



SOCIETY OF ACTUARIES

Article from:

The Actuary

January 1988 – Volume 22, No. 1

Military Retirement Cont'd.

future benefits more secure. It follows, therefore, that little will have been accomplished by thus funding the accrued liability, unless the psychological advantages of having "assets" in the retirement fund to guarantee the payment of future retirement benefits are greater than the disadvantages of creating a larger national debt.

A substantive advantage will accrue from accumulating a retirement fund consisting of Treasury securities only if it results in a strengthening of the national economy. Increased current taxes will probably strengthen the national economy; increased national debt certainly will not.

Conclusion

The new method of financing the military retirement system may appear to have advantages over the former current-cost method. First, the cost of benefits accruing for each current year of service is clearly identified and segregated from the cost of benefits accruing for past years of service. Second, provision is made for amortizing the accrued liability for prior service benefits, thus recognizing the cost of such benefits and, to a certain extent, enhancing the security of such benefits.

The real effect on the economy, however, of amortizing this past service liability will depend upon whether the amortization is achieved by increasing current taxes and decreasing the current deficit, or by merely increasing the national debt and leaving the current deficit unchanged. It should be noted that the first four amortization payments from 1984 to 1987 were achieved by increasing the national debt, and no change in this procedure appears imminent.

In short, the new financing method will not weaken the financial condition of the military retirement system, and it has the potential to strengthen its financial condition if the funding of the past service liability is handled appropriately.

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Editorial

Employee Benefits – Need for Change

by Barnet N. Berin and Robert D. Paul

(Ed. note: Robert D. Paul, not a member of the Society, is vice chairman of the Martin E. Segal Company. He is a leading pension, compensation, and employee benefits designer.)

Since the end of World War II, more and more retirees have been getting two checks, one from Social Security and one from a company pension plan. The connection between poverty and old age has been broken by an enlightened public policy that has led to the rapid growth of company sponsored and collectively bargained pension plans during this time. That policy has been to encourage the development of privately sponsored pension plans by allowing tax deductions for contributions to these plans. Taxes on these employer contributions and investment earnings are paid later when benefits are paid to retired employees.

Complexities

In 1974 Congress enacted the Employee Retirement Income Security Act, and frequently thereafter additional laws regulating employee benefit plans have been enacted. These in turn have required extensive regulations to explain their arcane provisions. Recently the Tax Reform Act of 1986 greatly increased the complexity of maintaining a qualified employee benefit program. For employee benefit plans, tax simplification has become a quagmire of obscure language, overly precise discrimination tests, and new rules that prospectively change benefit entitlements in mid-career. One inevitable result will be the creation of a second set of benefit programs outside the scope of these restrictions that may end up costing the U.S. Treasury just as much in taxes, at a later date, as is supposedly being saved now.

Objectives

We have lost sight of the original goal: the encouragement of privately sponsored employee benefit programs so

that workers and their families can live in dignity in retirement.

One reason for losing sight is obvious. Trying to raise tax revenue to meet the current budget crisis, as is true of many short-run strategies, loses sight of long-term interests. Surely the encouragement of private solutions to the problem of maintaining adequate retirement income which will relieve the pressure on Social Security and other public responses to poverty in retirement is a more cost-effective solution than the modest amount of tax revenue collected now.

A second reason for losing sight of the original goal is that most of the additional complications that have been written into the law address the issue of preventing small company owners from using the employee benefit programs as a tax shelter rather than as a systematic way of providing for life insurance, health insurance and pensions for their employees. In a small company, the principal owner's salary is almost always disproportionate when compared with the other employees; it cannot be otherwise. Because benefits are usually salary-related, disparities are unavoidable and apparent. Rather than tackle this subject directly, a burden has been placed on all companies to satisfy a variety of tests to avoid the kind of discrimination that can only occur in a small company. Reporting and disclosure are extensive and complex. Although larger companies have little difficulty meeting the rules, the cost of administering the programs grows larger and larger. Benefit design now turns on questions of compliance rather than on what is good practice. Many companies are reconsidering their commitment to defined benefit plans because of the excessive paper work and other costs of compliance.

