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Chairperson's Corner

by Carolyn E. Zimmerman

At the risk of stating the obvious, I am becoming more and more concerned about the trend toward "do-it-yourself" pensions—defined contribution and hybrid plans, IRAs, lump-sum distributions, and so on. I am certainly not the first—nor the last—person to comment on this, but I see this as a crisis in the making as more and more retirees are dependent on their own ability (and discipline) to manage a portfolio to provide lifetime retirement income.

We've seen many employers change to defined-contribution or hybrid plans. We have seen employees embrace these even though they may be receiving smaller benefits, because while they do not understand the value of their defined-benefit pension they can see the value of their defined-contribution account increasing year after year. (In the words of a recent Presidential candidate, they can "see it, touch it, feel it!") I had one client who changed from a defined-benefit to a defined-contribution plan and some of its older

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Excerpts from the PBGC Actuarial Valuation Report—1997 Fiscal Year

Editors Note: *The 1997 Annual Report of the PBGC and the complete 1997 Actuarial Valuation Report, including additional actuarial data tables, are available from Loretta Berg at the PBGC, 202–326–4040, upon request.*

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The 1997 Annual Report of the Pension Benefit Guaranty Corporation (PBGC) contains a summary of the results of the September 30, 1997 actuarial valuation. The purpose of this separate Actuarial Valuation Report is to provide greater detail on the valuation of future benefits than is possible in PBGC's Annual Report.

Overview

The PBGC calculated and validated the present value of future benefits (PVFB) for both the single-employer and multiemployer programs and of non-recoverable financial assistance under the multiemployer program. For the single-employer program, the liability as of September 30, 1996 consisted of:

- $10.50 billion for the 2,500 plans that have terminated
- $2.59 billion for 23 probable terminations.

Liabilities for "probable terminations" reflected reasonable estimates of the losses for plans that are likely to terminate in a future year. These estimated losses were based on conditions that existed as of PBGC's fiscal year-end. It is likely that one or more events subsequent to PBGC's fiscal year-end will occur, confirming the fact of the loss. In addition, the liability for reasonably possible terminations has been calculated and is discussed in Note 9 to the financial statements on page 37 of PBGC's 1997 Annual Report. A 10-year forecast of PBGC's financial condition is discussed on pages 18 and 19 of that report.

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challenges facing small business are also important. New businesses have a high rate of failure, and nothing done for pensions will change that. Easier access to IRAs was seen as a way to compensate.

Discussions on lump-sum distributions showed much disagreement. There is concern about leakage, but at the same time, many believe that people should have the right to use their money any way they want. There is disagreement about whether or not using money to buy a house will support stronger retirement assets. This issue also was discussed by the 1992 study group.

Another contentious issue was the plight of lower-income individuals. Some delegates thought that it was unrealistic for people with incomes below a certain amount to save, whereas others thought that education, incentives, or both would work. It was clear that ideas about an appropriate social safety net, while not discussed in the sessions, were radically different. Those whose primary concern was adequate retirement resources for minorities, women, and lower-income persons see the safety net as absolutely vital.

We saw some exciting examples of good communication about savings programs, but we also heard some warnings from the audience—specifically, that we need to be careful not to use too-high rates of return in our calculations and thereby over-promise wealth through saving. I saw some disconnects in the discussion about communication: An employer example presented was extremely tailored to the culture of the company, while the discussion focused on generic, widely available material; the employer clearly stated that success was tied to communicating for the culture of the company.

Did the summit line up well with my view on these issues? My answer has to be "yes" in some areas, but "no" in others. I think savings education is very important and that people must save more. Policy changes to encourage more savings also may help us meet objectives. Here we must be clear about our objectives. If our objective is to raise the aggregate of national savings, incentives could do that, but the most promising changes may be targeted at the higher-income 50% of the population. If our objective is to improve well-being in retirement, particularly for those not served well by the system today, we need to look to very different changes.

Our first goal must be to improve the wages and labor force participation of that part of the population and then to focus on incentives that will encourage more benefits and savings for that group. Raising limits on tax deferrals addresses the first objective but not the second. We must not pretend that savings education, tax incentives, or both will remove all the challenges to retirement security. The safety net is very important.

There was some focus on defined-benefit plans in the opening discussion, but not much in the breakout group I attended. These plans deserve more discussion because they offer a way to provide a base layer of benefits for employees with long service. (Of course, one key question is whether many people will reach long service with a single employer.) There was some focus on multiemployer plans, and certainly this is a concept to consider when exploring ways to offer security to people who stay in a profession but change employers. TIAA-CREF was suggested as a model.

Several members of Congress focused on their attempts at regulatory and legislative change. There is certainly support, in at least some quarters, for positive change in pension law.

