SOCIETY OF ACTUARIES

PENSION SECTION NEWS

December 2010, Issue No. 73

Share | Print-Friendly Article | Search Back issues

POLL

IN THIS ISSUE

CHAIRPERSON'S CORNER

By Marcus Robertson

Marcus highlights the council's activities during the 2009-2010 council year, and gives a well deserved thanks to the SOA staff and the members of the council and its teams for their support and hard work toward a very productive year. Full article >>

NOTES FROM THE EDITOR

By Josh Bank

A brief look at the roles and structure of the council's Communications Team during the past year and the expanded functionality of the team under Faisal Siddiqi, the new chair of the Communications Team for 2010-2012. Full article >>

A VIEW FROM THE PENSION STAFF FELLOW

By Andrew Peterson

Andy provides a succinct summary of activities that he, the council and many other engaged parties have undertaken this past year with regard to the now firmly established *Retirement 20/20* initiative, including links to working drafts of papers submitted and presentations made at June's *Retirement 20/20*: *New Designs for a New Century* conference held in Washington, DC. Full article >>

PERSPECTIVES FROM ANNA: DISABILITY BENEFITS IN A DEFINED CONTRIBUTION WORLD

By Anna Rappaport

Anna gives us an excellent "layman's overview" of concerns, challenges

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

and potential areas for improvement in the area of pre-retirement disability–a contingency that is perhaps too frequently ignored or underemphasized in the general pension actuarial literature during the trend from DB to DC retirement vehicles. Full article >>

THE NEW ERA OF DEFINED BENEFIT PLAN RISK

By Sheva Levy and Chris Lipski

If you are a plan sponsor looking for ways to manage the risks and maximize the return on investment associated with your defined benefit (DB) plan you are not alone. Sponsors of DB plans are being forced to focus on their plans as never before. A confluence of events–market downturn, aging workforce and changing legislation/regulation–has meant the status quo no longer applies to companies' DB plans.
Full article >>

EXCERPTS FROM THE RESPONSES OF THE PUBLIC PLANS SUBCOMMITTEE AND THE PENSION FINANCE TASK FORCE TO THE PRELIMINARY VIEWS OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD ON PENSION ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS (IN THREE PARTS)

Highly-condensed versions of the comments provided by the Public Plans Subcommittee and the Pension Finance Task Force to the GASB's Preliminary Views (PV) on pension accounting standards for public employers. A link is also provided in parts 2 and 3 to the full Academy response to GASB.

Part 1: Academy GASB PV Response–Transmittal Letter. Full letter >>
Part 2: Excerpts from PPS to GASB PV Response. Excerpted response >>
Part 3: Excerpts from PFTF to GASB PV Response.
Excerpted response >>

THE POST-RETIREMENT NEEDS AND RISKS COMMITTEE IN THE UNITED STATES AND THE PENSION ADVISORY TASK FORCE IN CANADA

A PSN *Interview of Anna Rappaport and Monique Tremblay*

In a recent interview with two highly recognized private sector actuaries in the United States and Canada, Anna Rappaport (U.S.) and Monique Tremblay (Canada) provided a broad but comprehensive view at the different-sounding but fundamentally quite similar SOA and Institute groups whose missions are to think about, seek input on, and help develop potential solutions to improve the retirement income security of North America's workers and their dependents. Full article >>

SOCIETY OF ACTUARIES

PENSION SECTION *NEWS*

December 2010, Issue No. 73

Share
Print-Friendly Article
Search Back issues

POLL

IN THIS ISSUE

CHAIRPERSON'S CORNER

By Marcus Robertson

Editor's note: This column was written by Marcus in October as he was finishing his term as PSC chair.

As this council "year" draws to a close and we greet new council members in November, I'd like to thank Andy Peterson and Sue Martz of the SOA staff for all their support over the past year. I'd also like to thank all the members of the council and our committees for the work they've put in to make this a very exciting and productive year.

Highlights of our activities over the past twelve months are many, and include:

- the conclusion of the *Retirement 20/20* Call for Models Competition and the awarding of four cash prizes;
- a successful *Retirement 20/20* Symposium in Washington, DC, with another being planned for Toronto;
- publication of *The Pension Forum*, whose focus on International Financial Reporting Standards is very timely;
- coordination and production of continuing education webcasts;
- initiation of direct communications with the American Academy of Actuaries and the Canadian Institute of Actuaries, with the ultimate objective goal of working together where we have common interests;
- establishment of a Pension Section subgroup on the business-oriented social networking site LinkedIn; and
- successful planning of Annual Meeting sessions.

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

You will read about some of these developments in other articles in this newsletter or on the section website, but I would like to comment further on a few of the activities in this article.

Retirement 20/20

The Call for Models Competition concluded this year when an expert panel judged 18 entries and selected four outstanding papers for cash prizes. You will hear more about all of the individual submissions over the next months, but congratulations must go to Ken Beckman, Rowland Davis, Don Fuerst and Tom Walker, whose papers the judges determined best met the challenging guidelines for content, originality and comprehensiveness. You can find the winning submissions on the *Retirement 20/20* website.

At the culmination of the competition we held a 1 1/2-day symposium in Washington, DC. The symposium featured presentations of the four winning papers as well as theme-based sessions that included presentations by authors who had interesting and well thought-out ideas but whose papers did not qualify for cash prizes. The symposium was attended by representatives of all the stakeholders in our retirement systems (i.e., society, employers, individuals and markets).

We are planning a similar event to be held in Toronto this fall. More on this event, which will be jointly sponsored with the Canadian Institute of Actuaries and the C.D. Howe Institute, later. (Editor's note: A one day invitation-only symposium, titled, *Getting Pension Reform Done: Issues, Options and Next Steps*, was held on Dec. 8, 2010 in Toronto.)

At this time, the council is moving ahead with the next stage of the *Retirement 20/20* project which will include, among other things, publication of most of the papers submitted in the Call for Models Competition. Stay tuned for developments.

Annual Meeting

Under the leadership of Ellen Kleinstuber, our Continuing Education Committee organized very interesting and challenging pension and related sessions at the October 17-20 Annual Meeting in New York. There were more than 15 sessions sponsored or co-sponsored by the Pension Section, many of which were eligible for EA credit. If you were not able to attend the Annual Meeting, please be on the lookout for follow-up information about the meeting on the SOA website or in upcoming SOA and Pension Section communiqués.

The Pension Forum

You should have received the most recent publication of *The Pension*

Forum by now. This issue of *The Pension Forum*, which was edited by Kelley McKeating with the assistance of Josh Bank, focuses on international accounting standards and is a must-read for all retirement actuaries.

Relations with the AAA and the CIA

The Society of Actuaries, as a research and education-focused body, often times can't effectively take the results of its research beyond its membership. Similarly, the American Academy of Actuaries (AAA) and the Canadian Institute of Actuaries (CIA), bodies that play more of an advocacy role, may be restricted in the types of research they can conduct.

Over the past year, we held face-to-face meetings with the Pension Practice Council of the AAA and with the CIA, in an attempt to establish formal working relationships. At this point we have just started discussions, but there seem to be a number of areas where the Pension Section Council can work with these bodies. Hopefully, some of the excellent research being sponsored and conducted by the Pension Section will be disseminated to a broader audience in the future.

Finally, I'd like to close by saying that the past three years have been very interesting and rewarding to me. I hope that all Pension Section members will seriously consider volunteering some time to serve as elected members of the council or on one of the council's three operational committees (continuing education, communications and research). I don't doubt that you will find the work rewarding!

Marcus Robertson, FSA, FCIA, is outgoing chair of the Pension Section Council for 2010 and a newly-elected member of the SOA's Board of Directors. He is a consulting actuary with Robertson, Eadie & Associates in Oakville, Ontario and can be reached at mrobertson@re-a.com.

SOCIETY OF ACTUARIES

PENSION SECTION NEWS

December 2010, Issue No. 73

NOTES FROM THE EDITOR

By Josh Bank

We hope you enjoy the current issue of *Pension Section News*. Per your input from both the 2009 Pension Section Survey and the poll question in May's *PSN*, we are putting more emphasis on "risk" topics, and we plan on adding a recurring/revolving column on risk issues throughout 2011. If you are a CERA (whether officially or secretly) and would like to get on our list of "Risky Business" guest columnists, please drop me or Faisal Siddiqi a line and we'll try to get you published in one of our upcoming newsletters or forums.

The Pension Section's Communications Team is entering a new era of expanded, two-way communications with its members under our new Team Chairperson, Faisal Siddiqi's leadership. Again in accordance with your expressed wishes in last year's survey, we have added two new vehicles to help our members get better connected with the council, with one another, and with current events in the pension world.

Firstly, we've established an SOA Pension Section group on LinkedIn, to complement the Society of Actuaries group that was set up over a year ago. You should have received an e-mail this fall notifying you of the new LinkedIn group and inviting you to participate in this informal yet professional networking site. Please log in some time, spend a couple of minutes reading what your colleagues are thinking, add your thoughts, or start a new topic. Who knows how many will be interested in your thoughts!

Secondly, Faisal and his crew have completed the design of a "mini *PSN*" (to be called *Pension Section Update* or *PSU* and similar to *SOA News Today* but more specifically focused on pensions), that will plug the 3-4 month gaps between successive issues of our flagship *Pension Section News* newsletter. We expect the first issue of *PSU* to be in your e-mail inboxes early next year. We are very excited about this new

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

communications vehicle and we're sure that many of our 4,000 Pension Section members will quickly adopt the *PSU* as one of their principal means of staying on top of both SOA and other pension happenings in North America and elsewhere.

Again, thanks for your valuable participation and ongoing engagement! Please feel free to contact any of the members of our Pension Section Communications Team if you have any questions regarding our upgraded communications vehicles. Our members (and our SOA staff partners) are as follows:

Faisal Siddiqi	Chairperson
Eric Freden	Vice Chairperson
Art Assantes	Editorial Advisor
Josh Bank	Editor, *PSN*
Ray Berry	Editor, *The Pension Forum*
Art Conat	FAS/IFRS Advisor
Maia Lustgarten	Co-Editor, *PSU*
Robert Maciejewski	Co-Editor, *PSU*
Andy Peterson	SOA Staff Fellow, Retirement Systems
Sue Martz	SOA Section Specialist

Josh Bank, ASA, EA is Editor of the *Pension Section News* and Associate Editor of *The Pension Forum*. Josh can be reached at jobank@gmail.com.

