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**DEBATE: DEFINED-BENEFIT PLANS, WHY BOTHER?**

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Recorder: ADAM J. REESE

This session will debate the future, if any, of defined-benefit plans. Have they been "legislated" out of existence?

MR. ADAM J. REESE: Our first speaker will be Alistair Cammidge. Alistair is a Fellow of the Institute of Actuaries. He has spent 11 years with Legal & General Insurance Company in England before transferring to the L&G operation in South Africa. Since then, Alistair came to the states in 1987 and joined Capital Holding Company, where he's now responsible for pricing structured settlements, single premium immediate annuities, and pension buy-outs. Alistair is also the U.S. correspondent to *The Actuary*. That's the magazine of the British-qualified part of the actuarial profession and that's published monthly by the Staple Inn Actuarial Society. Alistair's articles are entitled "American Notes" and try to keep the U.K. up to date on what we're doing on this side of the pond.

Our second speaker will be Dick Raskin. Dick is an Associate of the Wyatt Company. He's combined his legal and actuarial qualifications to provide consulting advice on employee sponsored, qualified and nonqualified plans for the past 30 years. Dick is a Director and a member of the Executive Committee and Chairman of Title IV Committee of the Association of Private Pension and Welfare Plans. He's a member of the Steering Committee of the American Pension Conference.

As a background to the debate, I would like to offer the following statistics. In 1980, 80% of employees covered by pension plans in the United States had a defined-benefit plan as their primary pension plan. Now that figure has dropped to less than 70%. I'm going to quote from a PBGC source here. "The cost per employee of administering a defined-benefit plan for small employers' plans with less than 50 employees was \$150 in 1982. The cost per employee has now risen to \$425." A Wyatt Company survey of 750 corporations showed that the average replacement salary for employees retiring on \$15,000 a year was 19% from a defined-contribution plan and 28% from a defined-benefit plan. That type of differential remained constant through pay levels up to \$100,000 a year. With that as background, I would like to introduce Alistair.

MR. P. G. ALISTAIR CAMMIDGE: "Defined-Benefit Plans, Why Bother?" Ladies and gentlemen, while at university in England I became convinced that it would be easier to make a living as a third-rate mathematician than as a first-rate historian, so in 1965 I decided to train to become an actuary. That concluded my very first actuarial exercise, which was to calculate from public British population data that pensions could not but become a growth business. That it has proved to be both on that side of the pond and this. I joined Britain's leading pension insurer. There it was drummed into my thick skull that there have been three great inventions – fire, the wheel, and the defined-benefit pension plan. Of the three, the last is uniquely beneficial in that it has been put to no harmful use whatsoever.

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However, in this country it has been decided to put the defined-benefit pension plan to no use at all. The view of the U.S. authorities appears to be that pension plans in general, and defined-benefit pension plans in particular, are no more than vehicles for tax evasion. As an actuarial student looking at the world through the window of the original match box on its edge office block, it seemed to me that exponential growth in the pensions industry must continue until every retiring worker enjoyed a two-thirds final salary pension with annual reviews to compensate, in some part, for continuing inflation. How could I have guessed that almost a quarter of a century later I would be working as an undertaker to pension funds? In the U.S., that dream of universal pension coverage is far from achievement. Indeed, it is receding over the horizon.

In this country the pensions industry resembles nothing quite so much as the defeated ships of the proud armada Spain set to invade England. As every English schoolboy knows, the Spanish Armada was mauled by English sea dogs and forced to sail north from the Straits of Dover into the wild waters of the North Sea, to double Cape Roth at the northernmost end of Scotland and out into the storms of the Atlantic. One by one the great ships floundered off the coasts of Scotland and Ireland. Of the 130 ships under his command, the Spanish admiral brought eight home. So passes the glory of the world and so pass defined-benefit pension plans in the U.S.

The accents of your chairman and myself notwithstanding, we are not here to debate the future of defined-benefit pension plans in Britain. I was in Zimbabwe immediately after that country was born of Rhodesia and vividly recall the new government assuring the pensions community that it wanted to see defined-benefit pension plan coverage expanded to cover the entire work force. That is not the attitude of the American authorities. They want not to expand, but to restrict still further defined-benefit pension plan coverage. We are not here to consider defined-benefit pension plans in Zimbabwe nor their future in any other country, not even Canada. We are here to debate the future of defined-benefit pension plans in the U.S.

Defined-benefit pension plans have no future in the U.S. because the government has decided that they will have no future. I make no party political point here. As a foreigner, for me to enter into your political debate would be worse than wrong. It would be stupid. For us, as men of mathematics attending a meeting of this learned society, it would be inappropriate to enter into political debate. For truth to tell, the extinction of defined-benefit pension plans is not a party political matter. It is the policy of both political parties. It is the policy of both Congress and the administration. The judicial branch affords defined-benefit pension plans no protection from those seeking to hunt them down.

Statistics of pension plan participation show a peak of some 56% of wage and salary earners between 1979 and 1983 declining thereafter and passing below the 50 percentile in 1986 or 1987. Once great herds of bison roamed this country, providing man with so many of the necessities of life. Ruthless hunting has reduced these magnificent creatures to a pathetic remnant on reservations and in zoos. We are poorer for the loss of these magnificent creatures. Once, great herds of defined-benefit pension plans roamed the American heartland. They are being ruthlessly hunted to extinction and soon there will be but a pathetic remnant of what is one of the most beneficent of human inventions. One day, all American actuaries will know

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of defined-benefit pension plans will be what they read in foreign actuarial publications and reminiscences of the good old days by retired actuaries.

