These are the dollars the governments spends. They are highly visible. "Tax expenditures," on the other hand, are the dollars that the government doesn't collect as a result of some tax preference, whether it's a deduction, an exemption, or a credit. These are often not visible to the taxpayer who is usually under the "illusion" that the money is his to start with and possibly to end with. If politicians find difficulty in dealing with the principal issues of raising taxes or cutting expenditures directly, they do not find tuning tax expenditures to be so politically difficult. There is a clearly established trend towards more restrictive tax legislation and more restrictive regulation as governments at least try to ensure that access to tax expenditures serves the public purpose. Both in Canada and the U.S., I believe this trend will accelerate and will dominate employee benefit design over the next decade.

For example, recent policy initiatives in Canada concerning registered pension plans and individual registered retirement savings plans are directed both towards restricting tax expenditures and towards creating an environment where our long-term structural problems can be addressed.

First, from the structural perspective, if we view the retirement income system as a mechanism to deliver goods and services to retirees rather than merely dollars out of an account, which I suspect is the traditional actuarial approach, with the rapid decrease in the number of workers relative to retirees, society will have to become much more capital intensive to deliver any given level of goods and services. Therefore, our government feels that long-term capital formation needs to be encouraged through much more generous access to tax preferences for retirement savings. In Canada, this now means that up to 18% of earned income up to an annual savings of $15,500 per worker by 1995 can be deferred from taxation through a pension plan, a deferred profit sharing plan, or individual savings.

But at the same time as the increased access to the tax preferences is legislated, the government actively intervenes to impose additional conditions to make the tax expenditures much more socially effective. The top income at which full assistance will be available is going to be compressed dramatically down to 2.5 times the Average Industrial Wage, about $75,000 today. Those earning more than that income will simply have to save outside of tax shelters in respect of their excess earnings. Furthermore, in order to become deductible, pensions must vest early, usually after two years. They must be fully portable, either to a new employer or to an individual retirement savings plan. On retirement, last survivor benefits must normally be elected.

Thus, the government is completely changing the rules of the game for pension plans. On the one hand, the average worker receives increased entitlement to tax preferences. However, very real strings are being attached and very real ceilings are imposed to try and ensure that tax expenditures are "spent" efficiently.

Furthermore, there is a real crackdown on actuarial funding and assumptions used, particularly for small plans where the government perceived that the actuarial profession was perpetuating extensive or encouraging extensive tax abuses. As a result of the extreme latitude that pension actuaries were taking in Canada, they almost completely lost the right to choose either the methods or the assumptions for valuing these plans or even the right to reflect the actual benefits accrued in determining tax deductible costs. These obviously threaten the essence of our profession fairly substantially. It took the very active intervention by the Canadian Institute of Actuaries to retain a significant measure of actuarial control -- intervention in which strict professional standards and active discipline processes were promised by the profession to the government in return for keeping control of the process.

The pension world in Canada, and I suspect around the world because of the age shift, is going to change dramatically. Some may argue that these changes are so dramatic that they threaten the viability of pensions themselves. Possibly. But it is important for actuaries in private practice to understand why governments are led to make those changes and impose those threats to the industry. Plans under the prior regimes were

not perceived as delivering sufficient value for the tax dollars forgone. Benefits were felt to be heavily skewed to upper income earners. Tax practices of professionals, particularly actuaries, were felt to place in question the previously allowed professional flexibility.

I suggest this type of reform is typical of the type we as professionals are going to have to become more used to. The social value of the products we deliver will be judged and compared with the value of the tax preferences offered. If we fail the test or if we cannot regulate internally perceived tax abuses, the rules may change suddenly and dramatically.

On the health side, it is obvious that an increasing proportion of health care expenditures are being devoted to prolonging death rather than extending healthy lives. Attention is rapidly being focused on the rate of increase in health care expenditures and on the reasons behind the increases. More and more we see heroic measures and medically questionable procedures increasing our costs. Can we as a society justify not posting DNR or "do not resuscitate" orders for the terminally ill unless we have the patient's prior consent? Currently, for example, in Canada, terminal cancer patients may be revived several times before the inevitable death occurs.

Certainly, without legal protection for the hospital or medical fraternity, they are likely to continue to order tests which are not medically justifiable and to order CPR for hopeless cases in order to protect themselves legally. As a society we cannot afford it -- therefore in the long run, we won't accept it. I expect that major changes in the rationing of health care to the terminally ill will arrive within the next five years, and certainly before the end of the decade. This will have enormous impacts on the design of health care plans, whether governmental or private sector plans.