SOCIETY OF ACTUARIES

PENSION SECTION *NEWS*

December 2010, Issue No. 73

A VIEW FROM THE PENSION STAFF FELLOW

By Andrew Peterson

In the last edition of the *PSN*, we inaugurated this new column as a way to pass along information about key initiatives at the SOA and other items of interest that may affect actuaries working in the retirement area. In that first column, I focused on three key initiatives that are keeping me busy this year including: *Retirement 20/20* and the recent call for models contest; the work of an SOA task force on the application of Enterprise Risk Management (ERM) to the pension area, and a new SOA-board approved project on developing a "rapid" retirement research capability. In this issue, I'd like to drill down a bit into the *Retirement 20/20* project.

Call for Models Contest and Washington, DC Symposium

If you've read Marcus Robertson's Chairperson's Column in this *PSN* edition, you will have read that we completed the Call for Models contest and held a symposium in Washington, DC earlier this year. As a reminder, the contest was about seeking ideas for new retirement system designs that better meet the needs of the 21st century. The authors were asked to go beyond what is possible within the U.S. and Canadian regulatory structures to define a better "tier II" system that meets the needs of stakeholders: individuals, society (taxpayers) and employers, and that also does a better job of using markets effectively (http://retirement2020.soa.org/call-models.aspx).

We received 18 papers that were judged on the basis of the principles we have developed during the five-year long *Retirement 20/20* initiative using the *Measurement Framework* template and other key criteria. We congratulate the four prize-winning papers:

- "The SERIOUS System: A New Model for Retirement Income Success," by Ken Beckman, ASA, MAAA, CFA
- "The Tracker Plan: A Controlled Risk Defined-Contribution

Needs and Risks Committee in the United States and the Pension Advisory Task Force in Canada

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

Retirement Program," by Rowland Davis, FSA

- "Affordable Retirement Income through Savings and Annuities," by Don Fuerst, FSA

- "The Total Career Benchmark Model," by Tom Walker, FSA, FCIA, CFP

Each of the prize-winning papers, as well as four other papers, formed the basis for our most recent conference, *Retirement 20/20: New Designs for a New Century*, held June 2-3 in Washington, DC. A second conference will be held, in cooperation with the C.D. Howe Institute and the Canadian Institute of Actuaries, in Toronto later this fall. (Editor's note: A one day invitation-only symposium, titled, *Getting Pension Reform Done: Issues, Options and Next Steps*, was held on Dec. 8, 2010 in Toronto.) The Washington conference featured presentations on the four prize-winning papers and additionally included presentations and panel discussions involving other select paper authors, retirement policy experts, academics, industry professionals and government experts.

After the winning proposals were presented we moved into panel discussions to explore the primary themes that emerged from the papers, including:

- Using "smarter" investment strategies that tend to be less risky (particularly as individuals approach retirement). These strategies tend to mandate either a default or required investment option, at least for a portion of an individual's retirement savings (remember, most individuals aren't actuaries, and studies show that many–if not most–individuals don't typically make smart investment choices). They also suggest more use of fixed-income vehicles like TIPS (Treasury Inflation Protected Securities).

- Showing retirement accumulations as streams of income, rather than a single sum. This uses the lessons of behavioral finance to help people understand that the goal of retirement saving isn't merely to amass as much wealth as possible, but to prepare for a potentially long period of not working by accumulating sufficient guaranteed income.

- Ensuring retirement savings are taken as annuity income in retirement, potentially protected from inflation increases. While this is very controversial in today's political climate, most conference participants agreed that lifetime income of some form is an important goal, and that it's important for the profession to help policy makers understand that Social Security (in the United States) is not enough income for most individuals.

- Giving employers the option of access to a plan that they don't have to sponsor. If employers are relieved of many of the administrative burdens of plans sponsorship, more employers and by extension, individuals may be able to participate in plans.

- Providing a greater degree of standardization. If we change our thinking so the primary focus of retirement plans is ensuring that individuals have a secure retirement income rather than ensuring that employers have endless options to provide benefits, then the priorities of the system will naturally shift. One consequence of the shift that some authors explored was having more standardization in the system–which tends to lower costs and improves the ability of individuals (and employers) to plan ahead.

Many of these ideas are new and are not without controversy. There was significant discussion, debate and some healthy disagreement both among panelists and the audience about ideas like mandating plans, guaranteeing benefits, and balancing the needs of different stakeholders. That's OK. Actuaries understand risk, and we need to take risks to explore what's possible, even if it may not always be politically feasible in the near term. We were reminded of the challenge of the current Washington political climate in the post-health care reform environment. But we also were excited by comments from several Washington insiders who suggested that there are specific ideas that we can take forward to help create better outcomes within the system today.

We encourage you to access working drafts of the papers online, including those from our four prize-winning authors and several other authors who appeared as panelists at the conference. In addition, the conference presentations from the event are also posted online.

Conclusion

So what do you think about these ideas? If you had to name your highest priority area to focus on in improving our retirement system, what would it be? Feel free to send me an e-mail with your thoughts to my address below or start a discussion (on continue an existing 20/20 discussion) on our newly-opened SOA Pension Section subgroup on LinkedIn. The new LinkedIn subgroup is located at the following address:

http://www.linkedin.com/groups?mostPopular=&gid=3320437

If you are not a member of the Pension Section or if you have any trouble linking to this address, please notify Sue Martz (smartz@soa.org) to discuss access.

Andrew Peterson, FSA, is Staff Fellow”Retirement Systems at the Society of Actuaries in Schaumburg, Ill. He can be reached at apeterson@soa.org.

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SOCIETY OF ACTUARIES

PENSION SECTION NEWS

December 2010, Issue No. 73

Share Print-Friendly Article Search Back issues

POLL

IN THIS ISSUE

PERSPECTIVES FROM ANNA: INTEGRATION OF DISABILITY BENEFITS WITH OTHER BENEFITS IN A DEFINED CONTRIBUTION WORLD

By Anna Rappaport

The purpose of this article is to encourage people to rethink how disability impacts retirement security in a Defined Contribution (DC) world, and to start a conversation about this topic. It is hoped that the conversation may lead to some restructuring of the intersection of disability and retirement benefits to better reflect the trend toward work schedule reductions near the end of workers' careers.

Basic premise

Disability is one of the major risks facing individuals as they go through life. It is linked to retirement security and for many people a significant period of disability before retirement will mean insecurity in retirement if they live to retirement, and insecurity for surviving family members if the disabled person was a major earner in the household. Disability can interfere with work and prevent people from building up assets for retirement as well as leading to premature use of funds accumulated for retirement. Disability may also mean that the spouse becomes a caregiver and gives up at least part of the opportunity to earn retirement and disability benefits based on his or her own work. Workplace disability benefits were traditionally established in a world where retirement occurred all at once, and where it was believed that there would be a clear distinction between retired and working, and between disabled and not disabled.

While Social Security covers both risks, recent trends in typical corporate benefit programs are to look at them separately, and there are two different sets of people who focus on these traditionally more strongly linked benefits. This perspective is provided because I believe that more attention needs to be paid to how disability impacts retirement security, and how employers and society integrate coverage for retirement and disability.

Disability is an important factor in early retirement

A study by the Congressional Budget Office (CBO) focused on reasons for early exit from the labor force.[1] It examined the Census Bureau's SIPP (Survey of Income and Program Participation) database to look at people aged 50 to 61 who were not participating in the labor force in 2001. In this study, status was based on self-reporting, and people were classified as retired or disabled. Some of the key findings included:

- Those not in the labor force because of disability generally had much lower income, higher poverty rates, and fewer assets than those who were retired. Disability was the most common reason for early exit among both men and women.

- Of the total population aged 50 to 61, 14 percent of men and 24 percent of women were reported as not being in the labor force at any time during the year. Of the men not in the labor force, 32 percent were retired, 64 percent were disabled, and 4 percent reported other reasons for not being in the labor force. Among the women 26 percent were retired, 40 percent were disabled, and 34 percent reported other reasons. People who gave reasons besides disability or retirement generally indicated that they were caring for others or were not interested in working.

- Men at ages 50 to 61 reported as not working were twice as likely to be disabled as retired, whereas women were about one-and two-thirds times as likely to be disabled as retired. Of the total population aged 50 to 61, 9 percent of men and 10 percent of women reported themselves as disabled, and 4 percent of men and 6 percent of women reported that they were retired and did not work at all during the year.

- About 80 percent of the men and women who reported themselves as disabled received Social Security disability benefits or were in a family that received Supplemental Security Income program payments.

Social Security disability benefit eligibility

Social Security is the only disability coverage available to the vast majority of the working population. Social Security offers long-term disability coverage to virtually all workers who meet stringent requirements for benefits. Social Security pays disability benefits to people who cannot work because they have a medical condition that is expected to last at least one year or result in death. In general, to get disability benefits, the covered person must meet two different earnings tests:

1. A "recent work" test based on age at the time of becoming disabled; and

2. A "duration of work" test based on length of contributory coverage under Social Security.

To meet the recent work test, the youngest workers, those below age 24, need to have at least 1.5 years of coverage during the three year period ending with the quarter during which they become disabled. Workers who are at least age 31 need to have worked five years out of the last 10 to satisfy the recent work test. . Under the duration of work test, the total work required gradually increases with age, varying from 1.5 years if disabled before age 28, increasing to seven years by age 50, and 9.5 years by age 65.