Like all foreign actuaries, before I came to live in your country I had read in the *Record* of this learned society of the threatened extermination of defined-benefit pension plans. I could not understand why something so contrary to logic could be. Another example of such perverse American practice is driving on the wrong side of the road. In England we drive on the right side of the road. You drive on the wrong side. Why? Well, I know why continental Europeans drive on the wrong side of the road. Napoleon decreed it, but the Royal Navy prevented the tyrant's armies from setting foot in England and so we continue to drive, as we always have done, on the left. But the Royal Navy preserved you, too. So why do you drive on the right? But let's go back to that other perverse American practice – slaughtering defined-benefit pension plans. The question is why.

It would be wrong of a foreigner to suggest that those within the Washington beltway have no concern for the old. The American Association For Retired Persons sees to that. As I've wandered around the globe, I have observed politicians in a number of countries. To me, they're like some fascinating but disgusting species of insect – cockroaches, say. One thing distinguishes the species around the world – short-sightedness. Politicians can never see beyond the next election and, in this country, that cannot be more than two years away. So their attitude is naturally defined-benefit pension plans, why bother.

I'm not singling out American politicians. It was a particularly loathsome British example of the species, Sir Harold Wilson, who once said a week is a long time in politics. Do not think me anti-American. As an Englishman, I recognize that, like most young people, the U.S. can blame its failings on its parent. As a professional expatriot, I might have gotten a job in Kuwait. I loathe politicians and cockroaches of all nationalities. On second thought, though, it would be unfair to characterize politicians as having their minds fixed on the next election. Normally they're riveted on some dirty little scandal – rape in a politician's palace, corruption in high places, sex in low places, and drugs everywhere.

In Britain we have a saying that "but an arbitrary line is drawn between those who go to the House of Lords and those who go to Pentonville Prison." It is difficult for actuaries, men and women of science, to demonstrate to politicians the mathematical truths about what the extinction of defined-benefit pension plans will do to those who will be old in 20 or 40 years' time. First, to understand our elegant formulations requires some small education in mathematics and a degree of patience. Neither quality is to be found but rarely among politicians. Second, breathing the mountain air of pure reason, we find the fumes and dirt of the politician's world repulsive. We feel that if we lie down with swine, we will get up covered with filth.

When politicians are not concentrating on the next election, they're thinking about money. One could argue that the two are but different sides of the same coin. Defined-benefit pension plans grew to be large, defenseless piles of money, like so many peaceful, plant-eating dinosaurs. They grew too big to hide and so fell prey to the savage tyrannosaurs which are now tearing them limb from limb. In short, the

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short-sightedness of politicians, combined with their greed for revenue, dooms the defined-benefit pension plan in this country.

An excellent example of the consequences of this attitude comes from a related sphere – from the collapse of Executive Life. No sooner had the state insurance supervisor taken the companies into conservatorship and then the feds intervened, but not to ensure that the reasonable expectations of policyholders were met. Quite the opposite. They sent in a bill for \$643 million of back taxes to be met before the widows and orphans get a penny. As the California insurance commissioner put it, for years we heard not a peep from the tax police. Now that we have conserved the company to salvage the life savings of the smaller investors, the IRS has moved with lightning speed to cannibalize the vulnerable carcass of this company.

It would only be cricket for me to admit in defense of politicians that they are but reflections of the world around them. The 1980s were the decade of greed and not only in the U.S. In China, "to get rich is glorious" was a politically correct slogan. The character, Gordon Gecko, in Oliver Stone's film *Wall Street* put it, "Greed, for lack of a better word, is good. Greed is right. Greed works. Greed clarifies, cuts through and captures the essence of the evolutionary spirit." Every morning on my commute to work I pass a sign that says "The fast track has a passing lane." The greatest man of the 1980s was the chap in the ill-fitting hairpiece who once earned "\$500 million in a single year." Whole countries were less productive. His remuneration was more than a thousand times the combined earnings of Defense Secretary Chaney, combined with General Powell and Sir Norman Schwartzkopf.

When I first came to this country, I inquired as to what your national pension policy might be, but answer came there none. If there's anybody in this room who could enlighten the darkness of my ignorance, I hope you will come to the microphone at the right time in these proceedings. In the 1980s, Congress enacted ten major changes to pension fund laws, adding 80 pages of laws to the statute book and spawning 560 new pages of IRS regulations. Consequently, defined-benefit pension fund administrative costs soared in the decade just passed. Your chairman has already given you details of cost increases brought out by the Pension Benefit Guarantee Corporation for the decade 1981-91. They represent a compound annual rate of escalation on pension fund administrative costs of 11%.

Congress has passed a death sentence on pension plans. To a foreign actuary, a defined-benefit pension plan seen in this country is reminiscent of nothing so much as the so-called East Germany a few years ago – the decline from past glories, the grimy gray decay, the attitude of why bother encapsulated in the title of this debate. We all know that the so-called East Germany has now been consigned to the garbage can of history. I fear that soon it will be too late for the defined-benefit pension plan also.