At the other end of the age spectrum, just as DNR orders will become an issue for adult patients who are terminally ill, so might DNF or "do not feed" orders for newborns who are not likely to survive to a quality life. We are highly likely to also focus in on the cost of treatment for level two or level three newborn babies. Studies elsewhere in the world indicate that it may be far more effective to provide a healthy prebirth environment than to pay for the health costs associated with low-birth-weight babies. Some countries have already reacted now by paying prebirth allowances to expectant mothers as soon as they register with a physician, a physician who will encourage healthy habits and adequate nutrition before the baby is born. The feeling in these other countries is that the reduction in health care costs might be three times the increases in prebirth expenditures.

In addition, far too high a proportion of our medical costs are related to tobacco and alcohol abuse. These are luxuries we are not going to long afford as a society. I think we can expect to see more and more legislation banning smoking in the work place and in public places. Already in the medical community, there is talk about a triage of rationing of health care, such that heavy smokers might be denied access to the system.

The financing of medical care costs will likely become an increasing issue in both countries. The current corporate-sponsored benefits, or even benefits financed through

corporate income tax, will likely put North American manufacturers increasingly at a competitive disadvantage against imports from countries which finance such costs from consumption taxes. Note that there are now only three Organization for Economic Cooperation and Development (OECD) countries which do not rely on consumption taxes to finance such social expenditures -- two of them being Canada and the U.S. Without tax changes, we may become increasingly uncompetitive. Therefore, I expect that sooner or later Canada and the U.S. are going to have to face the financial issues of financing medical care and their effect on global competitiveness, particularly of their manufacturing sector, within the decade. In the U.S., this may involve a direct move away from corporate socialism for financing medical care costs, particularly to help to restore corporate competitiveness. Without such changes, major domestic manufacturers may be increasingly unable to compete with foreign transplants as a result of the age shift from active workers to retired workers.

As you can see, the political environment I am predicting for employee benefits involves increasing government intervention in the retirement income field and in the health care field. What then can or should be the role of actuaries as individuals or as a profession?

In my view, actuaries should become politically active at all government levels, not to advocate specific solutions, but to educate legislators and officials on the range of possible alternatives as well as on the expected results of specific policy initiatives. We are uniquely qualified to directly influence the debate, if we choose to do so. Note that the role I am suggesting is very distinct from the advocacy role that we will naturally play for our employers.

If increasing governmental restrictions on access to tax preferences or medical care delivery are likely to occur, we can all see that some will be destructive while others will be constructive. As a profession, we should actively intervene to identify both issues and alternatives early and to aggressively promote a long-term point of view. Goodness knows there will be precious few other people raising a long-term point of view. Handled properly, actuaries can occupy an important and increasingly relevant role for future policy considerations.

One thing I learned as a politician is that the "currency" of Ottawa was knowledge. Politicians' doors are always open to those who consistently offer high-quality advice.

If we as a profession sit back, let's not blame the legislators for a deepening crisis which makes our work unworkable. Like Pogo, we will have faced the enemy and they will have been us.

MR. MOORE: Our next panelist is also an actuary but a different kind of actuary. Don Harrington is a Corporate Vice-President of AT&T, not a corporate actuary, not an Actuarial Vice-President, but a Corporate Vice-President. In this role, Don is expected to look at AT&T's corporate operations from a "normal" executive's point of view, and actuarial issues are simply one of many areas that influence his decisions. Of course, as an actuary he can better understand the actuarial advice that's given to him, but it's just one of many areas he has to deal with.

Don will discuss some of the benefits policies and priorities today, and how he sees these changing by the year 2000 and beyond. While he is an actuary and practiced very much as an actuary until AT&T's corporate changes recently, Don's special position at AT&T means that he must be able to look at corporate life from a nonactuary's point of view, and so we're going to ask him to comment on our profession from that viewpoint as well.

MR. DONALD P. HARRINGTON: I used to be an actuary. We start talking here about smoking policy, and clearly even that can be actuarial, depending on how you look at it. We could say that for example, in my position, should we ban smoking in the corporation? The question that I would first raise is, "Does the chairman smoke?" because clearly that's a survival function.

