SOCIETY OF ACTUARIES

Article from:

The Actuary

April 1978 – Volume 12, No. 4

The Actuary

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Published monthly (except July and August) by the SOCIETY OF ACTUARIES. 208 S. LaSalle St., Chicago, Illinois, 60604, William A. Halvorson, President, Myles M. Gray, Secretary, and L. Blake Fewster, Treasurer.

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EDITORIAL

THERE is a story, probably apocryphal, about *The Marriage of Figaro,* that Mozart, just before the curtain went up on the first performance, discovered that he had omitted to furnish an overture. Nothing daunted, he sat down and in no time flat dashed off the score of the overture.

The Editorials of *The Actuary* are frequently produced as the last item in the issue but not, alas, with literary brilliance comparable to the musical brilliance of Wolfgang Amadeus. The overture is usually a summary of the main musical themes of the opera, a taste of what is to come. Following this pattern perhaps the editorial could comment upon some of the contents of this issue.

The supplement containing Don Cody's analysis of the financial effects of the 1977 Amendments to the Social Security Act is worth your attention. As the author points out, this is an area in which all actuaries should be interested as citizens as well as actuaries and the actuarial profession should be available for guidance, both present and future, in maintaining a satisfactory Social Security system.

Membership Requirements may well be the dominant theme of future issues and deservedly so because the profession is trying to build a basic structure for the future. The problems of reorganization of the profession are many and very difficult. Comments on Mr. Boynton's letter are welcome and we hope to be able to publish some of them in our pages.

Mr. Shannon comments on what the future holds for ERISA and there is no question but that the future for all actuaries concerned with pension plans is going to be very lively. This will be no short term future.

Perhaps one of the most interesting themes is the review of the book on investments. Mr. A. Athanassiades suggests that this is a volume for all actuaries from students through Associates to Fellows. The future investments of both insurance companies and pension plans are not likely to show the same pattern as they have today and the actuaries can and should be more active in the investment area.

As in an opera there are secondary themes which may not have a place in the overture but play an important part in the whole work.

So ring up the curtain! *A.C.W.*

TO BE CONTINUED

Editor's Note: This article is submitted by the Committee on Retirement Plans. Comments will be welcomed by the Committee and by the Editor.

After ERISA, What?

By A. Guy Shannon

The passage of ERISA confronted most consulting actuaries with a couple of interesting staffing problems. First, how to get through the ERISA crunch, the three or four years of extra effort to digest the law and the initial regulations change plans and assumptions, and make some preliminary peace with the new legal environment. Second, after ERISA, what? What would the workload be like once the initial shock passed?

When pension actuaries started to climb Mount ERISA in late 1974, there was a good deal of speculation about the altitude of the plateau on the other side. Once we had mastered ERISA, would the routine work fall to pre-ERISA levels? Would considerably more work be required? Or would ERISA drive so many plan sponsors away from defined benefit plans that there would be less work to do?

Since the training of a pension actuary is a long and expensive process for both the young actuary and his employer, these were serious questions. Should the employer make a major commitment to the training process, only to find that he was substantially overstaffed once the initial crunch was past? Would a new actuary entering the pension field find that, after 5 or 10 years of strenuous effort to gain specialized pension experience, he had just become part of a great oversupply of 35-year-old pension actuaries?

Now that most of the initial crunch is over, how much work remains to be done? My guess is that the post-ERISA plateau will be a good deal higher than before. The next few years may be a bit less hectic than the last three, but they still will require a lot of work in the following areas:

1. 1977 *Social Security changes*: The 1977 Social Security amendments raise a great many questions, including the following:

a.) What about further changes? Will a roll-back occur? Would a roll-back change the scheduled increases in the taxable wage base, or the new PIA formula?

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After analyzing the automatic increase provisions under the 1972 Social Security amendments, many actuaries decided to assume that the Social Security replacement ratio would remain relatively stable in the future. Since the 1972 formulas did not produce stable replacement ratios when applied to typical "best estimate" economic assumptions, a stable replacement ratio assumption was really an assumption that the current Social Security law would be changed. In view of current taxpayer complaints and the upcoming elections, plausible arguments can be made for assuming the 1977 amendments will also be changed.

b.) How do the 1977 amendments affect current plans? Although Revenue Ruling 78-92 has given a partial answer, many benefit calculation questions are unanswered. For example, the decrease in projected Social Security benefits produces an increase in accrued and projected benefits under offset plans. When is this increase effective? 1/1/79, when many of the changes take effect? 1/1/78? The date the 1977 amendments were signed?