The strategy adopted by the U.S. authorities towards defined-benefit pension plans mimics that of the English fleet towards the Spanish Armada. Cut out and destroy the smaller and weaker ships. IRS field agents were instructed that any rate of interest below 8% or retirement age assumption below 65 was unacceptable when funding small defined-benefit plans. Such assumptions will dramatically lower funding ratios, thereby imperiling those plans whose small size necessitates them having the highest funding ratios.

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Whilst vigor in pressing home an attack on Spanish galleons would be praiseworthy in an English sea dog, for Spanish war ships to attack their own fleet would have been treason. I was taught that the role of the revenue is to act as a sheep dog guiding and guarding the flock of pension plans. What is to be done with a sheep dog that turns upon the members of its flock and kills them? Who guards the guardians? But blame lies not with the sheep dog, the IRS, but with the shepherd, the U.S. authorities who are ordering the sheep dog to slaughter the defined-benefit pension plan sheep. The IRS knows well how to guide and guard pension funds, but it must carry out the orders it is given. The good book tells us that the good shepherd cares for his sheep. Defined-benefit pension plans have a bad shepherd. We all know how the flow of incomprehensible legislation and regulations is breaking the back of defined-benefit pension plans. While sitting down one day with a cold towel wrapped around my head and trying to understand the nondiscrimination regulations, I was reminded of a story about Albert Einstein. "Is it true, Doctor," he was once asked, "that only two people understand your theory of general relativity?" "Who's the other one?" replied the great mathematician. The way to ensure future growth of defined-benefit pension plans is to avoid adding more complexity and instead emphasize simplification, said PBGC Director James Lockhart. Representative Rob Chandler testified, "If Congress and the Executive Branch write laws and rules that sponsors of pension plans cannot understand or costs them too much to implement, the time will come when they drop their plans." "It is not a concern for the future," he warned, "it is happening now."

One of the most cunning devices used by the authorities to undermine and destroy defined-benefit pension plans has been the effective excision of senior corporate executives from company pension plans. The authorities have gradually restricted the benefits a company can furnish its senior executives under a tax-qualified plan. Accordingly, companies have set up a variety of different vehicles to provide for their most senior men in retirement. Now, if somebody is to get a relatively modest proportion of their retirement benefits from a defined-benefit plan, their interests in that plan will likewise be relatively modest. But these senior executives are the people who are making decisions about the defined-benefit plans to cover the ordinary rank and file workers. So through lack of interest, they are leaving defined-benefit plans to wither on the vine.

Defined-benefit plans, why bother, is the attitude of corporate executives. However, we cannot blame others entirely for the slaughter of defined-benefit pension plans. We, all of us, have failed. We have failed because, as actuaries, we are scientists. As scientists, our work is not only to discover truth, but also to broadcast it. Mathematics not only possesses supreme truth and supreme beauty, it is the very word of God. In the words of the first verse of the first chapter of the gospel according to St. John, "In the beginning was the word and the word was with God and the word was God."

Our service to the word is performed not only in studies lined with tastefully bound copies of the *Transactions* of this learned body, nor only at the computer keyboard. The word having been given to us, we are to proclaim it. The parable of the Talents tells what judgment will be upon men of mathematics who hide away the truth revealed to them. We have not proclaimed the destitution of the elderly, which is the

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inevitable consequence of present policies of slaughtering defined-benefit pension plans. Instead, we have whispered it but once in private and passed on.

Characteristic of our profession's failure to broadcast the consequence of future retirees of present public pension policy is the grading of this debate as noncore for continuing education purposes. I believe that the exercise of pure reason shows that the fearful future facing defined-benefit pension plans belongs right at the top of the list of issues of vital importance to all actuaries. We must learn from others, particularly from marketers, how to get our word across. Actuaries tend to think of marketers in the same way as we think of politicians and cockroaches. We are disgusted by them. Marketers are such awful bonders that I'm intrigued how they can do so well for themselves. I took an instant dislike to them and their high pressure sales methods, but that is probably a point in their favor. If the marketers quit, the insurance business has had it. There will be nobody remaining but a bunch of jolly decent chaps. At least in America, marketers do not stab actuaries in the back. They come at you head on with a hatchet.

We must learn from marketers how to get our word across. How do cancer stick manufacturers sell death? With giant billboards on top of pylons, by showing dishy dollies fondling them, by corrupting politicians. Somehow we feel that if we begin shouting from the rooftop that the government wants to take away your pension, we cannot but continue down a primrose path that leads to handing money to politicians. With the finest of motives, we, ourselves, have ensured that defined-benefit pension plans have no future in this country.

Hard as it is for an Englishman to admit it, the loss of the Spanish Armada was due not entirely to storm or sea, or even to superior English seamanship. In great measure it was due to Spanish folly. The admiral was a landlubber with no experience of war afloat. Even more disastrous was the use of ships unsuited to the stormy seas of Ireland and Scotland. Likewise, the U.S. fleet of pension funds has had captains of spectacular unsuitability and vessels unsuited to sailing even a millpond.

In May 1990, the PBGC released a list of 50 companies with the largest underfunded pension plans. The total deficiency was \$13.6 billion. The largest had a deficiency of \$2.6 billion. One pension plan was listed as having \$247 million of liabilities and only \$77 million of assets, a funding ratio of 31%. To the \$13.6 billion deficiency must be added the PBGC's own \$1 billion deficiency, together with three Long Temco Vought plans then before the Supreme Court and underfunded by approximately \$2 billion. We can understand some observers concluding from these sorry statistics that defined-benefit pension plans should have no future in the U.S.