Options for disability coverage and fit with private benefit programs

Disability provisions can be found not only in Social Security, but also in employer-based benefit plans through group insurance policies and as ancillary benefits in (predominantly Defined Benefit (DB)) retirement plans, as well as through individually-purchased disability insurance products. Traditional benefit programs were heavily linked to income replacement, and focused on loss of income from disability, death and eventually retirement. They were designed to work well in a world where career employment was the norm. Traditional pension benefits were designed to replace income after retirement (regardless of physical ability) and disability benefits were designed to replace income before retirement for those who were unable to work because of a health condition. Traditional final average pay DB pension plans worked well alongside insured Long-term Disability (LTD) plans since the DB plans allowed disabled employees to continue earning pension credits while disabled, and started paying benefits when the LTD coverage ended for totally and permanently disabled employees. Retirement was assumed to be all at once and at age 65. DC plans work very differently with regard to disability benefits. DC plans may pay out the account value on disability, particularly if the individual's employment terminates. Extra disability coverage could also be offered in order to provide for continued savings.

Sources of disability coverage and bases for calculating benefits

	Social Security Disability	Employer LTD program	Employer STD program	Defined Benefit Pension	Individual Disability Policies
Prevalence of coverage	Everyone is Social Security system is covered, but Social Security has requirements with regard to work history for coverage to be effective. Traditional Non-working spouses have no coverage	Very common at larger companies, particularly for salaried employees. May be voluntary and many people may choose not to participate. Not very common in smaller companies.	More common than LTD. Very likely in larger companies, and prevalence declines with employer size. (Also a few states have mandates for short term disability coverage)	In state of decline. Most likely at larger companies.	Minority of the population. Most likely among higher paid professional, white collar, business owners, etc.
Disability benefit amount based on:	Lifetime earnings history and benefit formula	Current earnings and benefit formula	Current earnings and benefit formula	Formula in plan and disability provision	Amount of coverage purchased
Type of disability definition	Total and permanent, expected to last for at least a period of one year or result in death.	Can be your occupation or any occupation, or a combination based on your occupation first – depends on coverage	Likely to be your occupation	Depends on plan provisions, may be similar to LTD program	Can be your occupation or any occupation, or a combination based on your occupation first – depends on coverage
Link of disability to ultimate resources at retirement	Affects earnings history so benefit may be reduced somewhat	No direct connection, but LTD benefit may enable continued saving for retirement	No connection	Some plans provide continued accrual of service for pension benefit	No direct connection, but benefit may enable continued saving for retirement
Employer role in program	Pays Social Security tax	Plan sponsor, program could be self-insured (giving employer discretion in structuring program)	Plan sponsor, program could be self-insured (giving employer discretion in structuring program)	Plan sponsor, program usually self-insured	None

Click on the chart for a bigger view

Disability and emerging patterns of retirement

Retirement has recently tended to become much more of a *process* rather than a discrete, single-point event at predefined "early" or "normal" retirement ages. The concept of retirement has become somewhat blurred and characterized by earlier "phased retirement" ages and later "final retirement" ages that depend more and more on individual circumstances. Scaled-back work schedules are becoming a part of the retirement process for many workers, and health limitations are one of the more common reason for this scale-back. As retirement has changed, final average pay DB plans, for various reasons, have also become much less common. Defined contribution plans typically pay out benefits to disabled employees, and the money may well be spent before retirement age. Disability plans, as a rule, are not being adapted to reflect the new reality. They are not intended to pay benefits to phased retirees, but rather are intended to pay benefits to full-time employees who can't work because of physical or cognitive limitations. There is an increasing focus on rehabilitation, keeping employees with manageable health challenges at work and helping to get people who have suffered light to moderate (temporary) disabilities *back* to work. In addition, employers are required to provide reasonable accommodations to disabled employees under the Americans with Disabilities Act (ADA). The Social Security administration has been working to improve the operation and administration of its disability programs including helping persons who are entitled to benefits return to work. Some employer based disability programs offer rehabilitation and partial disability benefits today. Employers who are developing innovative or leading edge work options and phased retirement programs will want to be sure that there are no anomalies or unintended gaps with regard to disability benefits or the ADA.

There is the potential that people who elect phased retirement due to health limitations will then become disabled, and there are questions about how best to make sure that these two sets of programs intersect in a logical fashion. In addition, people going on phased retirement can lose disability coverage or see it reduced, so that they should probably not elect to reduce their schedule if they believe that they are likely to become disabled soon.

Care is needed in communicating with employees who have health limitations and are considering part-time or reduced work options. As noted above, reduced work schedules can adversely affect disability eligibility and/or benefits. The employee may view a reduced work schedule as desirable and it may indeed be beneficial to both parties. However, if the employee is eligible for work disability benefits under legal or contractual terms, the relationship between full-time vs. part-time work and disability benefits should be completely understood and clearly communicated.

Will changing work schedule change disability coverage?

In general, a short-term change in work schedule (e.g., a few years at the end of a long career) should not materially impact Social Security benefits, but a long period of reduced hours could substantially reduce benefits, which are based on career average (indexed) earnings. Private individual disability insurance may not be directly affected by a reduced work schedule, but employer provided coverage will nearly always suffer, since the worker could lose eligibility altogether, and even if he/she remains eligible, there is likely to be a reduction in benefits, which in this case are based on *current* earnings.

Summary of issues

So what are the issues as we think about the intersection of work, disability and retirement?

- People who are disabled need to continue to save for retirement for themselves and their dependents. Often this will not happen, and it is a problem with most DC plans.

- Retirement funds should not be used at time of disability, as this will reduce or deplete assets needed for future retirement for the individual and family. This is another potential problem with DC plans.

- People who are disabled need income replacement, and many working Americans have only Social Security disability benefits to rely on. Traditional nonworking spouses have no coverage under Social Security (nor do they have outside earned income that needs replacing). Still, the family will often need to pay for services previously provided by the disabled nonworking spouse.

- Current designs for disability programs do not contemplate–and thus do not have a good fit with–the increasing trend toward phased retirement. Disability programs are primarily designed for people who go from full-time work to full retirement all at once.

- Employer-based disability benefit programs are most often designed to work with a normal retirement age of 65. As work lives lengthen along with improved life expectancy and associated past and future changes in Social Security, these benefit programs will need to be adjusted.

Editor's note: Anna does not hold herself out as an expert on disability insurance issues, and hopes that any misstatements–however subtle, regarding the current state of governmental, employer-based or individually-contracted disability income replacement programs–will be taken in stride. As stated up front, the purpose of this article is to encourage people to rethink, in a general sense, how disability impacts retirement security in a DC world, and to start a conversation about this topic.

Anna Rappaport, FSA, is an internationally recognized expert on the impact of change on retirement systems and workforce issues. She is a former consulting actuary at Mercer and former president of the Society of Actuaries. Currently, Anna is president of Anna Rappaport Consulting in Chicago, Ill. She can be reached at anna@annarappaport.com.

Footnote

[1] Disability and Retirement: the Early Exit of the Baby Boomers from the Labor Force, CBO, November 2005

SOCIETY OF ACTUARIES

PENSION SECTION NEWS

December 2010, Issue No. 73

THE NEW ERA OF DEFINED BENEFIT PLAN RISK

By Sheva Levy and Chris Lipski

If you are a plan sponsor looking for ways to manage the risks and maximize the return on investment associated with your defined benefit (DB) plan you are not alone. Sponsors of DB plans are being forced to focus on their plans as never before. A confluence of events–market downturn, aging workforce and changing legislation/regulation–has meant the status quo no longer applies to companies' DB plans.

Risks–whether financial, compliance or employee related–may cause serious reputational and financial harm from inefficiencies, litigation or penalties. The responsibility to assess these risks resides in many places throughout an organization, but these efforts must be centrally coordinated–often under the guidance of human resources (HR).

The issue of underfunding

A Watson Wyatt Worldwide analysis of 450 Fortune 1000 companies found that a total loss of $445 billion in pension funds wiped out a 2007 surplus of $78 billion, leaving these companies with a combined $366 billion deficit on year-end 2008 financial statements.[1]

In spite of a partial equities market recovery in 2009, the U.S. stock market dropped by nearly six percent (on a market-cap-weighted basis) during the first eight months of 2010. Combined with a continuing–if not slightly worsened–discount rate environment on investment-quality corporate bonds, the funded status of the typical U.S. corporate pension plan remained at a historically low 71 percent.[2]

With employees hearing more and more bad news each day from many sources, the last thing employers can afford to do is have any sort of slip-up associated with their DB plans, whether it is actual or perceived.

With all of the risks associated with DB plans, many plan sponsors are

Needs and Risks Committee in the United States and the Pension Advisory Task Force in Canada

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

contemplating a change to DC plans. In this case the investment risk is shifted to the employees. However, the frozen DB plans still carry large legacy costs and administrative burdens.

Employers with a paternalistic mindset may still prefer to provide benefits using a DB vehicle. However, they are finding that employees do not fully understand DB plans as the value to them is difficult to see. DB plans continue to be an excellent retention tool if properly understood by participants, and the employers must educate participants on the value of the benefits that they are receiving.

With proper oversight, DB plan risks can be monitored and contained. Once the framework has been put in place to manage these plans, they can satisfy and motivate the workforce while still achieving stated business objectives. Employers with more nimble control environments and motivated employees will be best positioned for growth as the economy resumes its long-awaited recovery.

Changes due to the Pension Protection Act

Prior to 2006, IRS rules related to funding of qualified pension plans were a patchwork of rules that have evolved since ERISA was passed in 1974. The Pension Protection Act of 2006 (PPA) presented changes to the rules governing the funding of qualified DB plans effective Jan. 1, 2008. These rules were intended to make sure that qualified plans are properly funded so that benefits promised to employees are paid and the PBGC can better manage its responsibility for severely underfunded plans.

In addition to the accelerated funding requirements for underfunded plans, PPA also imposed potential benefit payment and accrual restrictions that can create difficult employee relation situations. While PPA intended to simplify the funding rules, it has added new layers of complexity. Minimum funding requirements, benefit restrictions and limitations on funding of nonqualified arrangements create a juggling act for plan sponsors. More focus will have to be placed on working with a plan's actuary to forecast funded status and make sure funding strategy meets business objectives.

The new funding requirements, along with the declining assets associated with these qualified plans due to poor market performance, have triggered significant additional short and mid term financial and administrative costs for plan sponsors. Although the Worker, Retiree, and Employer Record Act of 2008 (WRERA) and the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act (PRA) provide some measure of relief, they do not provide the full extent of relief that some plan sponsors had hoped for.

