The Actuary

November 1976 – Volume 10, No. 9

The Actuary

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Published monthly (except July and August) by the SOCIETY OF ACTUARIES. 208 S. LaSalle St., Chicago, Illinois, 60604, Robert T. Jackson, President, Jean-Jacques Deschênes, Secretary, and Ms. Anna M. Rappaport, Treasurer.

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EDITORIAL

THE Board of Governors meeting in Toronto was no brief formality since it lasted from early Saturday afternoon until early Sunday evening. In the extensive agenda which the Board considered there was no item more important to the members of the Society than the Report of the Actuarial Restructuring Committee. This Report was unanimously adopted by the Board and is now being distributed to the Society members.

We cannot overemphasize the importance of this Report to every member of the Society and we cannot too strongly urge that the Report be carefully read and considered by all members. Reason enough for this attitude comes from the following comment in the Report:

"Any successful restructuring will come about only if it is approved by *an overwhelming majority* of the present members of each body affected thereby."

The proposals of the Report are obviously very general, the missing details must come from the committees and task forces that will be called upon to implement the recommendations. In such implementation the members of the Society should have a complete knowledge of the Report and must have definite answers to any and all questions they may have about the proposed reorganization.

The important items in the Report are: (1) that the members be fully aware of the meaning and effects of the proposed new structure, (2) that the high standard of educational requirements for a qualified actuary be maintained. There must be no compromise with quality.

To these two we might add a third, that we continue to have a pride in our profession. The organization, old or new, must be more than an examination-setting body. Otherwise, no matter how expert we are technically, we will fail as a profession. The actuaries are a small group and our very numbers lessen the weight of our political clout but the rapier can be as effective as the broadsword.

The Report is obviously not the last word but it is a beginning, "one small step" and there is a long road ahead before we arrive at our goal. The recommendations come from a Committee of the Society and have yet to be reviewed and analyzed by the other actuarial bodies. In the end we will meet on a common ground for the future benefit of the actuarial profession.

Chairman Wooddy and the members of the Committee are to be congratulated on an excellent Report. The entire actuarial profession in North America is in their debt.

A.C.W.

PUBLIC EMPLOYEE PENSION FUNDS

Robert Tilove, *Public Employee Pension Funds*, pp. x, 370, published as a Twentieth Century Fund Report by Columbia University Press, New York and London, 1976, $20.00.

by Kenneth H. Ross

This book, the third on the subject of public employee retirement systems published in recent years, concentrates on the major public policy issues affecting plans of state and local governments. The two earlier publications were, "Protecting Purchasing Power in Retirement: A Study of Public Employee Retirement Systems," by John P. Mackin published in 1971 (see *TSA XXIV*, p. 503) and "Retirement Systems for Public Employees," by Thomas P. Bleakney, FSA, published in 1972 (see *TSA XXV*, p. 197).

A clear explanation is given in Chapter 8 of the various actuarial cost methods with schedules and graphs illustrating typical projections assuming a constant work force. There is a wide variety of actuarial cost methods available and a goal should be established as a matter of policy and an actuarial c[illegible] method designed to fulfill that goal remembering that a funding policy for a public plan is different from that for a private plan in three main respects because (i) governments are generally perpetual and have the power to tax; (ii) governments need a constant and stable base for contributions; and, (iii) governments need a funding policy that can withstand public debate. Six suitable methods are described by the author, each of which produces a more or less level percentage of pay contribution under normal circumstances.

Chapter 9 discusses various actuarial assumptions with emphasis on the rate of salary increase and investment yield and the relationship between the two. The author also discusses the relationship between actuarial assumptions and actuarial cost methods and states a preference for including among the assumptions *all* reasonably safe projections. He also advocates combining this approach with a contribution schedule that is truly essential for the retirement system without necessarily insisting on "full fur[illegible]ing." This contribution schedule should recognize all long term costs without trying to accumulate reserves beyond the

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system's actual needs based on the particular risk or remoteness of possible termination or of future limitations on ability to pay.