The authorities know that they cannot advertise their policy of terminating defined-benefit pension plans. Too many voters' retirement incomes will be destroyed. The voters would terminate them. So they proceed by stealth, employing salami tactics. First, cut down the small and the weak; then turn to kill the larger and stronger. Politicians in Washington treat defined-benefit pension plans as they treat women's bodies. The ability of politicians to create is small. Their power to destroy what others have created is great, too great, and ought to be diminished.

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Until we get the rascals out of Washington, there is no future for defined-benefit pension plans in the United States of America. Why bother? Quod Erat Demonstrandum.

MR. REESE: Countering the debate with an initial response from the panel will be Dick Raskin.

MR. RICHARD S. RASKIN: I guess the first point that I want to make has nothing to do with the debate. At least I learned in American history that it wasn't the English fleet that protected us from Napoleon. We were aligned with the French at that time and it was the English fleet that was impressing our seamen and that's why we had that little War of 1812. The other point, the main point, I guess, Alistair has made very eloquently – the point that the government intends to kill defined-benefit plans. I really don't think that's what the government intends to do. I think the government is a very simple entity. It acts to what it perceives as its immediate pressures and it perceives that its immediate pressure is the need to preserve the tax base in order to control the deficit. In doing that, it's coming after a lot of employee benefit plans. Defined-benefit plans are among them and so are defined-contribution plans. There have been loads of issues about reducing the \$30,000 defined contribution limit. A number of people who have sponsored tax reform have also proposed to take the \$30,000 limit down to \$15,000 or something like that. I think what we need to do as individuals who want to make a point and preserve our point that defined-benefit plans have a place and, in fact, all retirement plans have a place, is to illustrate what these plans do for the economy and do for society. When we can do that, when we can show the Congress that it is important to maintain plans, Congress will respond. I think the tide may be turning. It appears to me that a number of the staff in the Senate, in particular, are starting to see that there is a value to retirement plans in general and defined-benefit plans in particular and are starting to make the point that defined-benefit plans are very much tied to the national savings rate.

I want to do a little commercial, not for The Wyatt Company, but for the Association of Private Pension and Welfare Plans, which is an organization which is committed to lobby to preserve these plans. They've commissioned a paper to show that the savings rate is very key to the Society; in fact, shows that all of the savings in the U.S. economy in the last 10 years has come from the private pension system. I think that paper and the follow-up of that paper is going to be very impressive in Congress. I've heard a number of Senate staff, and maybe I just happen to run into Senate staffers, make the point that this paper is going to change their attitude. I think there is another collection of attitudes that we need to change and need to work on and that's what I want to demonstrate – why the defined-benefit plan has a key role in the future of the retirement system in the U.S. To do that, I'd like to talk about what is retirement. I believe retirement needs to be looked at from at least three points of view – the individual's point of view, the employer's point of view, and the government's point of view.

*From an individual's point of view, retirement is an entitlement. It's another one of those things that he's entitled to as a right of being an American citizen and that entitlement is to enjoy a certain lifestyle after working for a period of years or attaining a specified age or a combination of those.*

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From the employer's point of view, it's a process by which the older or longer-tenured workers who now may be redundant or lacking the skills to work in the new technological environment of the employer – and technology seems to be changing more and more rapidly – or is unmotivated or is unable by reasons of physical or mental deterioration to perform the job as well as younger workers are removed from the work force.

What the government needs to do is reconcile these two views – to have both the industry produce and the individuals be satisfied. The individuals do need to be satisfied because they are the ones who vote. If you think that individuals, when they perceive something as being wrong, can't raise a big problem and make government react, think about the tax withholding on investment savings and how fast that was revoked when the banks convinced the taxpayers that it was an additional tax. It wasn't an additional tax. It was a withholding. But once the Congress saw there was an election problem with this, they reacted.

I'd also like to point out that the retirement process has changed from what it was 20 years or more ago. It's no longer people who retire stop working today and that's it. It's not a sudden cut-off. Many people take another view of it and they don't work in the same way that they worked before. They gradually work out of the work force. They take a job that's less demanding either in hours or in responsibility and don't retire cold turkey. I just saw a former employee of ours who's now working for the Society, so he's retired from us but from his point of view he's not retired.

The retirement process has a lot of different people pushing at it. The government pushes at the retirement process by saying that the normal retirement age is 65 in ERISA, so that's one view of the government determining when retirement should occur. The government, on the other hand, says that under Social Security the maximum age is going to go up to 67, so it still has another view. Then under the Age Discrimination in Employment Act of 1967 (ADEA) it says you can't force people to retire at any mandatory age, so it has another view. I agree with Alistair that the government doesn't have a constant view as to what retirement is or when it occurs.

Employers want retirement to occur, at least larger employers want it to occur, at their convenience. When they perceive that there are too many workers in the work force, they like people to leave and they do things to encourage it. Early retirement windows are one thing that we all know that employers do to encourage people to retire. They may say that if you retire tomorrow, we're not going to change our retiree medical program for you until you're age 65 and we'll guarantee that you'll be under the same program. That's another way of encouraging people to retire, particularly workers who might think that the employer is going to change the program for them as active employees in the future.