The Sarbanes-Oxley impact

Now that organizations have had some time to absorb the impact of

Section 404 of Sarbanes-Oxley (SOX), the focus has been switched to processes that may not have been as closely considered during the initial implementation waves. The identification by external auditors of "significant deficiencies" or "material weaknesses" related to pension and OPEB processes has become more prevalent as auditors express their concerns surrounding the controls and procedures associated with compiling required financial information.

Large organizations with complex reporting structures find it difficult to document these processes. These organizations may sponsor multiple plans with varied plan provisions. It is likely these organizations have outsourced the plan administration, often with multiple vendors, and therefore rely on these administrators to transfer census data to the plan's actuary. However, the plan sponsors may find that they are left holding little in the form of evidence of controls or even the source data itself. The sponsor must balance oversight of the administration process in a way that still realizes efficiencies gained from outsourcing.

There are a number of critical action items that companies can undertake to ensure greater control over data integrity. There must be sufficient coordination between payroll and HRIS so the appropriate data, such as pensionable earnings and service history for active employees, are maintained for use in actuarial valuations. Many employers still face issues with the maintenance of census data for plan participants that are no longer actively employed. Often these groups account for a larger portion of plan obligations than the active population and require just as much, if not more, oversight.

There are additional complexities for global organizations that have financial results rolling up from many foreign entities. Foreign entities may be reporting results under local statutory or accounting standards. Oversight is needed to ensure that consolidated U.S. results reflect the appropriate accounting basis. Given all of these factors, there is clearly a need to strengthen internal controls around the entire reporting process related to pensions and OPEBs.

Regulatory compliance

The Employee Plans Team Audit (EPTA) program became a permanent IRS program on Oct. 1, 2003. EPTA is a broad-scope examination of employee benefit plans with 2,500 or more participants. An IRS report on the top 10 issues found in EPTA audits noted a "lack of sufficient internal controls to ensure that data provided to third party record keepers/plan administrators is accurate. Often the audit reveals that reports and testing prepared by third parties have inaccurate data, such as dates of hire or termination, ages of employees, amount of compensation, etc. Thus the plan administrator is improperly calculating such things as vesting or employer matching allocations." The report also noted that "large corporations with decentralized payroll systems may have problems administering the plan if there are no internal controls to ensure plan provisions are properly applied." Findings from an EPTA audit could affect the qualified status of pension plans. Even plans not subject to EPTA audits still can become disqualified if administration issues are identified.

Frequently, companies lack the internal resources for self-review to identify control issues; even if internal resources are available, the labor-intensive nature of the work makes it very difficult for any one group to identify all systemic issues. In addition to qualified status or internal control deficiencies, lack of control generally represents inefficiencies in administration of the plan and translates into unnecessary costs to an organization. During these cost conscious times in, there are clear benefits to properly assessing the controls environment associated with DB plan processes.

Vendor and risk management

Most large organizations today outsource a portion of their HR functions to a third-party administrator, the primary drivers being cost reduction and re-focusing of resources on functions core to operational goals. After the contract is signed organizations may fail to actively manage the vendor relationship. They are often faced with poor service, uncertainty on whether the vendor is performing according to the agreed service levels or the possibility of overbilling problems.

While it may seem that the risk itself is outsourced, the company should consider nothing is off the table. Activities must be carefully reviewed and documented to capture business improvement opportunities.

Regular monitoring steps include:

- Reviewing contract terms and invoices to identify potential billing errors
- Assessing vendor's performance against key performance indicators
- Assessing the current contract against leading practices
- Analyzing services in the contract compared to services actually performed to identify any contractual services that are not being provided
- Assessing regulatory compliance of vendors

When managed correctly, these relationships have great potential to reduce risks and maintain predictable costs.

The impact of FAS 158

Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (FAS 158), first became effective as of the end of the fiscal year ending after Dec. 15, 2006. Amounts that were previously deferred and recognized over time through the annual expense instead had to be recognized immediately as "Other Comprehensive Income/Loss." This caused large changes for some organizations.

FAS 158 consolidated guidance from various Financial Accounting Standards Board (FASB) sources on the process used to select assumptions for the actuarial valuation process. This has generated more focus on the actuarial valuation and reporting process. Auditors are now looking more closely at the processes and documentation associated with the discount rate setting process to assess its appropriateness for a particular plan, rather than simply comparing the assumption to general market benchmarks.

The plan sponsor bears responsibility for selection of the assumptions and is usually done with the assistance of an actuary. The actuary bears responsibility of the assumptions application to develop the projected costs. The actuary is not required to opine on reasonableness of prescribed assumptions. Therefore, plan sponsors need to be ready to demonstrate that processes used in the assumption-setting process are both appropriate given the particular plan's facts and circumstances and also the market conditions relevant as of the plan's measurement date.

FAS 158 included illustrations related to the creation of a deferred tax asset/liability associated with pension and OPEB liabilities. Although some organizations already followed this practice, such illustrations were not included in previous accounting standards associated with pensions and OPEBs. Therefore, additional focus on DB plans' relationship to the tax provision and FASB Interpretation No. 48 (FIN 48) considerations was triggered.

Investment disclosure and management

In December 2008, the FASB issued FASB Staff Position No. 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets containing new disclosure requirements related to pension plan asset. These requirements first applied on a prospective basis for fiscal years ending after Dec. 15, 2009. Frequently the plan sponsor's treasury department's trust and investments group handles decisions associated with plan assets. Now more communication and coordination is required between those producing the financial statements and the treasury function to make sure that the information is readily available for disclosure purposes.

In addition to disclosure and reporting, plan sponsors have begun to focus more on the investment process. Prudence in this area has always been procedural. However, the big issue now is whether investment strategy should be aimed at liability matching with an emphasis on fixed income. If not, it will be necessary to determine what the proper level of equity investments should be based on that liability. An understanding of the various investment classes is needed to set the assumed long-term rate of return on assets used to calculate the annual expense.

Health Care Reform

In addition to the myriad of complexities that Health Care Reform (HCR) has introduced for employers, there are specific considerations related to the valuation of OPEB plans. Sponsors must consider the impact today on their plan obligations of changes yet to be implemented such as excise taxes on benefits over a given threshold and changes to trend rate assumptions in light of the impact of HCR on the healthcare industry.

HCR also presents cost savings opportunities such as the Early Retiree Reinsurance Program (ERRP). Under this program, plan sponsors are able to submit for reimbursement certain expenses associated with claims for retired participants receiving medical benefits who are not yet eligible for Medicare. Although the cost savings generated may be significant, the ERRP carries administrative requirements that are complex. A strategic decision is required as to the value of participating in this program.

The new era of fiduciary responsibility

In addition, plan sponsors could be held personally responsible for breach of fiduciary responsibility for actions associated with the administration of DB plans. ERISA fiduciaries in the corporate environment may include senior executives (often CFO/finance department), the board of directors, vice president of HR and benefit plan committee members. Examples of types of activities that create ERISA fiduciary status are managing plan assets, selecting or directing plan investments, selecting third party service providers, deciding claims appeals, interpreting the plan provisions or oversight of any persons with these responsibilities.

ERISA's fiduciary rules are not intuitive or obvious. An ERISA fiduciary can be held liable for violating ERISA's fiduciary rules even if the violation was accidental. In certain circumstances, a fiduciary can also be held liable for breaches of a co-fiduciary. A fiduciary found guilty of a breach of fiduciary duties under ERISA may face potential consequences such as personal liability to reimburse the plan for any losses, punitive damages and even civil and criminal penalties. However, many times ERISA fiduciaries are not even aware that they may be in such a position.

There are some simple steps plan sponsors can take to try to minimize the risks associated with fiduciary responsibility:

- Review the plan's administrative operations to identify any cracks in the system. Lawsuits have been premised on preventable administrative mistakes, so take the time to prevent a small problem from becoming a big problem.

- Determine who the plan's fiduciaries are. Although a plan is required to specify a fiduciary, ERISA applies a functional definition: anyone exercising discretion over plan assets is a fiduciary. If the plan has allocated or permitted this discretion to extend to parties not observing fiduciary safeguards, this could be a problem for all.

- Determine who bears the financial burden in the event of a fiduciary breach. The plan document or a service provider agreement may indemnify parties performing fiduciary functions. Explore options for shifting this risk through insurance, limitations on indemnification or reversing indemnification provisions to place the risk on the party in error.

- Consider modifying the plan's administrative procedures to treat complaints of administrative error as claims for benefits. Requiring administrative exhaustion of these claims could secure a more lenient standard of review, or avoid litigation entirely, if the claim can be resolved at the administrative level.

Changes ahead

More changes are brewing. The Securities and Exchange Commission (SEC) issued its road map for the adoption of International Financial Reporting Standards (IFRS) in the United States. Absent any considerations by the International Accounting Standards Board related to convergence, IFRS will introduce significant changes to accounting for pensions and OPEBs. Plan sponsors need to start considering these changes prior to implementation to make sure they have processes in place to create necessary financial disclosures as of transition date.

The IRS has yet to issues guidance regarding some of the practical considerations related to the PRA. Additionally, PRA includes some strings related to items such as extraordinary dividends that may require individuals in a pension oversight role to familiarize themselves with aspects of their organizations that were previously outside their area of focus.

The new role of HR

DB plans clearly no longer fit simply under the realm of HR. DB plans touch many aspects of the organization and have evolved into an area of high focus for boards of directors and compensation committees, investors and employees. Organizations need to identify an internal resource that is able to coordinate the various considerations and stay informed on the continuing changes related to DB plans. As the HR function evolves, the responsibility for overseeing all touch points would likely reside there.

The appointment of a "DB controls manager" may be the answer for some organizations. This person should be familiar with the corporate structure and act as a liaison between HR and the other corporate functions. Preferably, he would have an audit background or an understanding of the audit function. This type of background would bring an added focus on the process and documentation needed to bring the DB processes to a point where they can stand up to scrutiny of an audit–whether it is conducted by external auditors or an EPTA audit.