About five months prior to receiving the outline for this session, I had put together a presentation regarding benefits at AT&T in the 1990s. Let me just tick off for you where I was coming from. I had factors impacting benefit policy and benefit programs. We have changes in the work force and changes in the growth rate of the work force. We have an aging population. We have attitudes, freedom of choice, and independence. In the government viewpoint, we have large budget deficits, benefit revenue issues, changes in social policy, benefit issues, expanded medical coverage, pension portability, pension discrimination, acquisitions, and divestitures. I have a team that does that. We have bargaining in 1992, 1995, and 1998. We have active and retiree costs. Another item that I had on my list was major employee concerns and employer/employee concerns during this period. I also had benefit administration complexities, benefit communications complexities, and benefit delivery complexities -- all complexities. I think the list supports where Anna was leading.

With that in mind, both Paul and Anna have set the stage. My purpose here is to take the abstract and the general and drive it down into the concrete and the specific. I want you to look at the situation through my eyes as I see it in the benefit issues -- not yours.

Anna listed some categories. Organization change -- let's go back. Consider for a moment AT&T before 1984. We have a market for telecommunications that is essentially closed to competition, a regulated monopoly. We have a structure of the business that is self-contained. We do our own manufacturing, we have our own research, Bell Labs, and we take care of our own delivery. We have career employees. The exchange we've made in this environment to the career employees is lifetime employment for taking on assignments reflecting a division of labor into its smallest component working parts. The result is a high level of expertise in functions, often without a match to the market. Lifetime employment, functional expertise, the jobs do not necessarily match to the market -- that's your population.

Now, the second category Anna raises is competition. In this environment, look at your behaviors. Who are your leading players in a regulated monopoly? The answer is lawyers, engineers, and subject matter experts, and marketing is not in the picture.

Our essential theme is "service is our only license to exist." It's a quote that we've had for years and years historically. Therefore, we do whatever it takes to solve the problem, sometimes irrespective of the cost. You deliver it. If we had a 747 to get across the

country in that environment and we didn't have any pilots, we'd disassemble it, break it down, carry it across, and reassemble it.

Because of the division of work, we have a high rotation of employees from job to job. One might infer that anyone can do any job.

We reorganize frequently, and it's hard to get the message across that reorganization can often be detrimental. The point being that you just don't mix things up, which we did then. Employees, however, were dedicated. They were loyal, trusting, and competent. AT&T is viewed as a caring employer, some could say paternalistic.

What about the benefits? Benefits are comprehensive in scope and provide a high level of replacement. But in 1980, a change was made from a final pay pension plan which we had from 1913 to a flat dollar plan for represented and a career average for non-represented. That was a neat sales job, let me tell you.

The strengths -- pensions, we've funded postretirement death benefits as early as 1964, and then again with group insurance in the late 1970s. The pensions and death benefits are well funded. Weakness -- medical converted from schedule to reasonable and customary somewhere in the early 1970s. So we have a problem with the medical.

That's background. That's where I'm coming at you from. Needless to say, we've made significant strides during the 1980s as far as getting competitive. Some, however, have been very painful. At the time of divestiture, we had 370,000 people. Right now, we have 280,000 employees. One of the good aspects for morale purposes, not necessarily for cost purposes, is that the retirees have grown during that period from 65,000 to roughly 130,000. Now you've got the ratio. The ratio is almost two to one. We funded the plan. We've been fortunate. Also, with respect to our employees -- remember the career exchange -- we've made a significant effort to move ahead on educational efforts about the nature of the business. We've increased employee accountability for taking charge of their own careers -- education again. They have to know it's up to them. We will guarantee as best we can, but it's up to them. They have more accountability in managing their own careers. We've refocused the marketing effort dramatically. And getting back actuarially, we have introduced a cap on postretirement medical costs, which is a premium cap. We did that in 1989 bargaining.

Still, there are nagging questions. What if the pension plans hadn't been well funded during the 1980s? What if we didn't have strong investment performance in the 1980s? What if the pension plans hadn't been redesigned? These questions and the issues regarding changing demographics of the work force really forced us to go back to the drawing board. One of the problems of being an actuary, you've got to start working on your communications all the time to get people to sit down and listen to you. There's no way to do that than to use numbers. What I did with them to focus attention was I said that I would create a relative value schedule. I look at cost on a relative value basis and I make a little assumption here that says in effect, "Suppose you're always complaining to me what the cost of our benefits are? Suppose we had only in the 1980s the same investment performance that we had had in the 1970s? In fact, I'll make it 20% better than we had during the 1970s?" Well then, I go back and I recalculate our cost for the

period to make the effect that it's somewhere between a 30-50-60% increase in the benefit cost that we would have had. That makes the point.