Individuals also want to be able to determine when they want to retire, so we have three different groups that are trying to control retirement and the point is that none of them can control or predict retirement. There's a five-legged stool that provides the resources for retirement – Social Security, individual savings, transitional or part-time work, in kind benefits, and by that I mean retiree medical benefits or retiree life insurance, perhaps an employer discount that continues into retirement for the



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services of goods that that employer provides, and then employer-sponsored retirement plans.

We need to judge each of these programs or legs of the stool by five criteria -- whether they provide adequate retirement income, whether they're efficient, that is they provide more retirement income with using less resources, whether they are flexible, and their flexibility has a different perspective from the employer's point of view and the employee's point of view. The employer wants to be able to control when employees retire, so flexibility from its point of view is employer control. From the individual's point of view, it's can I retire when I want to? Does it provide protection from inflation? When an employee is going to retire, the one thing that he knows is he can go out and be able to work again to protect himself from inflation. I think we see more people retiring when cost of living increases from year to year are lower rather than when they're higher because employees are concerned about inflation. Most important, perhaps, is it reliable? Is it going to be there when the employee needs it?

I want to talk about the legs of the stool that are unrelated to the employer before we get into the heart of the matter. Social Security does not provide an adequate benefit for most employees and it is very efficient. There is very little money in the Social Security system that is not used for retirement benefits. In that way it's a very efficient mechanism. It may not do a lot of other things that are by-products of the private retirement system. I am not at all taking the argument that we ought to replace defined-benefit and defined-contribution plans with Social Security.

I think that would be wrong, but for what it does, it is efficient. It is not very flexible because the benefits are pretty rigid and they give in at a particular point in time and cannot be controlled either by the employer or the individual. It does provide inflation protection because it's indexed. Despite complaints about Social Security, I think the power to tax is absolute and it is reliable.

Individual savings is not an efficient way for our society to go because we can't force individuals to save, so we can't rely totally on individual savings. There is a problem with individual savings that we need to focus on and that is if the individual savings provide adequate income through some mechanism at the time of retirement, what is viewed as adequate at that point, it can provide inflation protection. If it goes to provide inflation protection, it does so at an investment risk and that investment risk takes away from the reliability. So these items are caught up on individual savings. They will also be caught up on defined-contribution plans.

Transitional or part-time employment is something that no one ought to rely on. In order to do that, you need to have some starting point. One of these five variables has to be made constant between the two. Let's assume that we're talking about two plans -- a defined-contribution plan and a defined-benefit plan that would provide the same amount of income to the individual at age 65. In that case, if 65 is the retirement age that we're concerned with, they're both adequate.

In most defined-contribution plans there are ways that employees can get at the savings that are put aside for them, so even from the employee's point of view it's inefficient. From the employer's point of view it's also inflexible, the

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defined-contribution plan. While you can retire early and use the account balance, if you want to convert that into an annuity you're going to get generally less of an annuity than you're going to get from the defined-benefit plan which has subsidized early retirement. In that sense it's less flexible than a defined-benefit plan.

Again, I have assumed that both of these provide adequate income at age 65, so there's no inflation protection in the defined-contribution plan unless the retiree or the close to retiree is willing to take his money and take risk and generally that's not something that retirees tend to do. On the other hand, most defined-benefit plans are invested differently and many defined-benefit plans during inflationary cycles have adjusted the benefit upward. So while it's not a guaranteed inflation protection, it is somewhat, which is better than it's not there. A defined-contribution plan is less reliable than a defined-benefit plan because of the PBGC. The nonqualified benefit, the noninsured benefit is not guaranteed; but, as we found out, even so-called guaranteed investments in a defined-contribution plan can be less than guaranteed.

Let's look at it from the employer point of view. From the employer point of view, the two plans, again, would be equally adequate because they would be providing the same benefit at age 65. From the employer point of view, the defined-benefit plan is considerably more efficient because it provides less income at times that the employer doesn't want to be providing income to employees when they leave after five years of service at age 35 or 30 than a defined-contribution plan. From an employer's point of view, there is much more efficiency in a defined-benefit plan than there is in a defined-contribution plan. From an employer's point of view, there's also more flexibility in a defined-benefit plan than a defined-contribution plan.

Probably most of you who work with defined-benefit plans have worked with at least one plan that recently has had some sort of window encouraging employees to retire early. Certainly that's a very common phenomenon and likely to be, despite the IRS's efforts to curtail them, more common in the future. On the other hand, the employer can go the other way. If he has a nonfinal pay plan by withholding an update, he can encourage employees to stay longer. One of the real issues that different people will take different sides on is whether the retirement age is going to increase in the future or it's going to get earlier in the future. I think that's likely to be different by employer rather than by anything else. I don't think we'll see a total trend one way or the other.

A defined-benefit plan, particularly a nonfinal pay defined-benefit plan, gives employers a lot more flexibility than any other program over the retirement age and controlling that retirement age factor. That's an important point for employers because from the employer's point of view, one of the reasons or maybe the principal reason of having a retirement plan is to manage and control, rejuvenate and replace, and keep the work force. It doesn't want to lose the work force when it needs it. Maybe when it's in a high product cycle or high market cycle it wants to keep its employees, so it will withhold a so-called scheduled annual update in order to meet its business objectives.