Familiarity with the corporate systems would also be a prerequisite to help the resource understand the flow of entries in financial information system and census data throughout the organization. In this role, the DB controls manager would be an enabler and facilitator to design and implement controls which would then be performed by the HR team and other relevant functions.

It is the intent that the DB controls manager role would be distinct from the existing HR roles. Keeping the role separate would create an independent party who will be able to focus the overall process while the remaining HR staff would focus on the day-to-day oversight.

The DB controls manager would initially have to work to make sure that all of the processes meet current expectations. However, as changes take place, ongoing monitoring of the controls would be needed to make sure that they are updated appropriately.

Given the breadth of subject matter involved, the DB controls manager will need to rely on advisors with deep finance, accounting, actuarial and tax knowledge to keep updated on developments that have great bearing on the company's decision-making process. These advisors will need to help the DB controls manager understand the various issues. The role will need to work to maintain a consultative arrangement with advisors, and not strictly a compliance relationship, to ensure that the corporation does not encounter any unpleasant surprises with the DB plan processes.

Employee communications and education

DB plans are not easily understood by employees, particularly the younger workforce. With such significant investments required for maintenance and oversight of these plans, sponsors need to make sure that their investment is valued in the eyes of employees.

If there is any silver lining to be realized from this economic downturn it is that employees are more motivated to pay closer attention to their personal financial situation. Consequently, programs such as financial planning and education can help employees understand and better utilize the features of all their benefits programs. They, in turn, develop a better appreciation for the combined value of their total reward program, including their DB plan. By providing the communication and education about benefits such as the DB plan, employees can learn to plan around them. Greater attention to the financial acumen of employees not only improves productivity, it also enhances recruitment and retention efforts down the road.

By properly combining streamlined, low-risk DB plan operations with appreciative and incented employees, plan sponsors can maximize the return on their investment and make their organization a market leader and an employer of choice into the future.

Sheva Levy, ASA, is a senior manager in the Performance & Reward group of Ernst & Young LLP's National Tax Department in Cleveland, Ohio. She can be reached at sheva.levy@ey.com.

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Footnote

[1] Watson Wyatt Worldwide. Available here

[2] BNY Mellon Press Release. Available here

SOCIETY OF ACTUARIES
PENSION SECTION NEWS
December 2010, Issue No. 73

September 17, 2010

Governmental Accounting Standards Board
Mr. David Bean
Director of Research and Technical Activities
Project No. 34
director@GASB.org

Re: Preliminary Views on *Pension Accounting and Financial Reporting by Employers*

Dear Mr. Bean:

The American Academy of Actuaries'[1] Pension Practice Council appreciates the opportunity to respond to the Preliminary Views on Pension Accounting and Financial Reporting by Employers (PV). It is clear that a considerable amount of deliberation and research on the part of GASB Board Members and staff went into developing the document.

As described in the PV's "Notice to Recipients," the Board anticipates that responses to the PV will represent a spectrum of differing views on the major recognition and measurement issues. With the various practitioners and professionals approaching this task from different perspectives, this response is to be expected. Even for a particular group such as the actuarial profession, there are unique perspectives as a result of evolving actuarial knowledge and differing assessments of such issues as appropriate measurement techniques, cost allocation, and valuation.

The American Academy of Actuaries' mission is to provide independent and objective information, analysis, and education for the formation of sound public policy where actuarial science provides a unique understanding. It is a forum for development of policy solutions that sometimes results in providing more than one solution for policymakers to consider at the same time. This is the case with the Pension Practice

Council's response to the PV–you will find included two separate responses to the questions presented, one response prepared by the Pension Finance Task Force and another prepared by the Public Plans Subcommittee.[2]

We hope the GASB Board will find both responses informative and useful as you further refine the concepts and frameworks outlined in the PV. The Academy would be happy to provide further details or any assistance as this research project continues and would appreciate the opportunity to testify at one of the three public hearings in October.

Please contact Jessica M. Thomas, the Academy's pension policy analyst (202.785.7868, thomas@actuary.org) if you have any questions, would like to discuss these responses further, or would like to see the Academy's response to the 2009 Invitation to Comment.

Sincerely,

Ethan E. Kra, FSA, MAAA, EA
Vice President, Pension Practice Council
American Academy of Actuaries

Footnote

[1] The American Academy of Actuaries is a professional association with over 17,000 members, whose mission is to assist public policymakers by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

[2]The Public Plans Subcommittee and the Pension Finance Task force both operate under the Academy's Pension Practice Council. The Pension Finance Task Force is also jointly sponsored with the Society of Actuaries.

EXCERPTS FROM THE RESPONSE OF THE PUBLIC PLANS SUBCOMMITTEE TO THE PRELIMINARY VIEWS OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD ON PENSION ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS (PROJECT NO. 34)

(The full document is available here)

We appreciate the reflection of the many commentaries submitted last summer in the GASB's Preliminary Views (PV). Our summary response to the questions stated in the PV focuses on the issue on Total Pension Liability (TPL) and the way some changes, particularly from experience and assumption changes should be addressed in a manner that creates less expense volatility than the the PV suggests. We urge the GASB to reconsider the asset valuation method used in the offset to the TPL and the methods proposed for recognition of changes in the Net Pension Liability (NPL) to reporting periods.

We acknowledge the new direction presented in the PV focusing on accounting measurement separate from funding. We urge the GASB, however, to consider that the public may be better served if measures of pension accounting cost and funding cost are more closely related. This position is based on both practical and theoretical reasons.

1. Accounting vs. Funding and Accountability. Because the current ARC-based expense is a viable basis for contributions, the annual disclosure of contributions versus the ARC provides essential information to assess the employer's accountability for the pension obligation. The loss of that expense/funding connection raises practical issues that the GASB should consider and address:

    1. The GASB should consider how the new reporting will provide decision-useful information about employer accountability if there is no connection between pension

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expense and the amounts actually funded.

2. The GASB should consider how financial statement users will understand and reconcile two different measures of pension cost–one for accounting and one for funding.

2. Accounting vs. Funding and Interperiod Equity. The PV addresses interperiod equity (IPE), the matching of current period inflows of resources with current period costs of services. We suggest the GASB consider the volatility of measurements when attributing pension cost over reporting periods as another aspect of IPE.

    1. The matching of current period inflows and costs in a career context addresses what is often called intergenerational equity. Period-to-period IPE should provide that the cost attributed to a period does not affect that period inequitably compared to periods just before and after.

    2. The PV treatments of certain changes in actuarial assumptions lead to an expense measure that could be extraordinarily volatile from period to period. Given the long-term nature of the pension obligation, this could produce a clearly inequitable allocation of cost from one period to the next.

    3. The GASB could address this interperiod inequity by explicitly incorporating volatility management into its recognition of changes in NPL. This will lead to a balancing of demographic measures (for intergenerational IPE) with longer recognition periods (for period-to-period IPE).

3. Accounting vs. Funding and the level cost of services model. Aside from these practical points, there is a strong theoretical basis for maintaining a relationship between funding and expense in that both are intended to produce a level cost of service. This concept, as discussed below, is also consistent with the long-term nature of the pension obligation as described in the PV.

    1. The service cost and liability measures that the GASB has proposed for plans with an expectation of sufficient future funding (Entry Age method with long term earnings discount rate) are also consistent with the model approach most frequently applied for funding purposes among public plans, because both expense and funding are intended to maintain a consistent relationship to compensation levels.

This means the level-cost method is equally appropriate for accounting cost (expense) and funding cost (contributions).

2. As a result, expense and funding start out from the same level cost of services (service cost). The GASB PV expense differs from funding in how it recognizes variations around that level cost, variations caused by investment return and by changes in the TPL through benefit changes, experience gains/losses, and assumption changes.

3. We recognize that there may be reasons to recognize such variations differently for expensing vs. funding. The need to balance demographically based cost attribution with volatility management (alluded to in 2 above), however, applies equally to expensing and funding. This means that any differences should be limited.

4. Addressing these issues will greatly facilitate reconciling and understanding any difference between expensing and funding. It also could allow employers to consider funding at the same level as expensing.

With these principles in mind, here are our responses to the issues and question from the PV:

(Editor's note: The responses below may be moderately or heavily edited for brevity. Refer to the full document for further clarification.)

1. It is the Board's preliminary view that, for accounting and financial reporting purposes, an employer is primarily responsible for the portion of the obligation for defined pension benefits in excess of the plan net assets available for benefits. (See Chapter 2, paragraphs 5–10.)

We agree with this finding for the reasons ably presented in the PV.

2a. It is the Board's preliminary view that the unfunded portion of a sole or agent employer's pension obligation to its employees meets the definition of a liability (referred to as an employer's net pension liability). (See Chapter 3, paragraphs 1–8.)

We agree with the finding that the NPL–whether based on market value of assets or some smoothed market-related value–meets the Concepts 4 definition of a liability, as described in the PV.

2b. It is the Board's preliminary view that the net pension liability is measurable with sufficient reliability to be recognized in the employer's basic financial statements. (See Chapter 3, paragraphs 9–13.)

We agree that an NPL based on the market value is an important measure of liability that should be disclosed in the notes to the financial statements. We believe that the NPL based on the market value of assets (which for this item only we will call MNPL), however, is not a sufficient reliability measurement for recognition on the basic financial statements (BFS). We recommend that if any form of the NPL is reported on the basic financial statements, it should be based on a smoothed, market-related value, so as to obtain a reliable measurement from period to period.

3a. It is the Board's preliminary view that the projection of pension benefit payments for purposes of calculating the total pension liability and the service-cost component of pension expense should include the projected effects of the following when relevant to the amounts of benefit payments: (1) automatic cost-of-living adjustments (COLAs), (2) future ad hoc COLAs in circumstances in which such COLAs are not substantively different from automatic COLAs (see also question 3b), (3) future salary increases, and (4) future service credits. (See Chapter 4, paragraphs 4–13.)

We agree with the GASB's endorsement of a total pension liability component based on projected salaries and service, which is consistent with the GASB's conclusion that pension expense should reflect the employee's ongoing, career-long employment relationship with the employer. We also agree with the inclusion of automatic COLAs and ad hoc COLAS that are not substantively different from automatic COLAs.

