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EDITORIALS

From your editor

by Michael J. Cowell

Your responses to our reader surveys tell us that you want *The Actuary* to cover more public policy issues of interest to all members of our profession. Last year we tried to stay abreast of health care reform, presenting a wide range of views from actuaries involved in every aspect of the debate. In this process, we found that even President Clinton knew what an actuary is, and no longer were people asking "Where were the actuaries when . . .?"

The Actuary's editors were concerned not that we weren't covering health care reform, but that we were bombarding you with more about it than you really wanted to know. That debate is taking a back seat for now, but we can expect it to reemerge.

With health care reform the focus of 1994, what is the next battleground?

Many observers believe that it will be the closely related subject of the future of retirement. Not just Social Security and private pensions — as important as they are — but the broader issue of how much of a nation's resources can, or should, be channeled to support those no longer in the work force.

Few leaders who dare address these issues fully can do so without acknowledging the underlying actuarial problems of retirement plan solvency and the socioeconomic consequences of transferring vast amounts of wealth across generations.

Unlike the health care reform debate, in which many actuaries did not become involved until after the train had left the station, the future of retirement is wide open for us to board at the start. This issue is dedicated to getting the debate underway.

Mary Adams' editorial and the major feature articles address some of the fundamental questions. We can expect more to follow in the months ahead, and we look forward to your participation.

What can actuaries do to improve the outlook for retirement security?

by Mary Adams

As we approach the start of a new century, we thought it timely to ask senior pension practitioners their thoughts about the future of retirement benefits, particularly pensions. This issue of *The Actuary* presents their responses. These are their personal thoughts, not those of an employer, client, or any actuarial organization.

In the United States, the proliferation of recent changes, especially in tax law and regulations, has upset formerly well-balanced retirement programs. The thought of more and worse to come makes it necessary for our profession to look at where we are, where we are going, and especially what actuaries might do to improve future situations.

The pension consultant's basic tool for helping plan sponsors establish their retirement programs is threatened. The three-legged stool — one leg representing Social Security; another, employer-provided benefits; and the third, representing income from an employee's own savings — is in jeopardy. We worry not only about the length of each leg but also the quality of each leg. Will the seat of the stool be so tilted that it cannot be sat upon, or will a leg or two simply collapse?

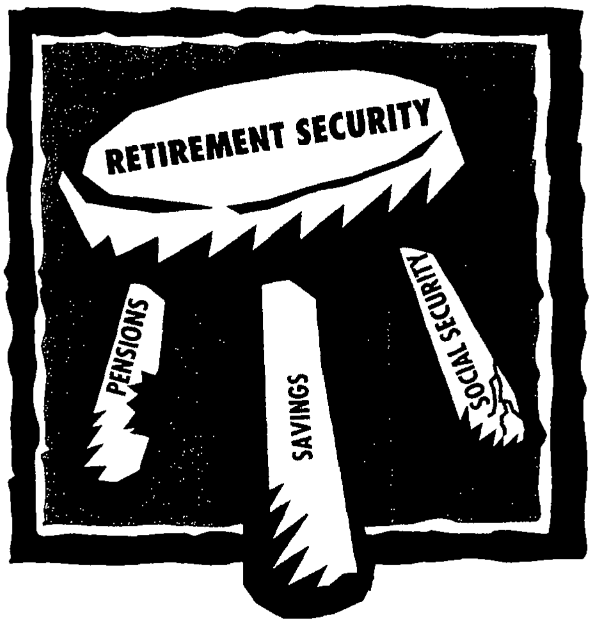
Social Security

First let us look at the Social Security leg. The current Old-Age and Survivors Insurance (OASI) formula produces benefits that seem just about right, but while some projections show a good long-term balance in the system, others do not. Changes effective in 1994 now subject 85% of the Social Security benefits of the "wealthy" to tax. The avowed intent of some legislators to diminish entitlements (Social Security being on the entitlement list) is not being kind to the stool's Social Security leg. While the legislators say there will be no changes now, what will the new century hold? What can actuaries do?

Pensions

The employer-provided benefits leg once was primarily made up of defined benefit (DB) pension plans. Twenty years ago, these plans were bolstered in many ways by the Employee Retirement Income Security Act of 1974 (ERISA). During the past several years, however, they have been severely battered by unending issuances of proposed, temporary, final, and revised versions of each regulation, associated with numerous new laws. The core of this leg is being eaten away. Will we have any defined benefit pension plans in the 2000s? What can we do about it?

The defined contribution (DC) portion of the employer-provided benefit leg has increased significantly, having suffered less at the hands of legislators and regulators than DB plans. Plan sponsors love DC plans. Once a contribution is made, they are off any risk: no possible unfunded liabilities and no Pension Benefit Guaranty Corporation (PBGC) premiums. Employees think DC plans are great because they are provided with huge lump sum payments at retirement. Because of the shift of the investment and decrement risks



from plan sponsors to the individual employees and retirees, provisions for disability and spousal survivorship benefits, which are common features of DB plans, are not present in DC plans. This has always been a weakness of personal savings, but the magnitudes of the amounts involved with DC plans accumulations present special problems. The decisions to be made by a financially unsophisticated DC plan participant are frightening. This part of the pension leg of the stool keeps on growing, but how substantial is it? What can actuaries do about it?

Savings

And now for personal savings, including employees' own contributions to 401(k) plans and to Individual Retirement Accounts (IRAs). This once distinctive leg is becoming blurred with the defined contribution benefit leg, or at least its problems are. Because of limits placed on the amount that can be provided by tax-favored pension plans, higher-paid employees have to rely increasingly on their own savings.

When personal savings and lump sum payments from employer-provided programs were at a level that the three-legged stool was comfortable, the double risk of the retiree was much less. The retiree knew that indexed Social Security benefits and the employer pension — usually not indexed — were payable for life.

In the current climate, retirees have to invest relatively large lump sum benefits to provide retirement income to last their lifetimes – and often that of their spouses' – and to reinvest and spend in such a way that needed cost of living increases in spendable money can be provided.

This is now. What is ahead? Will individuals be able to handle this investment task and keep this leg stable enough to make the stool usable? Do employers and employees recognize the magnitude of this problem? What can actuaries and the financial institutions they may influence do about preparing for the 21st century?

It is the intention of the editors to stimulate our readers' thinking about what is ahead. We expect that some will agree with these articles, and others will disagree. But most of all, we want to get the thought process started now. We look forward to hearing your views. Let us, as a profession, contribute our ideals to enhance benefit security for retirees in the 2000s.