What is the government policy really towards these plans? I agree fully that the government is very concerned with defined-benefit plans for individuals that it perceives as tax shelters. Whether we like it or not, a large number of actuaries have worked with a large number of employers in trying to make defined-benefit plans into

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tax shelters for individuals. I think what has happened is that we've more than killed the ability to do that beyond the point at which the government is going to be willing to allow that to happen. I think the government is starting to understand – at least particularly in the Senate and in the conservative wing of the Democratic party and the liberal wing of the Republican party, so I think it's in the center of the philosophic debate – that the rules have gotten too complicated and too complex and simplification is the major word on Capitol Hill – simplification to preserve the system, to encourage more people in the system.

I think one of the things that government recognizes as a wrong is the decline of the number of people in the entire retirement system and the decline of the relative percentage in the defined-benefit system. I think there is, in the thinking part of the government and in the Senate and hopefully we'll get it into the House, a concern about this. Remember, the government operates because of concerns. The government does not operate on anything else. It operates in response to what it sees as problems. One of the speakers at one of the sessions I attended talked about lawyers addressing problems. Most of the people in the government are lawyers. They look at what they see as problems and the government thinks that it's their job to correct the problems. Sometimes they make greater problems in correcting the problems. We all know that, but they're not there to cause harm. They're there to, in their own mind, correct what the problem is.

Our job is to help them see where the problems are in the defined-benefit system. There are two things that we have to help them see. One, that society has a need for defined-benefit plans. The need is in both providing retirement income to enable employees and employers to achieve their objectives. The other need is to provide capital, to provide the capital base for the U.S. to be able to compete in the world. I got up early and turned on CNN and listened to Speaker Foley get up and address a committee of the House. The first thing that CNN pointed out is this is pretty rare for the Speaker of the House to address the House. What he was talking about was competitiveness. He was saying that what we really need to do is to become competitive as a society.

I think that we can make a very good case for the fact that the savings rate is low, that pension contributions and contributing to pension contributions help strengthen the savings rate. It's part of the savings rate and that we need simplification in order to stop the decline of savings in the U.S. and that simply reducing the deficit by taxing the pension system, in effect, will be negative because it will decrease the total savings rate by an amount that's greater rather than less; because part of the money that is not collected, as in additional taxes, will be converted not to additional savings, but to consumption. As we make that point, we need to encourage savings plans, savings through the retirement system.

We also need to make the point that the defined-benefit plans are more effective and more efficient in achieving our goals. I think many of our clients, many of the larger employers are going to do that because the assets that are accumulated in the defined-benefit plan accumulate to their benefit. I think the biggest issue that happened in Congress as to whether the defined-benefit plans continue was the one as to whose money is the excess assets. There was a very strong debate led by the nonconservative wing, or the liberal wing of the Democratic party, that those monies

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belong to employees. If that happens, I can see the defined-benefit plans going down the tubes. But that argument seems to have been settled with the majority of the Democratic party and the majority of the Republican party both agreeing that the money belongs to employees.

Every administration that I can recall during the time that I've been doing lobbying -- and it's not the full 30 years, but it's been a long part of it -- has rejected the claim that the excess assets belong to the employees. I think the future direction is pretty good. I don't think it's so good that we all ought to go home and say we don't have a role. We do have a role. We have to explain that the retirement system is helpful to the American society and that we have to explain that defined-benefit plans generally are more efficient and effective than defined-contribution plans.

MR. WILLIAM C. HUFF: It seems to me that there are about three different things that are currently on the minds of legislators -- taxes, as normal, or bringing in revenue, trying to simplify the rules, and trying to move more of the benefits to the rank-and-file employees. It seems to me that an attractive course for legislators would be to mandate some sort of minimum benefit level for the rank-and-file employees and take away the tax deduction. I'd be interested in any comments that the panel has.

MR. RASKIN: The first part of it, a minimum benefit, has been proposed and that's been proposed a while ago and I think it was called the MBS. The viewpoint, I think, that prevailed at the time was that it would not really do as much for us as we wanted it to do. For example, the lowest-paid people in the U.S. get a very good income from Social Security and with that there ought to be, then, a reduction in the Social Security benefit. I don't think a minimum benefit is viable because you're going to object to that and your generation is going to object to that and I wouldn't blame you.

On the other hand, if you're not as sophisticated as you are and you're not an actuary, you don't see that in the way a defined-benefit plan is delivered. So a defined-benefit plan does deliver something that is going to help the employer achieve its goals and I think the concern with assets and asset accumulation for at least the affluent baby boomer is equally taken care of in direct compensation; so that you may either see an additional supplemental savings plan, as is probably the case most often in the U.S., or employees who want to save will say I want more salary. I think a lot of employees would rather have the 3% that goes into a defined-contribution plan put into their pocket and I think we'll see that pushed more, as we have to have less for consumption and people resist that.

MR. CAMMIDGE: I think it was Karl Marx who said that your political attitudes are driven by your economic situation. As an actuary, I would change that somewhat and say that your political attitudes are driven by your demographic situation. I would agree with you that as the baby boomers move through the population snake, so we will see a total sea change in savings and retirement provision. If I were to have the task of undermining the case which I, myself, made, that there is no future for defined-benefit pension plans in this country, I would make the case that the aging of the baby boomers will force a change in attitudes upon the politicians.