3b. What criteria, if any, do you suggest as a potential basis for determining whether ad hoc COLAs are not substantively different from an automatic COLA and, accordingly, should be included in the projection of pension benefit payments for accounting purposes?

We recommend that determination of "not substantively different from automatic" should reflect the basis, process, and authority for granting such benefits, including any recent changes in such factors. Past frequency and consistency of ad hoc COLAs also should be considered. We note that this could lead to valuing the ad hoc COLA using a stated assumption as to frequency (e.g., three out of five years).

3c. It is the Board's preliminary view that the discount rate for accounting and financial reporting purposes should be a single rate that produces a present value of total projected benefit payments equivalent to that obtained by discounting projected benefit payments using (1) the long-term expected rate of return on plan investments to the extent that current and expected future plan net assets available for pension benefits are projected to be sufficient to make benefit payments and (2) a high-quality municipal bond index rate for those payments that are projected to be *made beyond the point at which plan net assets available for pension benefits are projected to be fully depleted. (See Chapter 4, paragraphs 14–23.)*

We agree with the GASB's endorsement of a total pension liability and service cost measure based in large part on a long-term earnings discount rate, which is consistent with the GASB's conclusion that the "employer's projected sacrifice of resources can be effectively modified (reduced) by the expected return on investments" for accounting purposes.

When projecting assets for comparing to projected benefits values, the GASB should clarify that any anticipated contributions that are to fund benefits for current members should be included, regardless of the basis used for those contributions. We recommend the GASB clarify that the projected assets include all projected future contributions that are to fund the unfunded liability for current members.

4a. It is the Board's preliminary view that the effects on the net pension liability of changes in the total pension liability resulting from (1) differences between expected and actual experience with regard to economic and demographic factors affecting measurement, (2) changes of assumptions regarding the future behavior of those factors, and (3) changes of plan terms affecting measurement should be recognized as components of pension expense over weighted-average periods representative of the expected remaining service lives of individual employees, considering separately (a) the aggregate effect on the liabilities of active employees to which the change applies and (b) the aggregate effect on the liabilities of inactive employees. (See Chapter 5, paragraphs 8–10.)

We recommend that plan changes be distinguished from gains/losses, as well as assumption changes, as fundamentally different events requiring distinct treatment when attributing their effect to reporting periods.

4b. It is the Board's preliminary view that the effects on the net pension liability of projected earnings on plan investments, calculated using the long-term expected rate of return, should be included in the determination of pension expense in the period in which the earnings are projected to occur. Earnings on plan investments below or above the projected earnings should be reported as deferred outflows (inflows) unless cumulative net deferred outflows (inflows) resulting from such differences are more than 15 percent of the fair value of plan investments, in which case the amount of cumulative deferred outflows (inflows) that is greater than 15 percent of plan investments should be recognized as an increase or decrease in expense immediately. (See Chapter 5, paragraphs 12–15.)

This approach–essentially unlimited smoothing within a relatively narrow market value corridor–may be an overly simple method that will result in potentially significant volatility when determining pension cost, whether for accounting or funding. We recommend that changes in the smoothed market-related assets be amortized over a 15-year period, similar to differences between actual and expected liability experience.

This allows for effective management of investment volatility, both directly through asset smoothing and indirectly through amortization of changes in NPL due to changes in the smoothed asset value.

This also has the reporting advantage of avoiding two different deferred inflow/outflow accounts on the BFS–one for investment return and one for TPL changes–because the investment deferrals would be incorporated into the NPL.

5a. It is the Board's preliminary view that each employer in a cost-sharing plan is implicitly primarily responsible for (and should recognize as its net pension liability) its proportionate share of the collective unfunded pension obligation, as well as its proportionate share of the effects of changes in the collective unfunded pension obligation. (See Chapter 6.)

We do not disagree with the value and need for determination of proportionate shares of obligations among employers. There may be a need, however, to distinguish different methods for relatively large systems versus the aggregation of small systems. Within the public plan arena, there are some systems that are very dependent on the value of risk-pooling of relatively small municipal employers. Implementation of proportionate shares could become a material expense and undermine the risk-pooling benefits for these systems.

There are many anomalies that arise in the process of an artificial allocation. The resulting allocations no longer may be sufficiently reliable to fairly represent that employer's own obligation. If the employer's obligation is defined in terms of the funding requirement, then the GASB should be more consistent in the application of that principle.

6. The Board's preliminary view is that a comprehensive measurement (an actuarial valuation for accounting and financial reporting purposes) should be made at least biennially, as of a date not more than 24 months prior to an employer's fiscal year-end. If the comprehensive measurement is not made as of the employer's fiscal year-end, the most recent comprehensive measurement should be updated to that date. Professional judgment should be applied to determine the procedures necessary to reflect the effects of significant changes from the most recent comprehensive measurement date to the employer's fiscal year-end. Determination of the *procedures needed in the particular facts and circumstances should include consideration of whether a new comprehensive measurement should be made. (See Chapter 7.)*

We have no major concern with this concept. While similar to the requirements of Statement 27, the requirement to consider and possibly reflect changes since the last valuation will increase allocation of entity resources to pay for these additional actuarial fees. It also is subject to fairly broad interpretation as to what must be reflected in an update and what reasonably can be deferred to the next valuation. In the agent and cost-sharing plan arrangements, this could require significant additional work, especially in situations in which different employers have different fiscal year-end dates.

Prepared by Kenneth Kent, James Rizzo and Paul Angelo. We wish to thank the members of the Public Plans Subcommittee for their collaboration during the preparation of the Academy's response to the GASB.

SOCIETY OF ACTUARIES

PENSION SECTION NEWS

December 2010, Issue No. 73

EXCERPTS FROM THE RESPONSE OF THE PENSION FINANCE TASK FORCE TO THE PRELIMINARY VIEWS OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD ON PENSION ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS (PROJECT NO. 34)

(The full document is available here)

We believe that all interested parties, and especially taxpayers and bondholders, need to see the value of the pension obligation reported in a manner consistent with the fundamental principles of economics and the presentation of other government debt.

Our view is that the pension obligation is a liability that should be discounted at close to a default-free rate for presentation in the financial statements. Certain consequences flow from this point of view.

First, the annual cost would be calculated as the difference between the current year's pension liability and the prior year's pension liability, net of contributions, and is likely to show a great deal of volatility from one year to the next. It is our understanding that reducing volatility may be an important objective of a cash contribution method, but it is not an objective of financial reporting methods to the detriment of faithfully reporting the economics of the plan. In order for a volatile annual cost to be presented in a way that meets GASB's objectives, it will be important to show separately the different components of annual cost–the part that comes from deferred wages in the period and the parts that come from other sources. The annual operating cost of the plan, or normal cost, specifically, should be shown separately from the non-operating costs (i.e., financing and investment costs, gains and losses, etc.).

Second, other information not reported in the basic financial statements is important enough to warrant discussion elsewhere in the financial reports. In particular, employers should include a description of the plan's funding policy, the current and expected level of future cash flows, and the investment policy of the trust fund, including its allocation among different asset classes.

Our responses to the interrogatories thus reflect this broader view of financial reporting of pension obligations.

Should future costs be attributed to service periods using a single actuarial methodology, the entry-age-normal method, on a level percentage-of-payroll basis?

We agree with the board that a single methodology for attributing costs to periods is appropriate and promotes comparability. We do not agree with the PV that the value assigned to the pension benefits exchanged for services each year over an employee's career necessarily should bear a consistent relationship to the employee's base salary level. As a result, we also do not agree with the PV in using an entry age normal (EAN) approach to measure the obligation at a point in time.

We believe a better approach for determining the liability would be to recognize the value of the benefits attributed to service to date. Benefits earned to date represent a completed exchange transaction–a year of employee service has been exchanged for a stipulated increase in a future pension benefit. Pension obligations share many characteristics with other forms of debt. This approach would determine a liability that bears a more consistent relationship to the value of other debt in the financial statements.

We also note that the conclusions of the PV differ from the conclusions that other accounting standards rules setters have reached for pension plans in similar contexts (international accounting standards for public reporting by governmental entities, and U.S. and international generally accepted accounting standards for public reporting by nongovernmental entities). The PV does not address these differences or their effect on the public's expectations for financial statements. Very large inconsistencies, as these may be, could affect the credibility of all governmental accounting statements. We hope that the final document explicitly addresses this, and any other major differences among the accounting standards boards on similar issues.

Should the discount rate be (1) the long-term expected rate (EROA) of return on invested assets to the extent that current and future expected assets are projected to be sufficient to make benefit payments, and (2) a high-quality municipal bond index rate otherwise?

[Such a discount rate] would work against the objectives of accountability,

Needs and Risks Committee in the United States and the Pension Advisory Task Force in Canada

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20 / 20 Web site

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Calendar of Events

decision usefulness and assessment of interperiod equity. It would do so by requiring a metric that fails to represent faithfully the economics of the plan and sponsor and thereby would work against effective governance and plan management.

[Most large, well-funded pension plans would be using the EROA and we confine our remarks to that case.]

Most large pension trusts have substantial portions–often more than 50 percent–of their assets invested in equities and equity-like assets. Expected returns on the assets are usually higher than expected returns on bonds from the same issuer precisely because the returns on the underlying securities are more uncertain, or riskier, and market participants demand greater expected returns to compensate them for taking additional risk. The difference between the expected return on risky assets and the expected return on riskless assets is known as a "risk premium." Hence, the EROA rises as the actual or anticipated percentage of equities in the trust fund rises. The PV justifies using the EROA as the discount rate as follows (Chapter 4, Paragraph 16):

> *To the extent that plan net assets available for pension benefits have been accumulated to date in the pension plan and are reasonably expected to grow during the time when benefit payments are being made from those assets, the Board believes that the present value of the employer's projected sacrifice of resources is effectively modified (reduced) by the expected return on investments.*

We disagree with this logic primarily because it implies that either (1) the risk of equities underperforming the expected return is minimal, or (2) there is no implicit cost to the risk that equities underperform the expected return. In reality, the EROA is an expected value, not a certainty (or even as probable as the expected return from a matched portfolio of bonds) and there is a cost to assuming the risk of underperformance. A discount rate based on the EROA of the actual portfolio, therefore, typically understates the liability by the amount of the assumed future risk premiums.

