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Pensions

A. For employers with less than 25 employees, what pension arrangements have been found to be efficient from marketing, actuarial, and administrative standpoints?
B. What are the different problems involved in investing for an insurance company and for a private pension fund?
C. What is the influence of the following factors in insurance company operations on the relative advantages of trusteed pension plans and insured plans:
  (i) Federal income tax?
  (ii) "New money" investment income allocation?
  (iii) Increasing investment returns?
  (iv) Separate accounts or affiliated trust funds enabling insurance companies to invest in equities?
  (v) More liberal guarantees?

MR. JOSEPH B. CRIMMINS reported on the recent development by the Metropolitan of pension plans for small groups. Like life insurance and health benefits for groups of less than 25 lives, which Metropolitan has offered since 1957, the small pension arrangement is sold and serviced through regular agents. It was felt that this marketing method called for a relatively standardized approach, allowing for some individual variation but keeping such variation to a minimum. The contract employed is a special form of unit-purchase group annuity, with standardized benefits and contributions and with simplified billing.

The employer can choose between several standard schedules for future service benefits, employee contributions and past service benefits. The agent is in a position to develop a plan, illustrate benefits, and make cost estimates, all without home office assistance. Only at a late stage is the case referred to the home office for underwriting approval. Administration is in the same unit that handles insurance programs for small groups.

Should the Senate version of the Simpson-Keogh bill become law, Mr. Crimmins felt that rather drastic changes in the program might be necessary to meet the requirements of that bill regarding coverage for owner-employees. If it appears that these changes would remove much of the incentive for coverage, or substantially increase the administration cost, there is a possibility that the program might have to be abandoned.

MR. LOREN G. LOGAN reviewed the history of the Continental's group permanent plans aimed at the medium sized corporation and offered since 1943 on participating retirement income and ordinary life forms. A good volume of this type of group pension business was written.

More recently it has been necessary to look to the smaller employer, since medium sized prospects have dropped off. For this new market the

Continental expects to continue the group permanent path. Group annuities do not contain adequate margins for commissions and expenses, and liberal death benefits are popular among small employers. Continental prefers group permanent to individual policies because of more familiarity and experience. Group permanent for small employers has produced satisfactory increase in surplus.

MR. STUART J. KINGSTON stated that his company, National Life of Vermont, is active in the small and medium pension field on an individual policy basis. He has found that the smaller the plan the more variation from a standard plan is expected. This may be because a large percentage of the premium on the typical small plan is for the benefit of owners, who are rugged individualists as a rule.

Since the small employer is vitally interested in death benefits, Mr. Kingston felt that a death benefit at least equal to the values contributed is necessary for small plans. Such a feature eliminates any mortality discount.

MR. JOHN K. DYER, JR. commented that British consulting actuaries have to an increasing extent been moving into the field of investment counseling largely because of the widespread use of individual rather than corporate trustees. In view of the contrary development in the United States and Canada he would not expect a similar extension of activity by consulting actuaries on this continent, where he felt the consulting actuary has enough headaches already.

As to the investment for a private pension fund as contrasted with investing for a life insurance operation, Mr. Dyer saw a difference in objectives. While security is a major objective in either case, the concept of security is quite different.

Mr. Dyer felt that the insurance company is investing reserves as security against a contractual dollar guarantee, with investment results more favorable than those originally anticipated a secondary objective. He saw the pension fund trustee with the broader objective of a pension which will be adequate in the light of conditions prevailing at the time the pension is paid.

Mr. Dyer felt that the difference is that the employer who adopts a trusteed plan, and arranges his investments to produce substantial appreciation under conditions which produce pension inadequacies, is attempting to solve two problems—that of meeting the specific obligations created by his present plan, and the problem of future improvements as they become necessary. The employer who adopts an insured plan is satisfied to tackle only the first of these problems, leaving the second to be taken care of when it arises. The latter employer reasons that there are better

ways of providing for future plan improvements than attempting to build them into a pension fund which first of all must provide for pension guarantees. He may feel that future improvements are prerogatives for future management. No one can say which employer is right; it is a matter of management philosophy.

MR. C. L. TROWBRIDGE pointed to some important differences in the environments within which investment departments of insurance companies and managers of uninsured pension funds operate.

One of these is the legal difference. Just as the investment policy of the insurance company is not entirely up to its own management, but is influenced by certain state laws, the investment policy of the uninsured plan is not entirely up to the nominal fund manager (usually the trustee), but is to an extent influenced or controlled by the maker of the trust.