## DEBATE: DEFINED-BENEFIT PLANS, WHY BOTHER?

MR. COLIN E. SOUTHCOTE-WANT: Alistair, I was just about to support you and you seem to be giving up a little bit there. I have three points in support of the why bother angle. The first is that defined-benefit plans discourage mobility of the work force and I don't think the government wants that. I'd like your response on that when I'm finished here. My second item is that defined-benefit plans put the employer in the role of an insurer and I don't think employers want that. My third item is that the job of the IRS is to collect revenue. I disagree with Alistair to some extent. I don't believe that the IRS are sheep dogs savaging the sheep, but rather they're wolves who can't help themselves. I'm sure it's been said before, but I don't understand why the IRS is the body that's monitoring pension plans. It seems to me that there ought to be a different body doing that.

MR. RASKIN: I guess you made three points. The first had to do with mobility and defined-benefit plans don't provide for mobility. I guess if all employers generally had the same defined-benefit plan, by the time most of the benefit that's delivered in a defined-benefit plan is delivered from 45 up and by that time I think there is a great deal more stability than you probably believe there is. I think a lot of people are really stable during the period during which defined-benefit plans really accrue their benefits. I just don't really see that as necessary.

I think one of the things the government is very concerned about on defined-contribution plans is that, while it's portable, they haven't locked it up in such a way as to totally discourage people from taking it and spending it. They've probably gone as far as it's politically feasible for them to do -- to impose an excise tax and make it the last thing that you want to spend. I've got to tell you. It's something that's going to bother the government because the government is interested in encouraging savings and that's the real reason for having these plans in the first place. It's to provide retirement benefits and savings. It's not to provide, five years later, the purchase of a boat or something like that, or other consumer goods.

FROM THE FLOOR: Defined-benefit as an insurer.

MR. RASKIN: The second -- that the defined-benefit plan is an insurer. I think a lot of employers are very happy that they have taken the investment risk, not necessarily the mortality risk, and I don't think they view mortality as a risk. I think many employers are very happy that they've taken the investment risk and have been able to have a contribution holiday as a result of just the general economy, let alone that each one perceives that they had better investment experience than the other.

I think the build-up of assets and the build-up of the asset in the defined-benefit plan is something that the employers that have done that want to keep happening. I see a lot of pressure from large employers complaining about their inability to put away money now and they see this as a way to save for hard times for them that they can't predict. I see defined-benefit plans having exactly the opposite role that you do on that one.

FROM THE FLOOR: The third question was that IRS shouldn't be the watchdog. It should be maybe the Department of Labor.

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MR. RASKIN: I really don't have a view on that. It's the IRS that we need to deal with.

MR. REESE: Alistair, do you have any comments on that one?

MR. CAMMIDGE: Yes. The question of mobility is a stick often used to beat defined-benefit pension plans. I think it is well within the wits of us as actuaries to remove 80% of the obstacles to mobility within the defined-benefit plan context. As regards employers not wanting to shoulder risk, as I mentioned to you, I was trained by and spent my early career with an insurance company which accepted from employers whatever portions of pension plan risk the employers wanted to give it – whether they be mortality risks, investment risks, disability risks, early retirement risks, and so on. Abstracting the present difficulties of the legislative situation in this country, insurance companies certainly stand ready to take, from employers' backs, whatever pension risks employers wish to give to them.

Finally, your point about the IRS not being sheep dogs but wolves was an exceptionally good one. It's an example of what we might call management structure drives policy; because the object of the IRS is to raise revenue. Everything they do is approached from the revenue raising aspect. If your business is making nails, every solution you come up with is going to look either like a hammer or a nail. I would entirely agree with you that we need a different structure of pension plan supervision in this country, bringing all the regulatory agencies together not only under one roof, as is done in some other countries, but even merging them together.

MR. REESE: Before we leave this set of questions, let me challenge you guys with my views of mobility. Let's take two 25-year-old employees – Mr. Slow Coach and Ms. Fast Track. They stay with the same employer for 10 years and receive the same pay increase. At the end of the first 10 years, Ms. Fast Track leaves for another employer, takes a 15% higher salary, because to tell the truth they wouldn't move unless they're going to take a higher salary. They're also recognized by Employer B to be a fast tracker. They are, therefore, going to be earning not 6% annual pay increases, but 7.5%. Ten years later, Ms. Fast Track moves again for a 15% pay increase, takes another employer and takes another 7.5% pay increase per year compared with Employer C's Slow Track of 6%.

By the end of the 40 years, Ms. Fast Track collects the same pension benefit in dollar terms as Mr. Slow Track. I'm not convinced that mobility is impeded. If there is a piece which is missing because of lack of inflation protection, Ms. Fast Track can take care of that out of her higher salary. I challenge you to look at that mobility issue again.

MR. RIAN M. YAFFE: I think one thing we would all agree is that the government ought to have a retirement income policy that encourages retirement plans of whatever type of design. But I think that one of the factors that's influencing design more than anything else is employee attitudes. If we look at the demographics of this country and realize how competitive employers are finding the situation to get and keep good employees, the kind of plans we have are going to be determined by what employees want. The fact is that employees are not stupid.

## DEBATE: DEFINED-BENEFIT PLANS, WHY BOTHER?

When you look at the country and how quickly things are changing and how unpredictable things are, you tell me what employee – 35, 40, or 45 years old – is willing to depend upon what an employer promises is going to be paid 20 years from now. I don't think there are very many who are willing to rely on those promises. When you look at the 1980s with all of the bankruptcies, spin-offs, leveraged buy-outs, and so forth, I don't think any reasonable person can depend or would want to depend on what any business promises them. Therefore, I think there's been a change in the relationship between employers and employees from what existed 10 or 20 years ago.