I have a committee working with me: vice presidents, heads of various units, or presidents of various units working with me. We are starting to really think through where our benefits are going and where we're heading and what the issues are. I've explained roughly how we got here. This gets into Anna's third category: adapting to change. The first question -- one that you would go over with your clients, or if you're in my capacity, sit down and figure out how you will respond -- is something like "What is this policy with respect to benefit coverages?" What does that mean? It means that if you look at what our benefits do, do you want your individuals essentially in Chapter 11? Your employees -- what kind of employer do you want to be?

So you have to ask questions that relate to risk diversification. How much can they stand? Who does that apply to? Does it apply to employees only? Or does it apply to employees and dependents? Because once you get into the dependent issue, you've moved away from individual equity into a social issue. You've been through this. You used to read all the material on the exams about equity fairness, and you used to try to get through that so you could get to your mathematics. But you're back facing it by trying to take those abstract terms and boil them down.

Should there be a corporate minimum benefit level versus employee choice? Anna said employees are going to be looking for choice. Well then, should there be a minimum benefit level? That's a question that we have to hang out there and ask, "What do you folks want in the business units?" and try to support that. What are the risks involved?

Competitors -- how should we compare? How should we position ourselves? Should we do it on the basis of cost? Should we do it on the basis of design? How do we want to stack up? With whom should we compare? That's in compensation. Those are the dimensions of one question.

The second question is what constitutes the career work life exchange? Think about that. The career work life exchange is a fundamental premise that you made if you want to take a look at FAS 87 versus the accounting of APB 8. There was a fundamental wedge driven in there. Do you accrue cost or do you accrue benefits? Which one? If you view your people as widget makers, you could argue you accrue benefits. If you view them as a career exchange, you can say you accrue costs.

So the question has to come down to active status versus retired status. Length of service and age at retirement -- what are you thinking about? When do retiree coverages accrue? Exclusive of pensions -- pensions have been pegged in the statute -- but when do retirees' coverage for postretirement, medical and postretirement, and death benefits accrue?

Pension plan design -- do we have flexible retirement ages? We have them now. Originally the men had to wait more than the women, so the men sued you and got it back to the same time as the women, which is now 55. Portability features -- I have pressure on portability features from Bell-APTS. These are people in the MTS,

members of the technical staff, who view themselves as highly portable and compare themselves with the academic community. They would like portability.

Third, what coverages should be coordinated? What's your philosophy here relative to entitlement? That has to be addressed again. Pensions and savings? Ad hoc pensions and medical? We've done a lot of ad hoc agreements for postretirement increases.

What is the purpose of a pension fund? Employee security versus corporate existence? You know where the enrolled actuary stands on that. Should the pension fund be used to facilitate spin-offs? How much? Whose money is it? Should the pension fund be used for other purposes, including all of the above?

Finally, I break it down to you: What is the relationship of corporate benefits to new ventures? Again, questions that have to be addressed when you no longer have the entire market. Same plan or different plans? Existing retiree cost -- they all want to come in and no one wants to pay for the existing retiree cost. If they're making money off the brand, however, we try to say you pay for part of the existing retiree cost. What about economies of scale, collective risk diversification, and use of surplus pension funds in that process?

Repeat -- here's the issue that I'm facing you with right now: You can see in here the whole thread of actuarial work. I'm not actually doing the quantification, but I'm having it done for me on that basis.

Repeat -- I've told you the bargaining is 1992, 1995, 1998. I'm saying that by the end of 1992 bargaining, I have to be directionally focused or I'm not getting there by 1995, and I don't want to get there any later than 1995.

MR. MOORE: Don also has a few comments to make about how the actuary fits in from his point of view as a user of actuarial services, and I hope we can get back to that.

Our final panelist is a guest of the SOA by the name of Carol Lockhart. She has dozens of successes and honors to her credit in many fields relating to health services and health care.

Of particular interest is her position as Executive Director of the Greater Phoenix Affordable Health Care Foundation, which is a coalition of employers, consumers, health care providers, and insurers working together to resolve health care issues in her community. Among other employment activities, she is also a member of the PPRC, the Physician Payment Review Commission, and has been a state regulator and a director of a capitated Medicaid program.

Carol is going to give her view of the factors influencing health care policy and services, and how she sees these factors influencing the health care market and the interested parties -- the employees, employers, insurers, and us, the actuaries.

MS. CAROL LOCKHART: I feel outnumbered here, but I will try and provide something to you that might be of interest. I am going to talk about health benefits and

employee benefits, but from a little different perspective. What I want to try and do is give you a sense of the context within which you're working and within which your decisions influence other things, and how other things influence you as you make your decisions. What are those influences and how do they impact society and you in general?

