SOCIETY OF ACTUARIES

Article from:

# Pension Section News

November 1998 – Issue 38

**PENSION SECTION NEWS**
Issue Number 38, November 1998

Published quarterly by the Pension Section
of the Society of Actuaries
475 N. Martingale Road, Suite 800
Schaumburg, IL 60173
Phone: 847–706–3500
Fax: 847–706–3599
World Wide Web: http://www.soa.org

This newsletter is free to Section members. A subscription is $15.00 for nonmembers. Current-year issues are available from the Communications Department. Back issues of Section newsletters have been placed in the Society library. Photocopies of back issues may be requested for a nominal fee.

**Dan Arnold**, FSA
*Pension Section News* Editor
Hooker & Holcombe
65 LaSalle Road
West Hartford, CT 06107
860–521–8400
860–521–3742 (Fax)
E-mail: danarnold@compuserve.com

**Associate Editors**
**J. Bruce MacDonald,** FCIA, FSA, Canadian Topics
**Ho Kuen Ng,** FSA, Academic Topics and *ARCH*
**Karen Steffen,** FSA, Public Plan Topics
**Fernando J. Troncoso,** ASA, Mexican Topics

**Pension Section Council**
**Amy S. Timmons,** Chairperson
**Colin England,** Vice-Chairperson
**Sylvia Pozezanac,** Secretary
**Lindsay J. Malkiewich,** Treasurer
**Joan Boughton,** Council Member
**Bruce A. Cadenhead,** Council Member
**Adrien R. LaBombarde,** Council Member
**Martha A. Moeller,** Council Member
**Lee J. Trad,** Council Member

**SOA Staff**
**Susan Martz,** DTP Coordinator (smartz@soa.org)
**Peggy Grillot,** Online Systems Manager (pgrillot@soa.org)

Facts and opinions contained in these pages are the responsibility of the persons who express them and should not be attributed to the Society of Actuaries, its Committees, the Pension Section, or the employers of the authors. Errors in fact, if brought to our attention, will be promptly corrected.

Copyright 1998 Society of Actuaries.
All rights reserved.
Printed in the United States of America.

# The Critic's Corner

***by Joel I. Rich***

Welcome to the second installment of this new column reviewing tapes from various actuarial meetings. This installment is a review of several sessions from the SOA 1998 Spring Meetings in Maui, Hawaii.

## Session 5PD: Designing a Stochastic Evaluation/Forecast System

The discussion concerning modeling assets and liabilities reinforced the "noncommodity" nature of these projects. Issues included:

- The base period for setting your baseline assumptions (for example, stock/bond returns)
- Correlations between the various elements including economic and noneconomic functions (for example, inflation and turnover)
- The volatility of long-term projections (see my earlier note with regard to value at risk techniques which were designed to look at variations over hours, days and weeks).

The discussion reinforced to me the fact that the major value of these projects is the discussions with the client about the assumptions, interrelationships time horizons, and key client-related measures rather than the "let's take a projection methodology off the shelf, use some standardized assumptions and see what happens" approach.

## Session 6PD: Retirement Plan Consulting Challenges in the Pacific Rim

A very good review of current pension issues in Indonesia, China, and Japan. Those actuaries who have some foreign exposure (for example, foreign plans under *FAS 87*, IRS Section 404A deductions) will find this a helpful update.

## Session 64PD: "On the Way to Medicare"—Progress to Date

A very detailed discussion in the changes in the prospective payment systems (PPS) as well as Medicare Part C. While these changes will have a strong impact on retiree health valuations and costs, this detailed discussion is recommended only for specialists in retiree health valuations, especially those setting assumptions for future claims.

## Session 66PD: Strategic Asset Allocation for Pension Plans

The first speaker dealt with the more standard asset-liability modeling. His organization's approach was to minimize the present value of future pension contributions as well as minimize risk. They define risk as how bad the results are in the worst 20% of the cases. Duration matching was identified as a way to deal with these issues. Also key was the lack of symmetry because if you overfund a pension plan you can't get the money back dollar-for-dollar due to excise taxes and if you underfund, there are PBGC risk premiums. The more credible the liabilities you have in the model (for example, retirees only) the more likely you are to go into bonds under this model, whereas if you are severely underfunded, you should probably go into higher risk equities because you have to make contributions no matter what.

There was no discussion of organizations that are less concerned with the present value of future contributions than they are with accounting results or where the lack of symmetry and short-term risk factors are not considered a problem because of a desire for long-term cost reduction rather than concern over short-term fluctuations.

The second speaker spoke about applying a concept being used by financial institutions—net value-at-risk—to the pension arena. Net value-at-risk is a way that organizations with financial liabilities and assets look at the maximum expected loss for some holding period at a certain level of confidence. You can look at these in a number of ways, including Monte Carlo simulations, historical returns, co-variances, and so on. The main challenge is that these measures have been designed to look at the impact of yield changes over short time horizons. The application to longer term pension plans seems to be in its infancy.

*Joel I. Rich, FSA, is Senior Vice President at The Segal Company in New York, New York.*