To develop a discount rate that does not understate the liability, the discount rate should be based on the characteristics of the liabilities, rather than those of the assets. Pension liabilities are most similar to fixed income investments because of the relatively predictable nature of the future benefit payment streams and the nearly guaranteed status of those benefit payments. A discount rate based on yields on fixed income investments of quality and term structure similar to the liabilities meets the GASB's criterion of being "reasonably expected to grow" into the liability value and is independent of future investment decisions and events.

We present below several common situations in which using an EROA as a discount rate would work against effective governance, plan management and common sense.

Example 1: Assessing the Level of Government Debt

Accurate assessment of the level of government debt is an important piece of information in assessing interperiod equity and accountability, and is decision useful for any decision regarding the level of government debt.

In our view, a discount rate based on the EROA is a poor choice for determining the value of the liability. The pension obligation is a form of debt. It differs from the employer's tradable debt (publicly traded bonds) in several significant respects–it often has constitutional protections that make it senior to the employer's tradable debt, benefit payments are subject to income tax while debt service usually is not, it includes some demographic risks, and (of course) it is not tradable. These considerations suggest modifying the employer's borrowing rate towards a default-free rate of return. In today's economic environment, we would expect to see effective rates under this approach of something like 3.5 to 4.5% as opposed to today's average rate of close to 8%.

Using a discount rate so much higher than the rate used for other government debt–both on the financial statements as well as in the market for tradable debt–creates inconsistencies and underpricing of the pension obligation.

Example 2: Assessing Compensation Costs

Plan sponsors must know the annual cost of benefit accruals if they wish to assess their total compensation costs and the costs of individual pieces of compensation. For example, in collective bargaining situations, negotiations often involve trading wages for benefits as well as negotiating the value of total compensation.

Use of the EROA is not appropriate for this purpose for much the same reasons that it is not appropriate in determining the overall indebtedness of the employer with respect to the pension plan. The cost to the employer of promising to make a future payment to an employee depends on the specific conditions of the debt (e.g., constitutional protections, taxability to the beneficiary, existence of an investment trust). It does not depend on how the employer plans to invest the trust assets. Because of the near-guaranteed nature of pension benefits, their cost is most appropriately measured with a correspondingly low discount rate. To the extent the pension benefits are priced with a discount rate based on the EROA, the employer is taking investment risk without getting anything in return from the employees. In fact, this underpricing of pension obligations may be one of the reasons why employees in the public sector have much more generous pension benefits than employees in the private sector (employees and unions understand the valuable nature of guaranteed benefits, but employers underprice them). Thus, use of the EROA to measure pension cost in a period leads to mismeasurement of the cost of services.

Example 3: Asset Allocation Studies

Many plans use asset-liability modeling (ALM) studies as the primary quantitative analysis for determining their asset allocation. For asset allocations that reduce expected return as well as risk, using the EROA as the discount rate causes an immediate increase in the liability and decrease in the funded status. This result–a reduction in risk resulting in a decline in funded status–creates a structural bias against an asset allocation that reduces expected return, even as it reduces risk and volatility. Thus, using the EROA to discount the pension obligation makes it difficult for plan sponsors to de-risk because of the negative impact on reported funded status.

In fact, a change in asset allocation should have no immediate effect on funded status (i.e., the value of assets is unchanged and the value of the liability does not depend on the allocation policy of the trust fund). As a result, we believe a discount rate based on the EROA is not decision useful for determining asset allocation.

To be more decision useful in this context, the discount rate should be independent of the EROA, such as one based solely on fixed income yields. With this method, funded status would increase or decrease based on actual, not expected investment performance, and would only do so after such performance occurs.

The above examples illustrate how discounting the pension obligation using the EROA tends to mislead users, encourage unnecessarily generous compensation, discourage appropriate risk management of investments and encourage transactions that have no intrinsic economic value. These are surely among the reasons why virtually all other accounting standards boards have been moving away from using the EROA as the discount rate, and instead using fixed income yields.

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SOCIETY OF ACTUARIES

PENSION SECTION NEWS

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THE POST-RETIREMENT NEEDS AND RISKS COMMITTEE IN THE UNITED STATES AND THE PENSION ADVISORY TASK FORCE IN CANADA

A PSN Interview of Anna Rappaport and Monique Tremblay

Pension Section News *was privileged to conduct a recent interview with two highly recognized private sector actuaries in the United States and Canada, Anna Rappaport (U.S.) and Monique Tremblay (Canada). Anna and Monique each lead a strategic research and communications group that looks at aspects of retirement from a broader, more employee-focused perspective than what most of us, as external or internal pension consultants, regulators or technicians, normally see in our day to day practice. Here, then, are Anna's and Monique's responses to a series of questions posed to them. Their responses and opinions expressed are predominantly their own, and are intended to stimulate our thinking on the issues discussed, rather than to put forth official positions of their groups or of the professional organizations (SOA and CIA) that sponsor them.*

PSN: How, when and why did your respective groups come into existence, and how have your mission and/or your activities changed over the years?

RAPPAPORT: In the mid-1990s the Society of Actuaries had a Research Project Call for Papers called the "Retirement Needs Framework." Our goal was to understand data sources and modeling for the post-retirement period and provide information to help actuaries in dealing with the post-retirement period. We observed that most of the focus had been on the accumulation phase, and we needed a more balanced focus.

We discovered that it was not as easy as we'd hoped it would be and that we needed more work to help us deal with the post-retirement period. After two or three projects, our initial task force became the "Committee on Post-Retirement Needs and Risks." If I recall correctly, by this time, I had completed my term as president of the SOA, and I became chair of the

Needs and Risks Committee in the United States and the Pension Advisory Task Force in Canada

LINKS

SOA Pension Section Web Page

20 / 20 Web site

Contact the Editor

Calendar of Events

committee at its formation.

Over time, the committee evolved to set up its main recurring project, the Post-Retirement Risk Survey. This survey has been completed in 2001, 2003, 2005, 2007 and 2009 and results are on the SOA website. Each year we also undertake other projects and our website shows the results of all completed projects.

The committee membership gradually grew, and now includes interested parties and full members who can join projects and access all information. Planning is once a year. The interested parties group represents a wide variety of professions, such as actuaries, people from research and trade groups, financial service organizations, retirement consultants, plan sponsor representatives and some policy people. In addition, we have a group of academics from the fields of actuarial science, law, economics, demography, financial planning, anthropology and a few other fields.

TREMBLAY: Until the spring of 2009, the Canadian Institute of Actuaries (CIA) was addressing emerging pension issues through its regular operational modes, including the creation of task forces to look at specific needs in terms of public policy interventions. At that time, the Board identified the need for a more concentrated effort on public policy interventions in the pension area, at a time when all but one of the pension actuaries on the CIA Board were at the end of their mandates.

The Pension Task Force was thus created, with specific tasks assigned for short term. This led, among other things, to recommendations on the retooling of the private sector pension system, and a White Paper on government-facilitated pension plans. There had been discussions about pension reform in Canada for a while, but the financial crisis certainly acted as catalyst to reopen discussions on several fronts.

In the spring of 2010, all tasks so assigned were either under way or completed, but the need to keep proactively involved in the pension debate remained more pressing than ever, and the task force mandate was realigned towards an advisory role, helping the CIA react more quickly and ensure consistent alignment of positions resulting from the activities of the various committees working in the pension field. We anticipate remaining quite active during the coming months and years. It provides a status report to the CIA Board at each of its meetings.

PSN: How did each of you gravitate toward leading or coordinating the efforts of your respective groups?

TREMBLAY: The importance of financial literacy and financial empowerment for individuals has always preoccupied me. As a pension actuary at Towers Perrin, I always enjoyed working with the communications consultants to ensure that the pension plans I was involved in were well understood by both sponsors and participants. In the mid-90s, I got involved in the development of illustration software tools to project retirement income under various scenarios and to help participants who had to select between a defined benefit plan and a defined contribution plan.

A few years later at Desjardins Financial Security, I became the spokesperson for the firm's Retirement Survey, where each year the company measured various facets of financial preparation for retirement, and I was also responsible for the line of business providing group retirement and individual savings solutions.

During that period, I was also on the Board of the CIA, which allowed me to bring these concerns forward and help the profession get more involved in ensuring that the Canadian retirement system continues evolving and retains its place among the best in the world.

RAPPAPPORT: I first became interested in focusing on demographic change and helping financial systems respond to demographic change in the early 1970s, and this was a primary focus when I was at Equitable Life in New York from 1973-1976. That interest was also one of the reasons that I think Mercer asked me to join them in 1976, and I stayed with them until the end of 2004.

My interest in demographic change and retirement security was reflected in many activities. The role of the actuarial profession in dealing with the aging of society was a major focus of my SOA presidency. The formation of this committee was a continuation of that interest and work. One of my other big interests was in getting the actuarial profession to work jointly with other professionals and academics, and to use multi-disciplinary teams to think about common concerns. In the mid-1990s, before I was elected president of the SOA, with the encouragement of my predecessors, Sam Gutterman and David Holland, I reached out to other benefits research and education groups and collaborated with the SOA on many of these outreach efforts. That work has continued for many years and was another theme of my presidency. It has influenced the work of my committee as we have a very wide ranging membership including people from inside and outside of the profession. Virtually every project has a multi-disciplinary project team, which has resulted in richly-conceived, multidimensional ideas potential solutions.

PSN: Do your groups have formal (funded) sponsorship, and if so, who are your principal sponsors? Do you have a paid staff, volunteers or both? How were the groups assembled?

RAPPAPPORT: My group is supported by the SOA and we work with Andrew Peterson (staff fellow, retirement systems) and Steve Siegel (research actuary)–Andy for moral and strategic support and Steve for design and getting research projects under way.

The group was assembled over time. I have asked people I've met who I thought would be good if they were interested, some people from the Pension Section have joined, people from the old Pension Research Committee have joined, and other people have volunteered due to the good coverage and reputation that we've developed within both the SOA and other professional and academic circles.