INFLUENCES ON HEALTH POLICY AND SERVICES

What are the things that influence you as you move forward? A lot of people talk about national health policy. We have no national health policy. You might think we do. Canada has one. It has a policy about providing health care to individuals. The U.S. does not. We provide health care, depending on who's in power, who's got the most influence, who chooses to give it, and whether you happen to be in a state or community that will provide it. It varies. We do not have one national consistent policy. So don't presume that we do. Your community that you work in may not be seeing some of the things that you've heard us comment on or some of the things I say because we really do vary.

It used to be that, in health care, the provider was in charge. When you think about it, providers pretty much set the standards. If a physician wanted to order a procedure, he did. If a hospital had a piece of equipment, you used it. We really didn't do much to try and control that. In the 1980s we said that we are not going to do that any more, and certainly that was based on our financing policy which was fee-for-service. But we've taken away the blank check. We now say that you have to play within certain rules. That is a major change, and the group that's setting those rules are the purchasers. So we have moved from a provider-dominated health care system to a purchaser-dominated health care system.

The rules have changed dramatically. You on the actuarial side may not see some of the turmoil that I see on the health care side. But from a health care perspective, there has been nothing but turmoil in this last decade, and guess what? It's expected we will have turmoil for the next decade. You really are going to see some other dramatic things.

In the 1960s, we had the move towards Medicaid, improving access to health care. The political climate was that we owed the public something. In the 1980s, we moved away from that. We began to say that the costs are too high, we as a society can't absorb all those costs, we want to take away access, we want to begin to control it. Many of the comments you have already heard have been about people now being on single-issue politics. The American Association of Retired Persons (AARP) is very influential, not just in numbers but in votes. They vote. Babies don't vote. The people that are going to have power are the seniors, and they are going to set a lot of political policy. As I make other comments, you will see how that is going to influence a lot of other things.

We are renegotiating the social contract with people. I agree that the question of rationing is going to be a significant one in this decade -- and we will see it. Though we do have it already -- 37 million people in this country have no insurance. That is a form of rationing. We also have a lack of leadership politically in many states, and unfortunately nationally on the budget, so we can't even run the federal government.

In terms of social policies and influences, we talked about the importance of family, but we also have to look at the fragmentation of family. When you are looking at providing insurance and writing policies and so forth and doing some of those numbers, the reality is that many of those people working are now mothers with children at home. Many of those mothers do not work in large companies. Many of the people I see, particularly women, work in small companies that either have no insurance or have very little insurance, and so there's another dynamic going on. They may be moving into the work force, but many of them are doing it without insurance. Many of the uninsured in this country are mothers and children. They are going to influence what's happening here. They're also going to influence the tax burden because when they don't get it through work, they do get it through indigent health care programs or other kinds of programs.

We also have things going on in our society, like drugs and homicide. I saw on TV that we expect 24,000 deaths from homicide this year. It's got to begin to do something to your numbers -- that, AIDS, and all of the other things that are going on. Prejudice and prejudice in the work place are also going to influence what's happening.

If we move down to the economics, you've already heard much about that, but before, health care costs were not an issue. Five percent of the GNP -- we can live with that, but now, it's 12% of the GNP. That makes it a real issue. As business tries to compete in the world economy, that begins to impact on the bottom line.

Competition, recession, all of those things are going to have an impact. One of the things I hear from the employers I work with is that health care is an issue, but it's no longer a primary issue. Survival is the primary issue. I work with coalitions. The businesses are telling me, "We want to be involved. We want to make change, but it's not on the priority list any more. If we can keep it under control, we'll live with it, but right now, we're too worried about keeping our company going and not having to lay off workers." There's a real change. Health care is important, but it doesn't have the same dynamic that it did before.

The other thing that I'm seeing happen is that businesses are so concerned about their own survival and their own position in the economy that instead of working at a state level for change, they're saying they want national change, whether it be in health care or in other things, because if they're a multistate corporation, they don't want to have to deal with the differences between states. I'm sure those of you who work with companies that have insurance in different states understand that. Many companies are now saying they will only play along with local state changes if they do not conflict with any potential change that we have down the road, which I think is probably in the next five to 10 years, when there might be some national policy.