The summit was a personally interesting experience, and I was proud to be part of it. Delegates have gone home with the impressions of the summit, and there are many pension policy proposals being considered in Washington. I hope that when the next SAVER Summit is held two years from now, I can say that we who attended the 1998 summit accomplished good results.

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employees complained because they were "grandfathered" under the defined-benefit plan. They didn't understand that meant they got the better of the two benefits—but given a choice they would have taken the defined- contribution plan without question!

But think about this—the plan participants who welcome a defined-contribution plan because they don't understand the value of their defined-benefit pension are the same ones we are asking to understand how to make an account balance provide enough income for the rest of their lives. Very often a retiree's account balance represents more money than he or she had access to during working years, which can lead to unrealistic expectations and false security.

I recently received an e-mail from my uncle, who is thinking about retiring when he reaches age 55 (five years away). By then, he expects to have the massive sum of $150,000 in his 401(k) account (his only retirement plan), and he wanted advice on how much he could draw out of the account each month. Clearly, he had no idea how quickly $150,000 can disappear! (Nor did he realize how little comfort he would get from the luxury conversion van he bought with his lump-sum distribution 10 years ago.) Unfortunately, we have all heard countless stories like his.

To make the situation even more difficult, more and more companies are transferring the responsibility for medical coverage to their retirees. As we have all seen, once employers became aware of the cost of this coverage (because they were forced to account for it under *FAS 106*), they realized they could not afford it. If employers didn't

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understand the cost of lifetime medical coverage, the typical employee has little chance to understand it and plan for it.

I often wonder what will happen when the infamous "baby boomers" begin to reach retirement age and realize how much of their retirement income depends on their own financial expertise. At least Social Security provides guaranteed income for life—but with recent proposals to take Social Security to a defined-contribution approach, we could lose that safety net as well.

We have enjoyed incredible returns in the market over the past few years, boosting retirement savings and affluence in general; however, much of that is ascribed to baby boomers fueling the market with their investments. Obviously, there are many other factors as well, but if the baby boomers help to fuel a market now, what happens when the net cash flow reverses and the baby boomers take money out of the market instead of putting it in? If they are responsible for the boom, they could also be responsible for a bust—just about the time they need the money for retirement.

So what happens then? I can easily see the situation of them pressuring their employers for defined-benefit guarantees when they try to retire and realize what they're facing—but will employers be willing or able to reshoulder that responsibility?

As pension professionals we are in a better position than most to work toward a solution—but again, there aren't any easy answers. I can't in good conscience ask my clients to maintain a defined-benefit plan when their competitors are not—and when their employees might have more appreciation for a defined-contribution plan. I would be the last person to suggest that the government step in and force employers to provide a guaranteed pension or that our taxes be increased (even more!) to provide income for retirees who squander their account balances (or never had enough to start with!). Yet I would also be the last person to suggest that we abandon those retirees who are unfortunate enough to run out of money.

There are no easy answers, but some of the best answers probably lie in education, making sure that employers understand and are comfortable with the risk their employees are taking as pensions move toward defined-contribution approaches, strongly encouraging education programs geared to help employees with investment decisions, and/or encouraging employers to pay fees so that employees can consult investment professionals. We can also make our legislators aware of our opinions and concerns through the various committees maintained by the American Academy of Actuaries. Please write our editor with your thoughts. We would like to hear from you!

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A Paper to Note

Retirement Age—Increasing or Phasing out?

In our work with pension plans over the years, we have witnessed a decline in age at retirement. In the paper "Retirement Trends and Patterns in the 1990s: The End of an Era?" Joseph Quinn documents this trend and also points out that it may be changing. Over the last 10 years, labor force participation rates at older ages have stabilized or even increased. In addition, the paper reviews some of the influences that may be responsible for a shift in the trend. One explanation is an increasing tendency for workers retiring from full time jobs to take part-time, "bridge" jobs before leaving the workforce entirely. Perhaps a single age at retirement is a thing of the past. The paper appears in Volume 8, Number 3 of *The Public Policy and Aging Report*, Summer 1997, published by the National Institute on Aging.

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Editor's Note: *"A Paper to Note" is sponsored by the Committee on Retirement Systems Professional Education and Development. Copies of the papers are available from the SOA library, 847–706–3575. If you've come across an interesting paper that the pension actuarial community should hear about, please contact Cathy Cimo, 847–706–3587 or ccimo@soa.org to refer your suggestion to the Committee.*

Additional Web Site Addresses

Please note the following web site addresses that were inadvertently omitted on page 6 (Online Resources for Pension Actuaries) of *Statistics for Employee Benefits Actuaries—April 1998*. These same addresses were also omitted on page 12 of the April 1998 issue of *Pension Section News*. We apologize for the omission.

American Academy of Actuaries . . . . www.actuary.org
Actuarial Board for Counseling and Discipline . . . . www.abcdboard.org
Actuarial Standards Board . . . . www.actuary.org/asb.htm