It used to be you could work for a company and the CEO could guarantee you your job for as long as you wanted to work there. Today, the CEO can't guarantee his or her job, let alone yours. I think this realization on the part of workers is going to drive the particular design of retirement plans. I agree with the point about cash balance plans, because the idea of being able to see what you have, the bird in the hand, is very attractive to employees. So I don't think it really is going to matter too much whether the government makes defined-benefit or defined contribution more attractive. I think it's going to be driven by other factors.

MR. CAMMIDGE: If I can comment on that, I would entirely agree with the thesis that the value of future promises or promises made about the future is at the heart of the pension fund system. Therefore, in this country, as elsewhere, there are certain rules which protect at least accrued benefits in pension funds. It may be very difficult, of course, to protect benefits that have yet to accrue and benefits that are not grounded on a sum of money already in the fund that can be used for the benefit of those for whom the fund is to provide.

I see this every day in my work, because I spend quite a lot of time selling life annuities or deferred life annuities to senior corporate executives, members of unapproved pension funds, which do not have the legislative safeguards that ERISA and other legislation provide for approved funds. Many unapproved funds have no assets whatsoever and the members of these funds, senior executives, are therefore totally at the mercy of the present senior management of the company or of a totally different future senior management, as the question rightly pointed out, and I see these unapproved pension funds and their members coming to my company and to quite a number of other leading insurance companies and opting to buy life annuities and deferment, which then go into the members' pockets and are totally safe from any change in future employee attitudes.

Now, that's a serious decision to make because on those life annuities you have to take a big tax hit up front; i.e., the cost of the annuity is regarded as pay when the annuity is bought and the employee must pay tax on it. Even so, executives are coming forward in large numbers to buy these annuities, demonstrating quite clearly the speaker's point – that he has no faith in the promises of corporations that are not backed up by approved pension funds.

MR. RASKIN: Can I comment on that? We have a large number of clients that have considered buying annuities for their executives. The driving factor is not generally the financial viability, or the survivability, or the guarantee of that benefit; but it's the fact that many executives think that the tax rate now is lower than it's going to

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ultimately be and that buying annuities now, getting income now may be a good thing rather than a bad thing. I'm not quite sure that the point you make is borne out by the evidence that you present.

I think with respect to providing guarantees, it's very difficult to say that employees don't trust their employers with respect to promises made. I still think that, by and large, most employees do trust the fact that the money that's set aside in a defined-contribution plan is going to be held for their account and it's not going to be misused or the defined-benefit plan that's been promised and accrued is going to be paid. I think to say anything less than that would be more cynical than we need to be.

I agree that in either situation no one assumes that the same benefit plan is going to be in place for prospective accruals in the indefinite future, because everybody realizes that their companies are undergoing change in many, many ways and the entire compensation scheme is likely to get changed.

MR. PHILLIP RON SCHECHTER: Traditionally, the nonactuarial view of a defined-benefit plan has been a plan that would give a worker a certain benefit, a certain security at the age of 65 and the company would know how long it could hold the assets back on this and make long-term investments of a type that really nobody else could. Mr. Raskin, you talked about the flexibility that a defined-benefit plan offered the company in terms of an early retirement window or in terms of retaining employees. I'm just wondering if this alternate use of a benefit plan (a) undermines the public opinion of the status of this plan and whether it should be tax subsidized, and (b) whether the fact that the company doesn't know exactly when it will pay out the benefits will reduce the term of the investments back in the plan and decrease the plan in this way. I'm wondering if the flexibility is actually worth the costs to the plan.

MR. RASKIN: I think the major reason for the flexibility is to be able to control the size of the work force. I think viewing the corporation in the larger environment is more important than the investment return under the pension plan, particularly over the short term. I agree with you that some investment return is lost if you need to keep your options open, but most pension plans, not all, pay streams of income. If you're paying a stream of income by starting it earlier, it doesn't mean that you're going to generate tremendous cash flow needs.

MR. SYLVESTER J. SCHIEBER\*: Two observations – one on the mobility issue. It always mystifies me that people are so concerned about these plans inhibiting mobility. When I go back and read the history of pension plans, that's one of the reasons they developed with the structure that they did, including vesting and so forth. It seems to me that when a company brings in a new employee and makes an investment in training that person and so forth, they have a vested interest in restricting or discouraging their mobility, even the fast tracker. It works just as well for the fast tracker as for the slow tracker if you, in fact, provide them wage increases.

\* Mr. Schieber, not a member of the sponsoring organizations, is Vice President and Director of the Research Information Center at The Wyatt Company in Washington, District of Columbia.



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It seems to me that the catch we get ourselves into when we worry about that is that we confuse micro policy with macro policy. Just because the federal government wants to encourage some labor mobility does not mean that every firm in the country has to adopt policies that exactly mirror the macro policy goals. IBM or General Motors or take your pick of companies, after they've made an investment in an employee, they have probably a fiduciary responsibility to try and minimize mobility. I think we're whipping ourselves needlessly on the mobility issue.

The second thing, and this is coming from a nonactuary. If the members of the SOA wish to begin getting more involved in the policy process and displacing the lawyers in Washington who predominate the policy process right now, it seems to me that individually you'd need to begin to do your homework in terms of understanding how that policy process works, understanding the macro issues in relationship to the micro issues that you deal with your clients, and come participate in the process as responsible citizens. Somehow we've got to get the lawyers out of there or we're never going to correct this.