You've already heard about the demographics, but let me point out a couple things. We have a lot of babies being born. They are being born to minorities. Minorities have a high incidence of low birth rate and infant mortality. We also have a lot of crack babies being born and a lot of babies with AIDS. This is the future working population. This is a population that is already encumbered and may not be a productive work force. We have serious problems about the kind of work force we're going to have in the future. Infant mortality, prenatal care, all of those kinds of things are real issues that society

must begin to address. The people coming into the work force will not even be able to function and have the educational level necessary to work. It's going to change what's happening.

In other words, all four of those key things I've mentioned really question the state of the health of the nation, the company, the family, and the individual. I guess the comment I'd make is that they're all compromised right now. That's the climate within which you're working.

You've heard some comments about law and regulation. We seesaw between a regulatory period and a competitive period, and then we go back. We're swinging back towards regulation. We do expect more regulation in all forms. It will affect actuaries. It will affect businesses.

We've seen major change in financing, moving from fee-for-service to perspective payment. We've seen DRGs for Medicare in 1983. I serve on a commission that's been recommending changes for physician payment. And we will see a Medicare fee schedule in 1992 that affects physicians. It will affect the market in which health care services are delivered. Will people move to the same kind of system? A lot of people did in terms of adopting DRGs. Will they now adopt the Medicare fee schedule? They might. If they don't, we may see a significant amount of cost shifting because Medicare fees are going to be set and very clear. The question is going to be where is the physician going to get the balance of the revenue he would like to make. Probably he's going to get it from private insurers and those payments. So there may be cost shifting. There may be a movement toward an all-payer system, where everyone participates in one type of financing system.

Technology -- we've seen some changes. You used to have a lot of technology development when you had a fee-for-service market. You now have perspective payment. A lot of medical research has slowed down because we don't have as much capital available. The question is going to be whether this continues. The other thing that's happening is instead of just saying we can have people create new procedures and new equipment, we're now saying you have to prove that it makes a difference. It makes a difference whether you do five diagnostic tests or two to find out whether someone has a gallbladder problem. If you know after two what's wrong, do you really need to do all these other things? There's going to be a real challenge, both for the technology and for the individual physician and the care that they institute for their patients, about whether it's efficacious. If it's not, there will be a question about whether it should even be used. It certainly will not be approved for payment.

Benefit plans, consumer choice, and provider behavior have all attempted to control the price of a product, the location of a product, the quantity, the utilization review issues, and the quality. Price, quantity, and location have probably been the big issues for the 1980s. Quality is talked about as the big issue for the 1990s. I think it's a nice discussion. I'm not sure I see it being as much a reality yet. I think cost is still the primary issue. So we will see benefit plans still moving toward managed care. We will still see attempts to control utilization. We are going to continue to see attempts to control costs, which have not been controlled. I run a group called Great Phoenix Affordable

Health Care Foundation. Believe me, it's not affordable, and we haven't controlled the cost.

The provider behavior that's going on is one of movement to try and find markets. What we've seen happen is that as we increase controls on hospitals and utilization in hospitals, services move out of the hospital into the mental health area and outpatient services. We're going to see that continue, but now everybody is putting controls in on that side. It's going to be who can get ahead of the other one in terms of figuring out the controls and where to move the market. The physician is less in control of his practice than he ever was before, and in the 1990s, the control will decrease. That's not something that makes physicians happy.

How will all these things influence the market in general? Basically, we are talking about movements to managed care, utilization controls, and possibly some standardization in utilization controls. Right now it's a mishmash. You can't tell what the standards are and why one thing is approved in one organization and not in another. We're going to see the financial burden. It's already been shifting to the consumer and the employer from government. We're going to continue to see that. We're going to see increased regulation. I think there will be decreased access to health care benefits -- I'll talk a little bit more about that later. Then we will see some real debate on a national health care policy.

Paul mentioned that we tend in a democracy not to move until we have a crisis. The national health policy debate probably won't be advanced very quickly until there is a perceived crisis. So far, the crisis is not there. There's a lot of anger, but there's not a crisis.

IMPACT OF POLICY AND SERVICE DECISIONS

What is the impact on the consumer, the employer, the provider, and the insurer?

If we look at consumers, we're going to see increasing and continuing limits. Anna had a whole list of things. I agree with those. We'll see limits on care, but we're also going to see limits on the number of beneficiaries covered because companies cannot afford it anymore. When the panel was talking before, everyone was asking if it's a big employer talking about the small employer. I'm talking about many companies who are facing financial crunch. They're going to begin to say that they have to make some very tough choices. Those choices are going to limit the number of services and/or the number of beneficiaries. I see it happening in larger companies. Probably the easiest thing that's being cut right away is mental health benefits.

