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FIRST FORMAL VALUATION OF THE U.S. MILITARY RETIREMENT SYSTEM

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Reflecting Congressional desire for unified reports on all Federal retirement systems, Public Law 95-595, signed by the President in October 1978, requires annual reports from these systems similar to the ERISA reports from private sector plans. The law did not, however, subject these systems to ERISA's funding, minimum benefit level, or individual participant reporting requirements. The President has delegated his PL 95-595 responsibilities to the Office of Management and Budget (OMB).

The law contemplated, but didn't require, consistency among the reports. Preston C. Bassett, actuary for the President's Commission on Pension Policy, was most helpful to us all as we sought appropriate uniformity in our report formats and our actuarial procedures.

Assumptions

The funding method we agreed upon was entry-age normal. OMB required that our long-term annual inflation assumption be 5 percent, but otherwise left the assumptions to each actuary's own judgment. For the Military Retirement System we selected an assumption of 5.5 percent annual salary rate increase and a 6 percent investment return, so as to be consistent with historic differentials of 0.5 percent and 1 percent. Since our system is fully indexed, its liabilities vary but slightly for different economic assumptions with the same differentials.

Our Report contains a brief plan description; statements of assumptions and rates; various ERISA tables such as net assets, accrued liabilities, normal cost as a percentage of covered payroll, accumulated plan benefits, and a 75-year projection of outlays.

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ACTUARIES SPEAK TO THE PRIVATE PENSION PROBLEM

We are pleased to have received, in response to our June editorial, "What Say We?", the views of eight actuaries on the doubts about the private pension system that were expressed by Karen W. Arenson in the New York Times. Their thought-provoking comments may reasonably be classified under three headings: Advice to Actuaries, Censure of Governments, and Chiding of Journalists.

Our appreciation to the following whose ideas, we hope, are adequately summarized here: Lynd T. Blatchford, Howard Hennington, Frederick W. Kilbourne, Daniel F. McGinn, Lawrence Mitchell, Cecil J. Nesbitt.

Our invitation caused one reader, Elmer R. Benedict, to give us a look at an immense amount of work he has been doing on a major aspect of the general problem caused by inflation. Mr. Benedict's project is described in a separate article.

And from George L. Hogeman has come an analysis of the actuary's opportunity whose excellence impels us to surrender to him our customary editorial space.

Prof. Nesbitt closed his catalogue of ideas with a fearless forecast: "The next twenty years should be interesting for pension actuaries."

Advice to Actuaries

(1) Encourage employers to introduce, and to fund in advance, limited indexing of benefits. The money for this can come from the inflation-swollen investment yields. (H.H.)

(2) Offer the retiring employee the option of a lower indexed benefit rather than a higher fixed benefit. In effect, the employer and employee would be shar-

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INTERNATIONAL CONGRESS IN SWITZERLAND

by Abraham Hazelcorn

The 21st International Congress of Actuaries opened on June 19th with an inspiring affirmation of independence and belief in personal dignity—the William Tell Overture.

The meeting, spanning eight days, was replete with characteristic Swiss hospitality and efficiency, making the more than 2,000 people content and comfortable. Through the first half we were in Zurich becoming acquainted with Swiss German culture; then we moved to Lausanne to continue amid Swiss French culture. Nor were the two other cultures of Switzerland overlooked, specially in two of the social evenings.

The business sessions were devoted to National Reports and to five major topics:

(1) Generalized Models of the Insurance Business.

(2) Testing Hypotheses by Statistical Investigations.

(3) Statistical Basis and Experience in Disability Insurance.

(4) Estimating the Value of Insurance Companies.

(5) Inter-relations between Demographic and Economic Development and Social Security.

There were also several special meetings, notably one on training of actuaries and conduct of research. Each major topic was introduced at length, and then discussed. An American, Prof. William S. Jewell, gave a stimulating introduction to Topic 1. (*Ed. Note: See separate article in this issue*).

At Lausanne the authorities experimented with a format that probably will become standard practice, i.e., breaking into smaller groups akin to our concur-

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Actuaries Speak

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ing the extra cost of this. This option will have to be well publicized to employees if it is to be sufficiently used. (H.H.)

(3) Improve our communications. Many participants and laymen now think that plans promise more than they really promise. (L.T.B.)

(4) Use our skills to portray vividly the effects of inflation. Actively lobby with business and government leaders to deal with this scourge. (L.T.B.)

