Article from:

The Actuary

March 1995 – Volume 29, No. 3

OPINION

Epidemic that swept England now threatens America

by Daniel F. McGinn

It took more than two years, but the germs from an epidemic that originated in England have spread to California and possibly to other parts of the United States. According to recently published accounts, some 1.5 million persons have been afflicted by this British "bug." The carriers of this infectious disease are hucksters who appear to be descendants of the notorious 19th century snake oil salesperson.

It seems that those persistent "salespeople" have been persuading retirees to switch from their unions' pension plans to private plans run by an insurer. These private plans, the retirees were told, would pay them nearly three times as much as they had been getting from their union plans.

Those who agreed to switch, however, were bitterly disappointed when they actually got less, not more, than they had been receiving. In England, government officials investigated and reported that the victims' money had been transferred to "risky, inappropriate investments by salespeople more interested in what was good for themselves rather than for their clients."

Fade out England, fade in Southern California. Recently, some similarly persistent salespeople (sometimes disguised as consulting actuaries or lawyers) have been trying to persuade companies with traditional pension plans to scrap them and replace them with 401(k) plans.

Defined benefit plan vs. 401(k)

The traditional defined benefit (DB) pension plan is far superior to any other type of retirement income plan. Not only does it provide significant monthly pension benefits when a worker retires, it also frequently provides substantial benefits for disabled workers and the surviving spouses of workers who die before reaching retirement age.

A 401(k) plan is a "defined contribution" plan that can be an excellent way for an employee to accumulate capital and defer taxation. Often, the plans allow an employee to borrow from accumulated funds under "hardship" conditions, when emergency medical services are needed and for educational purposes.

It just doesn't do the job, however, in providing lifetime retirement income protection. A 401(k) plan provides no ancillary benefits, and the surviving spouse receives only what has accumulated in the account.

Recent experience

In 1990, almost 61,000 DB retirement plans were terminated, and 1.8 million Americans lost traditional pension coverage. The substitute usually has been a 401(k) plan. While employer's risks were reduced, investment risks were transferred to participants who don't understand investment risks well enough to manage their 401(k) investments.

Fanciful projections

The major problems with these 401(k) plan changeovers are a direct by-product of how they are sold to employees. Employees who go into labor negotiations as union representatives have been given false information with inflated projections of 401(k)s. The salespeople who promote these plans use a simple projection: they assume contributions to the 401(k) plan will earn interest at a tax-deferred rate of 8 or 8.5% every year over periods as long as 40 years, making a young employee a near-millionaire by the time he or she is 55 or 60.

This is where the matter of ethics comes in. It would be impossible to earn 8 or 8.5% year-in and year-out over extended periods of time and, in some years, the return on invested funds will be negative, not positive. If a few years of zero returns and negative returns were injected into the projection, the fat numbers projected by these salespeople would really be deflated. However, for the salesperson to disclose such facts while making a sale would be "inconvenient." This fact should raise a lot of red flags for anyone listening to the sales pitch for 401(k) plans.

Portability

Then again, there is the beguiling appeal of the "portability" of 401(k) plans. "You don't have to wait five years to earn a right to your pension," goes the salesperson's pitch. "When you leave your employer, you can take everything in your 401(k) plan with you." This is true, yet in many situations the only contributions in the plan have been the participants' own annual salary deferrals.

Experience has shown that fewer than 5% who leave employment use their 401(k) plan balance to buy an annuity or invest for retirement. Most spend their entire account balances on impulse items.

The consultants reassure employers that corporate executives don't have to suffer if the company switches to 401(k) plans. "We'll just set up separate nonqualified, deferred compensation arrangements for the senior executives." They conveniently ignore the fact that the rank-and-file workers are the big losers when a 401(k) plan is adopted instead of a DB plan.

(continued on page 16)

RETIREE CORNER

What do you think of your CCRC's financial practices?

Jack Moorhead, who has retired with his wife to a Continuing Care Retirement Community (CCRC) in New Hampshire, wants to ask a question of other retired SOA members in CCRCs. "Such members are likely to have a keen interest in the financial outlooks in CCRCs," he writes. "Perhaps readers of this column would be willing to write to me at my *Directory* address, telling me if you are comfortable with your own CCRC's practices in balance sheet and monthly fee determination. If perchance you aren't, maybe I have a suggestion worthy of your consideration."

Retired actuaries add unusual value to volunteer work

Two retired actuaries are using the skills they developed during their professional life in the usual volunteer organizations, but in unusual ways.

Lawrence Lubin, in Englewood, N.J., began as a treasurer of a local unit of the American Cancer Society. "Easy stuff," the friend who solicited him said. "She was right," Lubin said. "It was relatively easy, and I was serving a good purpose."

The friend then introduced him to another level of involvement — a committee dealing with discrimination in insurance or employment for persons with a cancer history — where he has experienced "an unbelievably fulfilling volunteer activity."

"Whenever anyone calls the American Cancer Society in New Jersey and they mention the word 'insurance' or 'discrimination,' they're given my name and phone number," Lubin said. "Most of the people who call me just need a calm voice to help explain insurance benefits or, for example, COBRA. Sometimes I have to explain underwriting; sometimes it's New Jersey law and the availability of life or health insurance. Sometimes they need an attorney. Job discrimination problems are a different story, of course, but I have brochures and 10 years of experience to help me out. In addition, the Cancer Society provides some medical and legal backup."

Lubin receives about 100 calls a year. He calls this "job" one of the most rewarding aspects of his retirement. He invites readers to contact him for more details if they want to do something similar in their states.

* * *

In June 1984, Chuck Keene and his wife retired and moved from Indianapolis to Sun City West, Ariz. In the past 10 years, his voluntary activities have been mostly with his church, serving as chairman of a Pastor Search Committee and the Administration Committee of the Session and as an elder. During this time, his financial projection skills were applied to building expansion planning.

After being a pension consulting actuary for 30 years, Keene said, "I have now taken the next chronological step, and I am the church's 'consultant' to our congregation on our Memorial Garden/Columbarium project."

However, his most recent job as men's golf coordinator for the church really lets his skills shine through. With 21 two-men teams in the 18-hole league and 8 teams in the 9-hole league, the computer programs he wrote for scheduling, scoring, establishing tee time responsibility, calculating handicaps, and listing weekly league standings have been invaluable. "Since matches are on a combination of match and stroke play, both based on handicaps, and are played on two different courses with different handicap holes," he said, "golfers in the SOA may appreciate the complexity of the scoring program."

All this work has not kept Keene from finding time to score four holes-in-one since retiring.

Epidemic (continued from page 13)

Turning things around

Consulting actuaries have often urged Congress to correct the problems we have described in our forums.
Yet, we don't feel that our elected representatives in Washington should be telling employers what kind of pension and savings plans they should and shouldn't adopt.

We have a vested interest in the future of DB plans, but we firmly believe they play an important role in providing for American workers' long-term retirement security and, ultimately, the future economic security of our country.

It seems highly unethical for knowledgeable pension consultants to promote 401(k) plans as true retirement plans. Employers and labor representatives should resist the simplistic appeals of DC plans and stop the spread of this "bug," lest it turn into an epidemic threatening the retirement security of the entire American workforce.

Daniel F. McGinn is president and chief actuary of McGinn Actuaries Ltd., Anaheim, California.