Certainly, for the small employer we're seeing dramatic changes, so that the consumer in a small employment setting can almost not get insurance many times. They cannot afford the cost and they cannot even get access to it because of other practices. There will be increased numbers of uninsureds, increased frustration as there are limits on benefits, and increased unionization. We are seeing that in a few companies already, because employees are saying that they don't want their benefits taken away.

The employers -- we're going to continue to see a restructuring in the health benefits plans, increased use of maybe one health organization or one provider organization, so that they don't have to deal with multiple insurance companies, people doing triple options. There will be many people who will be responding to simply defining basic options, in terms of a basic benefit plan. Again, there will be a move away from some corporate socialism, as Don called it.

Providers will see increasing controls, frustration, and increased retirements among physicians. There will be increasing guidelines. There's a major initiative as part of the physician payment reform to develop guidelines and appropriateness guidelines. Those will go into effect and people will be expected to follow them.

The insurers will see increased regulation. Some of the things I would mention here are the things that frustrate many in the rest of the world: the black listing for small companies that say that you don't want to insure certain kinds of groups, i.e., the imposition of severe underwriting restrictions. I was just telling the panel that I had one family call me about their son. They had gone into the doctor. The doctor gave him a physical. The kid was fine, but the physician wrote on the chart, "has asthmatic tendencies." They switched employment. The next time when they went to get their health insurance, they were denied insurance coverage for that child because "asthmatic tendencies" was on the record. He had never had an asthma attack, and he was not ill. Underwriting restrictions like that are making people very angry. You may be saying, "Oh, that doesn't happen in our place." It's beginning to happen more and more.

We are seeing more pressure to do community rating and not experience rating, certainly with certain groups and small businesses, and guarantee a transfer of conversion when they move to another company.

How can you be an influence in the next generation? Basically you have a number of things to do. You are, I think, the experts. I don't know how many times I hear people say, "Ah, but the actuary said . . ." So people do listen to you. You have a great deal of responsibility. You have a responsibility also to use judgment in what you say. You can give the numbers, and we know that numbers can be structured to present many different scenarios, but people are going to need good, sound judgment on how as they move forward in a time of cost constraint. Do they provide benefits that are responsible, that do provide a real scope of coverage, but yet also aren't going to bankrupt a company or a government? We're going to be looking at both. We do need your assistance in helping to understand those, and to have you balance that equity versus the social policy question. I think what I see happening for actuaries is that you will have to be part of that debate on social policy. Do we provide services to our future populations? You have to help solve that.

You will also be the ones who are most aware of what's happening in the trends. I understand you had some discussions on AIDS and other kinds of things. You are the ones that have the information that can help alert many of us to what's happening out there, and you can point out some of the tendencies that we may not be focusing on. I think you can help guide us in those things.

I think you're going to be looking at a future that is maybe not always very positive. What's the health care future look like? We're primarily going to have people with chronic illnesses and diseases that are self-inflicted from smoking, being overweight, abusing alcohol, and so forth. We're going to have environmental diseases, whether it be from pollution, nuclear waste, or whatever. We will have technological illnesses. We mentioned earlier the neonatal intensive care units. On both sides of the technological scale, the elderly or the very young, we are going to make some very serious ethical and moral decisions. You will have to participate in that debate.

We will also have significant numbers of uninsureds, and there will be more and more middle class uninsured individuals. They vote, and they may begin to make some demands on the system for changes. There will also be the question of the right to life and the right to die. All of those are going to be very difficult questions, and I hope you participate in the debate.

MR. MOORE: That actually sets the stage very well for the last part of our discussion, which is really from the floor. And I hope that Don will add a few comments about his view of how the actuary can influence things in the corporate arena.

MR. HARRINGTON: I guess what we're talking about here is what you as individuals bring to anything you do. What we're really talking about is a view of the way you look at problems, and what's been most helpful to me in several of the areas in which I work is the contingency area. It's not short term; it's longer term. You know what valid statistics are, and you're trying to use that technique, at least I do. I feel very comfortable with it and use it all the time in trying to get insight into the process so that I can make some meaningful professional judgment. It isn't running a series of numbers all the time or mechanically reacting, but looking from that viewpoint as to how you express yourself, think through the problem, and then articulate where you want to be on the issue under consideration. I had a situation recently in dealing with fiduciary matters, accountability issues, and freedom of labor lawyers to act in a situation where I found we were coming into conflict. I literally diagrammed the problem using contingencies to position myself so that I could balance things off. I didn't need to run a series of numbers. I didn't have to have machines running all the time. But I could position myself as to what were the key points.