For excess benefit plans using an integration level which automatically adjusts to reflect changes in the maximum taxable wage base, projected benefits have decreased significantly, especially for younger employees. Many such plans use a project-and-prorate definition of accrued benefits. Have the accrued benefits for young employees under such plans been decreased by the 1977 amendments? Effective when?

These questions are urgent ones for plans which provide annual benefit statements to their participants showing both accrued and projected benefits at various assumed retirement dates.

c.) Should plans be redesigned? If you assume that the 1977 amendments remain in effect, many questions come to mind. The indexing provisions of the new PIA formula are more complex than the prior formula, making it harder to administer an offset plan. Many plans shifted to an offset formula in response to the 1972 amendments, as protection against unpredictable sharp increases in Social Security benefits. Since the decoupling provisions of the 1977 amendments have significantly reduced the risk of excessive increases in Social Security benefits, offset formulas may be less attractive than before.

For excess benefit plans using integration levels tied to the Social Security maximum taxable wage base, the abrupt increase in wage base from 1977 to 1981 creates several design problems. For example, a career-average plan might provide a current accrual equal to 1% of pay up to the current maximum taxable wage base plus 2% of pay in excess of the wage base. This benefit design might give a satisfactory result with a taxable wage base of $17,700, but not at $29,700. Should excess benefit plans be completely redesigned, perhaps to base benefits on the new Average Indexed Monthly Earnings (AIME) under Social Security, or to use a formula directly related to the new 3-part PIA formula?

What about valuation assumptions? Although the new Social Security formulas are more stable than the 1972 models, projected replacement ratios are still fairly sensitive to future economic changes. Valuation assumptions still need to be chosen with care for any plan which automatically reflects future changes in Social Security benefits or taxes.

2. *Proposed changes in integration rules*: President Carter's tax reform proposal includes a fundamental change in the present rules for integration with Social Security. If some form of these proposals are adopted, all pay-related plans will have to be reconsidered, and many will have to be amended. Despite administration claims that the proposed rules will be simpler than the present ones, a "best estimate" of the work created by any revised integration rules should assume a considerable wait for the inevitable regulations, and the addition of a good many complications along the way.

3. *Change in mandatory retirement age*: The 1978 amendments to the Age Discrimination in Employment Act will require changes in plans with mandatory retirement ages below 70. These amendments should be based on a careful review of the effect of later retirement on the design of all employee benefits. Should group life and medical benefits be continued after 65? At what levels? Should pension benefits accrue for service after 65? On what basis? Should increased incentives for employees to retire before age 70 be provided as a substitute for mandatory retirement?

4. *Routine compliance with ERISA?* Thanks to additional reporting requirements, increased attention to the valuation process, greater awareness of employees about their benefit status under the plan, and plan audits, the routine annual maintenance of many pension plans will take a substantially greater time post-ERISA than before. Some plans have fallen by the wayside, of course, but the total amount of routine maintenance work has probably increased substantially. ERISA may have kept some plan sponsors from considering benefit improvements as often as before. However, the union negotiation process seems little affected by ERISA, and inflation, Social Security changes and other long-term changes continue to raise questions about benefit design.

5. *Sons of ERISA*: Several offspring of ERISA will require attention:

a.) Repentance at leisure. Much of the initial compliance work with ERISA was done in haste. Experience with the new plan provisions will often show that the credited service rules are impossible to administer, the coordination of death benefits from the pension plan and other company insurance coverage is haphazard, or the benefits are not what the union thought it negotiated. Many plans may require clean-up amendments to correct these problems.

b.) Increased regulation. At best, the regulatory apparatus generated by ERISA is only in its early adolescence. Despite frequent announcements of simplified regulation, more can be expected. Government agencies will find increasing time to read carefully the plan documents they are approving, Schedule B offers a lot of nits to be picked, and the process of becoming an enrolled actuary (and staying enrolled) will get harder.

c.) Litigation. Plan participants have not yet rushed forward to pursue their new rights under ERISA by suing all available parties. This state of affairs could change; a few well-publicized cases might convert some current ambulance chasers into happy and successful fiduciary chasers.

d.) Future legislation. The prospects seem excellent for further legislation to amend ERISA, to extend the blessings of ERISA to public employee plans, and complicate matters further.

In summary, the other side of Mount ERISA looks like a high plateau, with a lot of opportunity left for young actuaries who want to enter an increasingly challenging field. □