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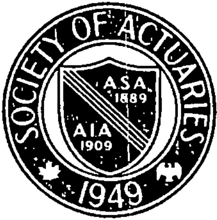

The Actuary

The Newsletter of the Society of Actuaries

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GUARANTY FUND FOR PRIVATE PENSIONS

by Murray L. Becker

(Editor's Note: *Since the following article was written a Bill for the "Pension Benefit Security Act of* 1968" *has been introduced in the Senate* (S.3421) *and the House* (H.R. 17133). *This Bill proposes, among other items, the creation of a government corporation to insure the vested liability of pension plans*).

Dan M. McGill presented his recent paper on the subject of a guaranty fund for private pensions to the Senior Branch of the Actuaries Club of New York on March 26. Dr. McGill is Chairman and Research Director of the Pension Research Council, Wharton School.

The idea of some form of "reinsurance", in the event of pension plan termination, has been getting increasing attention in the last several years. Dr. McGill indicated the possibility of a guaranty fund for pension plans is very real and that legislation to establish such a program could be introduced next year. He feels that a guaranty scheme is feasible from a technical standpoint, if certain conditions are satisfied and adequate safeguards are built into the system.

Some of the conditions and safeguards would involve regulatory controls that many employers, unions, and others have generally opposed as being potentially detrimental to the continued sound growth of private pensions. Furthermore, the conditions and safeguards would so narrow the scope of the arrangement that the social objectives underlying the proposal might be largely defeated.

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THE COLLEGE OF INSURANCE

by Walter Klem

Another source of candidates to fill the ranks of the life and casualty actuaries of tomorrow is envisioned in recent developments at The College of Insurance in New York. In September, 1967, a first class of 16 carefully selected high school graduates started on a work-study program that will bring them a B.S. degree in five years. A somewhat larger number of applicants has already been accepted and enrolled for the second class starting in September, 1968.

The curriculum of the B.S. course is specifically designed to turn out broad-gauged graduates whose education has been orientated toward the pursuit of an actuarial career. More than half the subject matter to be studied qualifies under a liberal arts heading. The remainder includes courses in business law, economics, electronic computing, and accounting, in addition to the fundamentals of insurance. An introduction to life contingencies is included in the last two of the eight instruction terms. Alternating with each instruction term of four months is a like work period with the student's employer and cooperating sponsor—insurance company, general insurance broker, consulting actuarial firm, insurance agency, or service organization. Theory and practice are thus combined in a total program which experience has demonstrated is ideally suited to fulfill the broad aim of the College of developing each student as a responsible citizen.

The College of Insurance was chartered in February, 1962. It is an outgrowth of the educational activities conducted by the Insurance Society of

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SURPLUS SURPLUS — A REJOINDER

by John C. Wooddy

In the March issue of *The Actuary*, Irving Rosenthal commented on a portion of the Report of the Special Committee on Insurance Holding Companies in a note entitled "Surplus Surplus — Computers To The Rescue?"

In the main I agree more than I disagree with Mr. Rosenthal. My reaction to the proposals of the Special Committee, however, is somewhat less vehement than his.

In the first place, when the term "Surplus Surplus" first appears in the Report on Page 26, it seems fairly clear the Committee is limiting its applicability to property-liability insurance companies. It must be admitted, however, this interpretation is somewhat blurred by the discussion on Page 43. There the Committee indicates that the portion of the assets of existing insurers which might be permitted to be transferred to a holding company for use in other enterprises, be limited to "Surplus Surplus." However, the Report goes on to state on Page 45 that the application of this concept to life companies is not recommended at this time.

Companies Differ

For a non-life company, one year's incurred claims are much larger relative to assets, surplus, and premiums than for a life company. Consequently, the short-run prospect of insolvency from excess claims is far more significant than for a life company. Furthermore, it is fairly obvious that some companies are stronger and less likely to become insolvent from excess claims than others. The Committee suggests some attempt

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Guaranty Fund

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In his discussion Dr. McGill did not take a position for or against the establishment of a guaranty scheme. Rather, he confined himself to recommending the technical characteristics that should be associated with any such scheme brought into existence.

The first issue is whether the reinsurance plan should be administered by the government or by a private organization. Dr. McGill recommended a government agency, in view of the compulsory nature of the program. This would also facilitate making the government a residual risk-bearer, as it probably must be. This recommendation contemplates that private insurers would underwrite the guaranteed benefits of terminated plans, thereby minimizing the accumulation of assets in the administering agency.