A second difference, according to Mr. Trowbridge, is a by-product of the legal difference. Unlike the insurance company investment department, the pension fund trustee may be subjected to pressures from employer or union to apply other-than-investment considerations. This can lead to mediocre investment results.

Mr. Trowbridge also discussed:

(1) the advantage of fund size, permitting investment in private placement securities and in mortgages;
(2) the timing difference, contrasting continuous investment activity in the insurance company to sporadic investment by the trustee; and
(3) a psychological difference, arising from the fiduciary sense of the typical trust officer.

Mr. Trowbridge stated that these environmental differences give rise to the following typical differences in type of investment:

a) Portfolios of the major life companies today are predominantly in mortgages and private placement bonds, with publicly offered bonds a poor third.
b) Uninsured pension plans invest heavily in publicly offered securities, both bonds and stocks, not infrequently in the stock of the employer. The largest plans are active in the private placement market, but more typically these arrangements are too large and require too much investigation for the private pension fund. Even the large pension funds have done little in the mortgage area.

Mr. Trowbridge indicated that the picture might look different in the future. We are seeing new legislation which may have the effect of getting more life company funds into the stock market, especially for the pension policyholders. We are seeing the development of common trusts intended to increase the size (and at the same time diluting the control) of uninsured pension funds. Some trust funds are beginning to get interested

in real estate mortgages. For these reasons Mr. Trowbridge stated that he thought the differences might be expected to diminish.

MR. B. RUSSELL THOMAS discussed the differences in investing for an insurance company and for a private pension fund under three headings, (1) the nature of the liabilities, (2) statutory restrictions, (3) accounting procedures.

As to the nature of the liabilities, Mr. Thomas pointed out that contracts of life insurance companies call for the payment of specific amounts upon maturity of the obligation, and that therefore it is logical to invest reserves in fixed income securities. Once reserves have been invested at a rate of return at least equal to the return assumed in computing premiums, there are two elements in the cost of insurance which may be subject to fluctuations, (i) the mortality experience and (ii) the expense rates. Mr. Thomas suggested that it might be appropriate for a life insurance company to invest in securities which would increase in value or produce greater income during periods in which mortality and expense rates increase.

The nature of the liability under a private pension plan, especially if benefits are based on the employee's final 5 or 10 years compensation, indicates to Mr. Thomas the investment of a significant portion of the pension fund in assets that tend to increase in value as the general level of compensation of employees increases.

As to statutory matters, Mr. Thomas stated that the laws of many important states have the effect of limiting life insurance company investments in common stock to much less than the average percentage in private pension funds. Most pension trust agreements by their own provisions are exempt from any statutory restrictions otherwise imposed on the trustee.

Mr. Thomas's remarks on life insurance accounting procedures centered around the necessity of valuing stocks at market value. Downward fluctuations in market value of stocks could result in loss in surplus if a substantial portion of the total portfolio were in stocks. Some of such loss may be absorbed by the mandatory security valuation reserve, but this reserve would not likely be sufficient to absorb possible stock losses if the stock percentage were to rise to 10 to 15 percent.

The pension fund trustee is not obligated to value on a market value basis, so virtually all pension trust fund assets are valued at cost. Mr. Thomas stated that there might be greater reluctance to invest in common stocks if market value accounting were required.

MR. PHILIP D. SLATER, commenting on section C, reviewed the effect of the new federal income tax law as it applied to insured pension

plans. By 1961 the new law should eliminate a major fraction of the tax, thus tending to remove the disadvantage currently existing under insured plans.

As to the "new money" investment income allocation, Mr. Slater pointed out it could be done by line of business only, by contract within a line of business, or both by line and by contract. A number of companies have adopted this method, and others are considering it or awaiting insurance department approval. This approach gives a more accurate allocation of investment income. The result of the "new money" approach is that investment results are more comparable with what would be obtained if insured assets were segregated. It tends to equalize performance of insured plans as compared with trusteed plans.

Increasing investment rates are beneficial to all types of funding, according to Mr. Slater. A significant feature of recent investment conditions has been a more rapid increase in interest rates on mortgages and bonds than on stocks. In view of recent weakness in the equity market, the investment picture for insured plans is attractive at the present time, especially if the "new money" basis of allocation is being used.