Consequences

The complications created by this plethora of laws are so great that the Internal Revenue Service is having considerable difficulty dealing with

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them. Regulations promised a year or two ago are still not published. Questions remain unanswered for months, sometimes years. New statistical tests required under the Tax Reform Act of 1986 for group life and health insurance will only add to the burden of regulation and enforcement for the IRS. Experts at the IRS are in short supply, especially in offices around the country. Answers to the same question vary; sometimes, the answer is simply not known. Some questions are never put to the IRS because plan sponsors and their advisors cannot wait the length of time it takes to get answers. But sponsors still face risks of excise taxes and interest penalties for serious mistakes.

Endless reporting and testing by plan sponsors are performed as faithfully and carefully as possible. Increasing time and expense are spent in attempting to comply with the mounting complexity. The reports are completed, checked, mailed to the appropriate agency in Washington, D.C., received in huge bags of mail, opened, and then much later filed

away, rarely ever to be examined or even looked at again. Paper accumulates; eventually the reports will be thrown away. But they require attention—administration that serves no useful purpose. There are caretakers of never-used documents.

Simplify

The target of most of these efforts in the employee benefit field is the small company. In a simpler world we could do one of two things: have special rules that apply only to small companies or simplify the rules for all plans, recognizing that no set of rules or regulations will be 100% foolproof or perfect no matter how complex. Simplicity has virtues all its own. Simple rules will encourage employers to adopt employee benefit programs with the important benefit to the country of adequate health insurance and adequate pension benefits to supplement Social Security. We need to save more as a nation. How better to do it than through employee benefit programs?

A Proposal

Many experts in the field of employee benefits agree that the tax code can

be simplified while preventing abuses without the excessive number of rules, regulations and reporting requirements that have blossomed ever more frequently in recent years. The White House should convene a small group of leading practitioners in each of the professions involved in the employee benefits field and give them a twelve-month period in which to develop a simpler employee benefits tax code. It is important that this panel be selected only for its competence and that it work out of the limelight of publicity. Its members should pledge that they will seek no commercial advantage from their respective roles. Their work will help to preserve the very best features of the employee benefit programs now in operation while preventing individuals from unfairly using the provisions of the tax code solely for their benefit and not for the benefit of those they employ.

There invariably exists a simple solution. However, it takes someone familiar with the field to seek out and find the solution.

Presidential Editorial

Major Issues Facing the Society

by Gary Corbett

As I embark on my year as President of the Society, we face a number of issues. Most of them reach back to Harold Ingraham's term and even before. In an organization like the Society, it is virtually impossible to complete an initiative within a President's one-year term. Thus, to move the Society ahead, successive Presidents must share consistent goals and objectives. This consistency is aided by the policy that the President-Elect chair the Society's Committee on Planning which, in reality, is a committee on issues. In this role he or she can lay the groundwork for issues to be pursued during his or her Presidential term.

The major issues I see facing the Society are: education and examinations, research, actuarial principles, strengthening the profession, the future of the actuary/the actuary of the future, and employee benefits.

Education and Examinations

At the October 1987 annual meeting, the Board of Governors voted to proceed with all the Flexible Education Method proposals outlined in the White Paper distributed to members earlier in 1987. However, when it came to college credit, the Board decided to establish an experimental program, limited to the former Part 3 subjects, starting with the 1990 academic year. The entire college credit proposal will be evaluated in light of the experience with intensive seminars and the college credit experiment. It was tempting to defer completely the decision on granting credit for university courses. However, a deferral would have accomplished nothing. We would know no more five years from now concerning the advantages and disadvantages of college credit if we did nothing in the interim. Many members feel there are significant advantages to be gained by alter-

native education and credit-granting methods; others feel just as strongly that the proposal would weaken the value of the Associateship and Fellowship designations. We will never know who is right until the concept is tested. For this reason, the experimental program received the unanimous approval of the Board.

The Education Policy Committee will evaluate a far-reaching concept to reduce significantly the number of subjects in which the Society educates and examines. The subjects would be restricted to those that are absolutely necessary for an actuary and unique to the actuarial profession. Over and above this limited number of courses, education, generally at the university level, would be required in other subjects such as accounting and economics. This concept, known as the Swift Proposal, both because it

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