(5) Delay no longer in making adequate provision for inflation in cost calculations. There often has been an unduly pragmatic attitude among actuaries —directed excessively to satisfying management's desire to limit the impact of pension costs on share earnings. (D.F.M.)

(6) Promulgate a set of actuarial principles and standards to govern the actuary's assumptions and methods. The Academy has a committee working on this. (D.F.M.)

(7) Do more to advise our corporate clients on how to cope with various mixtures of future economic possibilities. (D.F.M.)

(8) Employ completely separate accounts for active and retired members within a pension plan. At retirement time, transfer the member's actuarial reserve from the former to the latter. Aim to invest the retiree's reserve so as to achieve a real yield of, say, not more than 3% per year. Use capital gains to purchase periodic paid-up pension additions. By such means, exploit the flexibility, strength and wisdom of the participating insurance principle to help maintain adequate retirement income. There are difficulties in doing exactly this, but surely actuarial ingenuity can at least approximate the application of the time-tested participating principle. (C.J.N.)

(9) Learn more about the basic actuarial science of pension systems under growth conditions. A start has been made in several papers by Bowers, Hickman and Nesbitt on the dynamics of pension funding. See also the paper by D. G. Boden and T. D. Kingston, *"The Effect on Inflation on Pension Schemes and Their Funding,"* Transactions of the Faculty of Actuaries, No. 256 (C.J.N.)

(10) Find out how retirees are managing under inflation, and where the greatest needs for adjusting retirement incomes are. (C.J.N.)

Censuring Governments

(1) We must elect representatives who are determined to keep, and capable of keeping, the economy from getting into severe trouble. (H.H.)

(2) Government, not business or the public, is the primary culprit. Politicians are elected in response to their promises, which may be an inherent failing of democracy. Unscrupulous politicians have found they can convince the public that business and the wealthy have infinite funds, and that, with time and faith, 2 + 2 can be made to equal 5. (F.W.K.)

(3) Higgledy Piggledy
Candidate Wiggledy
Promises everything
Voters may wish.

But if his programs
Are Un-Actuarial,
Can he provide from
Two loaves and five fish?

(F.W.K.)

Chiding Journalists

(1) A responsible press could engender an electorate properly skeptical of politicians' promises. (F.W.K.)

(2) The press is irresponsible when it implies that there is little difference between private and public pension plans. (F.W.K.)

(3) To single out private pensions as being particularly, even uniquely, sensitive to rampant inflation is little more than sensational journalism. (L.T.B.)

(4) The article fails to recognize the possibility that recent economic trends may not continue. Within the appropriate atmosphere that government should foster to encourage capital investment and plant modernization, corporations can develop a sound foundation for business improvement, thus increasing the number of jobs and their own profits. From this would come increased revenue to maintain, or achieve, adequate funding of their pension plans. (D.F.M.)

(5) Inflation is threatening the underpinnings of the entire pension system—our economy! To limit our thrust to inflation's effect upon retirement plans is futile. We must look at its effect upon our total economic well-being. After all, unemployment creates terrible retirement problems for the unemployed. (L.M.)

General Observations, Mostly Cheering

(1) Our pension instruments are not entirely blunted by inflation. Social Security, taking care as it does of a substantial part of most retirees' after-tax income, and fully indexed, provides a solid foundation on which to build adequate retirement benefits. Sources of helpful ideas for coping with inflation are (i) Robert J. Myers' monograph, *"Indexation of Pensions and Other Benefits"*, Pension Research Council, 1978. (ii) the systems used successfully in TIAA-CREF plans. (C.J.N.)

(2) Due in part to the normal absence of guaranteed post-retirement benefit adjustments in corporate plans, these generally are, despite their problems, in much better shape than are public retirement systems. (D.F.M.)

(3) With the aid of objective actuarial standards and principles, modern forecasting techniques, the discipline imposed by ERISA's funding standards and the demands of the FASB, actuaries can and will provide adequate long-term funding advice. (D.F.M.)

(4) Plans capable of meeting ERISA funding standards are likely to deliver the benefits that have been promised; but whether those promises are the "right" promises is another matter. I am pessimistic about the extent to which voluntarily elected cost-of-living annuities will catch on. An answer may be legislation like the joint and survivor annuity provisions under IRC 401 (a) (ii). (L.T.B.)

(5) As inflation becomes more critical, the private plan pension becomes even more important to retirees, and also gives strength to the economy. The private pension system's underpinnings are generally sound, and will continue so long as the inflation does not destroy their assets and the companies that sponsor them. (H.H.) □