I found that technique helpful throughout everything I've done. I've been working in areas of depreciation and investment performance. I spent three years in investment performance in the early 1970s. In fact, I did a seminar at the SOA meeting. Compensation -- when we had business units fighting with each other trying to decide how to do profit sharing so that we could control the corporation, brought back to me very clearly which one was preferable, which one wasn't. Even relocation is an interesting program for those who haven't worked in relocation. I've maintained that you don't know what real greed is until you get involved in relocation problems. The issue is there. We've created incentives for dealing with reimbursement of people who claim that they've received a shortfall on variable housing rates as they've moved under the relocation programs. How do we deal with relocation inventories? I've spent time working with the medical department on the studies that they do on comparing HMOs and PPOs. So quantifying is throughout the business.

We have a credit operation that extends a leasing corporation. I know if I'm getting a sandbag from them when they come in to have their compensation plan redesigned. I know how their products work. Same techniques you've all used. There are multiple areas. There are areas on pricing. You know which business unit is pricing in one direction and who is pricing in another direction, and who is betting on the come and who isn't.

But the real issue you get down to is not the mechanics. When I have actuarial studies coming in to me, if they're working with anyone else, I often press them for their opinion that they gave someone else. I don't want people who are working with me just getting numbers out, without getting involved in articulating very carefully what the limitations are on those numbers and what they think the numbers say.

MR. MOORE: So your comments are very consistent with what Carol was saying about the need for judgment, as well as the facts of the situation. Is there anyone who has a question or comment about the actuary's role in this changing benefit scene? If not, I'm going to ask the panel members to continue a bit.

MS. RAPPAPORT: I think one of the biggest issues for actuaries, when we're doing our traditional jobs, is not just giving opinions, but also framing the questions and thinking about what the issues are. So often we're asked a question that looks like a relatively narrow question, and we don't stop to think. We probably do stop and think about what are the laws that impact it, what are the accounting implications. But we don't stop to think about what are the business issues and how does this tie into whoever it is that's sponsoring this program to their business. And I think a tremendous thing that we could do as a profession would be to learn to do more of that. I'm personally concerned because I work in an environment where I see a lot of actuaries doing a very good job, but I also see sometimes actuaries not doing as effective a job as they might because they tend to be narrow. And I see us competing with a lot of other people for "the best jobs." So I think as a profession we have a lot to be concerned about. If we just learn to make sure that we're framing the questions right and thinking about the right external issues all the time, I think that would help us in our futures a lot. It would also help us to not do things that people might be sorry about three years later. Maybe that's always a good question to ask. If we do this, are we likely to be sorry three years or five years from now?

MR. MOORE: What about the other panelists, Carol and Paul? In terms of the comments you've heard from the others, where do you see the actuary playing more of a role in this changing benefit scene?

MR. MCCROSSAN: Jim Schlesinger has talked about the breakdown of the cold war. We in North America who have been basically the center of the world, particularly the U.S., have been living in a very self-indulgent way. We've been able to get financing from the rest of the world, whether it be Germany or Japan, to finance our extravagant habits. That era has ended this year, and I don't think the people or the politicians have recognized the impact of that yet. But it's my suggestion that within two years at the outside, that will have been driven home in spades. That means as Anna suggested and as I suggested, that the deficit is going to have to be attacked with vigor, or else we're

going, both countries in North America, to move to second-class status very rapidly. Therefore, I anticipate that this will become the predominant agenda over the next couple of years. So, control of costs, whether they be government or whether they be corporate, is going to become an attack with a vengeance that we haven't experienced before in this North American society. Actuaries are both bean counters and those who look forward in terms of the implications. That's what actuaries are going to be challenged to do over the next two years; do the bean counting, but do it in a way that makes sense for the future and isn't just destructive.

MS. LOCKHART: I would just add again a comment that I think actuaries are going to have to be very clear about knowing who is your client and what is your duty to that client and whoever else might be involved. It might be management, it might be an insurance company, and depending on the setting you're in, it might very specifically be the consumer or the employee. I think you're going to have to be very careful that you almost take an advocacy role at times because as these dollar questions get worse, it will be easy to say, "Well, we can just do it this way" when there might be another way it could be done that would be a little less harmful to the consumer, might be a little more supportive. So I would advocate for your being advocates to the point that you can and understanding that you will probably have to play that role very often.