The risk that the guaranty fund would insure might be (1) partial termination of the pension plan, (2) complete termination of the plan, or (3) complete termination of the business as well as the plan. In no uncertain terms, Dr. McGill indicated that complete termination of the business and plan is the only feasible risk for reinsurance.

Partial Termination

Many of the problems cited by critics of the proposal result from the concept of partial termination. While exclusion of partial terminations lessens the social utility of the system, as long as a reasonable level of vesting is required the employees in greatest need of benefit guaranty will enjoy the protection of the system.

If a firm is sold to, or merged with, another company, the surviving organization would be required to assume the accrued pension obligation. Where a plan terminates and the employer continues in business, the firm would be expected to continue contributions for the benefits that would become the obligation of the guaranty fund should the employer subsequently go out of business.

What is the obligation to be insured? A pension guaranty fund is feasible only if superimposed on minimum standards of funding. In such case, Dr. McGill's recommendation is that the obligation of the guaranty fund be to fulfill the *benefit* commitment. The alternative, apparently favored in government circles, is to fulfill the *funding* commitment, i.e., to limit the liability of the guaranty fund to the completion of the employer's funding program for covered benefits, without regard to the sufficiency of the projected contributions.

By insuring the benefit commitment, the system is able to underwrite the entire asset deficiency, regardless of the cause. This includes any deficit arising out of actuarial losses as well as those resulting from capital losses.

Dr. McGill recommends that all qualified plans be required to participate after their fifth year of operation. The purpose of the five years is to prevent firms on the verge of going out of business from establishing a plan that would have to be paid for by the guaranty fund. The five years would also apply to benefit increases. Multi-employer plans should be required to participate, with whatever modifications necessary. However, there is a strong possibility that the Government will exempt multi-employer plans, many of which are opposed to the guaranty fund because the whole concept implies the establishment of minimum funding standards.

What benefit should be insured? Dr. McGill recommends vested pension benefits. This assumes that the law would require minimum vesting standards. Dr. McGill also recommends no insurance of pension benefits in excess of a stated maximum. Ancillary benefits should be guaranteed only if they are in payment status at the time of pension plan termination.

In the event of termination of a covered plan and business, the guaranty fund would assume full responsibility for the payment of all guaranteed benefits. It would take on jurisdiction over any assets of the funding agency since these are assumed to be available for the satisfaction of guaranteed benefits. Its jurisdiction, in Dr. McGill's opinion, should extend only to unallocated funds, thus excluding insurance or annuity contracts already purchased for specific individuals.

The guaranty fund would discharge its obligation by the purchase of insurance or annuity contracts from a pool of life insurance companies for the full amount of guaranteed benefits. This would fix immediately and irrevocably the amount of funds needed and, hence, the amount of assets to be transferred from the funding agency. If there were delinquent funding obligations outstanding against the employer, the guaranty fund would be authorized to seek collection of these sums from the assets of the liquidating firm. Any sums collected in excess of the deficit originally assumed by the guaranty fund would be turned over to the original funding agency for application to non-guaranteed benefits.

Problem of Financing

As for financing, Dr. McGill feels that a self-supporting system is highly desirable although not absolutely essential. He recommends a combination of advance premium payments and, if necessary, after-the-fact assessments. He feels that there should be a maximum assessment permitted, with governmental subsidy as a last resort. The premium would be based on the differential between the present value of the vested benefits and the particular fund's assets.

Dr. McGill concluded his presentation by emphasizing that the entire system is practical only if there are mandatory vesting and funding standards or, as an alternative to funding standards, employer assumption of the unfunded vested benefits as a legal obligation enforceable against the firm's assets. If the employer were made legally responsible for the payment of all vested benefits, many of the safeguards that would otherwise be necessary for a viable guaranty mechanism could be relaxed. □

ACTUARIAL CLUB MEETINGS

June 4, Los Angeles Actuarial Club, Thistle Inn

June 13, Baltimore Actuarial Club

June 20, Chicago Actuarial Club, Annual Golf Outing, Nordic Hills Country Club, Itasca, Ill.

June 20-21, Southeastern Actuaries Club, Montainview Hotel, Gatlinburg, Tenn.

Nov. 17-19, Casualty Actuarial Society (annual), Washington, D.C.