TREMBLAY: The CIA operations rely almost exclusively on volunteers. What has worked well for us in recent pension projects is that we've attempted to create task forces with a clear and definite mandate to be delivered over a fairly short period of time. We've also counted on the able assistance of Chris Fievoli, CIA resident actuary, to "hold the pen" and assist in the drafting of the papers produced by our task forces.

PSN: Can you describe, either explicitly or implicitly, a basic organizational and/or governance structure for your group? Can your group's organizational structure be "Org-Charted," whether formally or figuratively? Do you have a formal or informal succession plan in place?

TREMBLAY: Our task force is temporary by nature, and is there to address current, pressing public policy issues. In its March 2010 realignment, the task force was comprised of four actuaries, plus two members from the CIA Secretariat to cover the communications and information flow on the topic. We added two actuaries in the fall to help identify and address new issues, and in recognition of the need for a better connection between our CIA initiatives and analogous initiatives by the SOA in the United States–e.g., *Retirement 20/20* and Anna's Committee on Post-Retirement Needs and Risks.

It is understood with the Board that our task force, in each of its status reports, will include a recommendation as to the need to maintain and/or modify/terminate its mandate.

RAPPAPPORT: My group has a long list of names. At present it has no co-chair, although it has had at some times in the past. Once a year we hold a planning meeting, and about 15 to 20 people usually attend. Project teams are formed and anyone on the mailing list can join. The mailing list now has over 100 names on it.

PSN: What are your formal and informal ties to actuarial, regulatory, industry, academic and other (e.g., think tank) groups or organizations in your country?

RAPPAPPORT: I was appointed to the Department of Labor's ERISA Advisory Council in early 2010 to serve from 2010 to 2012, representing actuarial counseling. I also serve on the General Accounting Office's Retirement Security Advisory Panel. Prior to my appointment to the council, I testified four times in the last few years.

I am on the Board of the Women's Institute for a Secure Retirement (WISER) and provide informal assistance to that organization's president throughout the year. I have served on some project advisory teams for them. I am on the Pension Research Council (connected to Wharton at the University of Pennsylvania) Advisory Board and been involved with this for many years.

I am a member of the National Academy of Social Insurance and previously have served as membership chair, and previously was on the Board of NASI. I am very involved with two networks of senior women in Chicago and with a task force at the Bar Association which deals with issues of women as they age. I also write and speak a lot, as do many of the other core and advisory members of our committee. Others in our group also serve in some capacity in many of the above (and other) organizations.

TREMBLAY: The CIA has a formal follow-up system and regular meetings with various government and private stakeholders involved in all aspects of the actuarial profession's many activities.

Notably, our task force was involved in extensive public policy meetings and interventions in the last two years, and has identified and trained a group of actuaries across Canada to act as official spokespersons on the issues and views of the CIA in the pension area, allowing us to respond very quickly to requests for information and meetings to discuss emerging issues.

PSN: Could you each give us a brief overview of the multi-pillar retirement security systems in your respective countries?

TREMBLAY: The first pillar in Canada is a residency-based universal benefit paid out of general revenues. It is "refundable" for higher income Canadians, and supplemented by a means-tested income for lower income citizens. There is also a public earnings-based DB pension plan for all employed and self-employed Canadians, which provides retirement, disability and survivor benefits on earnings up to average industrial wage, with a normal retirement age of 65 and reduced early retirement benefits available from age 60.

Employer pension plans (second) pillar is also an important component of the Canadian system, regulated by the Income Tax Act and provincial legislation, except for federally regulated industries such as banking, transportation, etc. There are a variety of tax-assisted plans, with defined benefit plans for a good proportion of civil servants and for some employees of larger and more mature industries. There has been a significant trend towards defined contribution plans for smaller industries/businesses and/or future service in several traditionally DB-based plans. Legal complexities may lead to employers not contributing themselves but just providing access to tax assisted savings programs that are not subject to pension legislation, and finally, small businesses typically offer no plans to supplement the federal and provincial government-mandated programs.

The third pillar, private savings, is extremely important to the attainment of adequate total retirement security, particularly for middle income Canadians, but it is the area where most challenges are observed, despite the availability of tax incentives, and a wide spectrum of solutions are offered by financial institutions.

RAPPAPORT: The current U.S. system includes Social Security (Pillar 1) which covers virtually all private sector workers and many public sector workers. Benefits are paid as monthly income with survivor benefits. Disability, spouse and dependent child benefits are also paid. Full retirement ages have gradually been raised over the past three decades, and are scheduled to reach age 67 for people born after 1960.

A portion of the workforce have a next layer of benefits (Pillar 2) in a contributory or non-contributory employer sponsored pension plan, which might be DB or DC. DB plans are generally in decline. Public sector workers very often have DB plans, but they usually require employee contributions. In some cases, they supplement Social Security and in others they replace it.

The next layer (Pillar 3) is employee savings, which can be provided through an employer sponsored program on a tax preferred basis (401(k) and its offshoots), or by the employee him/herself, through vehicles independent of the employer, whether tax preferred (traditional or Roth IRA's etc.) or taxable (brokerage accounts, money market funds, bank savings).

PSN: What do you see as the principal "mega trends" in North America's retirement income security programs and in the larger arena of general retirement security systems here and abroad? Are any of these good trends, or are they predominantly negative? Is there any low-hanging fruit to be picked for quick, effective improvement of the systems?

RAPPAPORT: Underlying many of the changes is a shift of risk to individual employees, a move by employers to manage and limit their own risks, and a tendency on the part of employers to better contain their corporate spending for retirement benefits.

The biggest long term trend is the shift from DB to DC. Some employers have terminated their DB plans and then shifted to DC. Many others have frozen DB plans or closed them to new entrants, using DC as the major vehicle for future accrual of benefits.

Another major trend, which is closely related, is the move to more frequently allow payment of benefits in the form of lump sums.

TREMBLAY: Most of the points raised by Anna in relation to the United States are also true, at least to some extent, in Canada.

We are also facing decisions on the public programs, as the actual average retirement age is not much over 60 on a national basis. In addition to the cost of the plans, there is a manpower issue due to demographic changes in the workforce. We must attempt to retain employees in the workforce longer, and also change behaviors in retirement age and in use of the retirement system's various features.

PSN: What are the top three things that need to be changed from a macro perspective in order to create an environment that is more conducive to positive changes in the retirement security arena?

TREMBLAY: These are my personal views, although several of them are taken from various CIA works and positions over the years, and you will definitely recognize some of the themes.

The greatest challenge I see is one of cultural change. We need to change society's views and attitudes about retirement and find new ways to make retirement policy and personal practices remain consistent with the evolving realities of increased life expectancies and emerging labor force shortages.

Uniformity, or should I say, lack of uniformity, is a big irritant in Canada. Pensions are provincially regulated, and the public programs are managed predominantly by two entities, the Canada Pension Plan and the Quebec Pension Plan. So far, the provisions and management have not differed in many materially significant ways, but demographic and political pressures are likely to lead to the creation of more significant imbalances. We are also operating in a rules based environment, which makes it difficult to come up with innovative designs and solutions, so uniformity, simplicity and principles-driven are key concepts that we constantly repeat to governments and politicians on every possible occasion to create a more favorable and viable environment for retirement income and pensions.

Finally, responsibility for overall retirement income adequacy is key. It is my opinion that it is ultimately an individual responsibility, but making maximum use of all available tools and means, which come from various sources, including governments and employers, is a big part of the system's success going forward.

RAPPAPORT: These are my personal opinions, and not necessarily those of any particular organization or committee. The policy environment in the United States has been difficult, unstable and unfriendly to DB plans for a long time. Litigation and the accounting environment have been challenging as well. A more friendly and stable environment would be step 1, and a national retirement policy that is coherent and makes sense would certainly go a long way toward achieving this goal.

Underlying many of the problems is the inability of diverse stakeholders to work together and to reach mutually tolerable compromise. Until those with different perspectives learn to do this, the unstable environment is likely to continue.

We need a more sensible and integrated focus on the post-retirement period. And I also think we need some new options for risk sharing. DB plans place nearly all of the risk on employers and DC place virtually all of the risk on employees. We should think about new options under which risk is more of a shared concern, and under which the various risks are evaluated and managed by those who are most informed and skilled to handle them.

PSN: What are your / your committees' official or implicit views about the "paternalist" vs. "individual responsibility" approaches to retirement security? Is one more important/effective than the other, and why? Should there be an effort to lessen the distinction between these two approaches? If so, what are your committees doing to promote this convergence?

RAPPAPORT: The SOA Committee on Post-Retirement Needs and Risks does not take positions on different philosophies. We do however encourage more focus on the post-retirement period and systems to help manage post-retirement risk.

Our committee seeks to understand and communicate the reality of individual understanding and knowledge, and the limits of individual action. We try to identify strategies that will work well given the realities. In more than ten years of work, we have discovered that it is much easier to understand problems than agree on solutions. It has become very clear to us that there is a lot of difference of opinion on the "right solution" in different situations.

TREMBLAY: The Canadian Government has created a Task Force on Financial Literacy, as it sees a need to formalize and better equip Canadians to ultimately look after themselves.

In Canada, the profession does not have a definite position on the question of who is ultimately responsible for providing income security in retirement, but we recognize the fact that about a third of Canadians, mostly middle income earners, have not saved enough for retirement, as demonstrated by various studies and publications.

There are quite a number of approaches available at this time, but the fact is that these individuals don't save enough. Nobody seems to have a complete understanding of the why, and at the same time, all kinds of stakeholders take very strong and often polarized positions on solutions and remedies to this situation. It is hard to ensure that we are not just replacing one issue by another, so our task force is trying hard to identify critical success factors in any undertaking towards improving/fixing the Canadian retirement system.

The emphasis so far has been mainly on making sure Canadians retire at the right time with appropriate financial security. A lot more time and energy needs to be spent on longevity and other post-retirement risks, and ensure that the financial system is there to support Canadians at all stages of their retirement. The SOA's *Retirement 20/20* initiative has generated a lot of compelling and thought-provoking material, and many of their findings and approaches are pertinent to the Canadian situation as well. The challenge is to remain focused while addressing all important parameters of the equation.

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