There is one aspect of the level of funding that this reviewer thinks should be given consideration. Two fund balances can be available from the accounts of the system or developed by actuarial valuation; namely, the accumulated member contributions and the retired reserve fund representing the balances available for retired members and beneficiaries. In my opinion, the total assets of the system should never be less than the sum of the balances in the members' accounts and in the retired reserve fund since these might both be considered as representing liabilities that should be fully funded at any given time. This posture is helpful in dealing with legislators and others who try to liberalize benefits with the plea that the assets are far in excess of the amount currently required for benefit payments. If they are made to realize that the contributing members have little, if any, equity in the fund besides their own contributions (although many of them have substantial vested accrued benefits) and that the liabilities for retired members and beneficiaries should be fully funded, they may be less likely to think in terms of the total assets as being available for liberalizing benefits for present pensioners and others retiring in the near future.

The current benefit levels in the plans of state and local government employees are frequently more generous than corresponding plans in private industry. While most public employee plans require substantial member contributions, this feature is more than offset by; the liberality of the final average pay definition, the fact that most benefit formulas are not coordinated with Social Security, and the generally very liberal provisions for early retirement. Furthermore, a high percentage of these public employee plans provide for automatic increases after retirement on the basis of the Consumer Price Index or by means of periodic ad hoc increases.

In a chapter entitled Goals and Limits Retirement Income it is pointed out that a goal of 80% of final salary including Social Security has special significance for an employee retiring at age 65. This level can provide as much *net income* as when the employee was working. In view of this it is reasonable to set a goal for retirement income not in excess of a full continuance of net income for the retiring career employee.

There are three chapters that relate to Social Security, the first describing the need for reform, the second discussing the merits of coverage for public employees and the third, suggesting ways of integrating public employee systems with Social Security. The question of the merits of government units electing Social Security coverage is very well presented and then later the possibility of withdrawing from coverage is discussed. The question of withdrawal of public employee groups is a very lively issue at the present time and the author's discussion is well worth reading.

Other chapters involve the discussion of portability of pension credits, investment policies, and procedures and pension plans for policemen and firemen. Plans for the last group inevitably require extremely high contribution rates because of early retirement ages, liberal pensions and special provisions for service-connected death and disability.

A later chapter covering several general policy questions discusses special treatment of pensions for legislators, judges and executives in the public employee plans. An interesting question is raised whether or not the nondiscrimination requirements of the Internal Revenue Code with respect to qualified pension plans would be satisfied when such members are provided more liberal treatment than the general state employees.

Three chapters are devoted to the public retirement systems in New York, Massachusetts and Illinois. They provide a detailed insight into the problems that arise in these systems and mention the so-called "leap-frogging" phenomenon where each public retirement system in a state tries to outdo the others in liberalizations.

Many of these public plans provide either directly by law or indirectly by interpretation that benefit rights, whether accrued or for future service, may not be diminished or impaired for an existing member nor may his contribution rates be increased. Consequently, if retirement benefits in one of these systems get out of line, it is not possible to reduce them for the present membership but only for members joining in the future. Such changes have occurred in several of the large systems within the recent years.

Note: A more detailed review of this book will be published in the Transactions. □

OASDI

Report of the Consultant Panel on Social Security to the United States Congressional Research Service, Government Printing Office, Washington, D.C., August, 1976, $1.90.

by C. L. Trowbridge

This report contains the results of another government-initiated study of the OASDI system. This study puts forth a second solution to a problem first publicly identified by the 1975 Advisory Council on Social Security (a problem which has come to be known as the "decoupling" issue). Because the solution proposed by the actuaries and economists making up this consultant panel is significantly different from that of the Advisory Council, this report has inspired some degree of friendly debate among actuaries (and others) interested in the technicalities of the OASDI benefit formula. Panel members are Peter A. Diamond, James C. Hickman, Ernest J. Moorhead, and William C. Hsiao, Chairman.

The Reports of the Quadrennial Advisory Council on Social Security, published in March, 1975 and reviewed in the 1975 *Transactions*, include an extremely important recommendation. To correct what the Advisory Council considered to be a serious flaw in the OASDI benefit structure (operating under the so-called "automatic" provisions incorporated into the Social Security Act by the 1972 Amendments), the Council proposed a set of benefit formula changes. These would isolate the benefits for those not yet beneficiaries from the CPI adjustments for those already on the beneficiary rolls—hence the "decoupling" terminology. The purpose of these proposed changes is to stabilize replacement ratios by the elimination of what has come to be recognized as an over-indexing of the worker's potential benefit.

As compared to those who write summaries of publications, those who write reviews are not expected to be entirely objective with respect to the work under

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