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Editorial

Thoughts from a consulting (pension) actuary

by Mary Hardiman Adams

Here are a few items that consulting actuaries in the pension field are thinking about these days.

An immediate item — reaction to a proposed standard of practice

In mid-September 1992, the distribution by the Actuarial Standards Board (ASB) of an exposure draft covering "Selection of Economic Assumptions for Measuring Pension Obligations" was *fait accompli*. This draft was the result of several years' work by the ASB Pension Committee.

This standard is intended to be used to guide pension actuaries in everyday practice. It also is intended that the non-pension actuary and the non-actuary user of pension valuation reports would find information on pension actuaries' thinking processes in selecting economic assumptions for valuation purposes useful.

The technical material in the exposure draft, by its nature, is not easy to discuss. It is difficult to conclude how standard the material in the proposed standard is. It is much more difficult, however, to phrase properly an admonition that an actuary "should," "must," or "may" either "use," "think about," "consider using," or simply "be aware of" a particular item.

By November, the ASB will have held two hearings. One was in conjunction with the annual meeting of the Conference of Consulting Actuaries (CCA), October 20 in Phoenix, Arizona, and the other in Washington, D.C., on October 28, in conjunction with the annual meetings of the Society of Actuaries and the American Society of Pension Actuaries, October 25-28. The deadline for written comments on the exposure draft is December 15, 1992.

Actuaries who have not participated in the hearings or have not yet submitted written comments should be sure their thoughts, reactions, and ideas are taken into account when the ASB and its Pension Committee revisit the proposed standard.

Remember, the deadline is December 15, 1992. Send comments to the ASB at the Washington, D.C., office of the American Academy of Actuaries.

A back-burner item — increases in pensioners' benefits in a low-inflation economy

Employers have been struggling with medical cost-containment and coping with compliance with FAS #106. For defined benefit plans in low funding ratio situations, there has been the matter of fulfilling minimum funding needs and paying PBGC premiums.

Very little activity has been observed recently in looking at the adequacy of pensions in payment. Here and there, a few companies have granted modest increases, and some negotiated contracts provide increases. Why bother? Who can afford it?

Inflation, as measured by the CPI-W, is now about 3% (3.2% on the CPI-U). This is perceived as low, and it is. But an inflation increase of 3% for five years would erode a flat dollar pension by some 14% (for 10 years, the erosion would be nearly 26%). Social Security benefits just about keep up with inflation. For pensioners whose Social Security benefits comprise a small part of total retirement income, purchasing power can be reduced substantially, even with low 3% inflation.

Money to finance increases in benefits may be well out of the reach of plans with lower funding levels. However, at the opposite end of the situation, over-funded plans can grant increases in benefits to pensioners as one way of using the excess assets. In any event, the initial increase in the value of the benefits must be amortized and included in an employer's pension expense.

We also can raise the question, why worry now? Maybe this is not the time to worry. Rather it is time to be alert, to be prepared. We now have no

regulations requiring cost-of-living adjustments. We do not have onerous testing rules on coverage, nondiscrimination, etc., that we had a few months ago. The worry is future uncertainty. If inflation flares up, will employers be ready or able to take on the financial burden of taking pensions to a once-again adequate basis? In a high-inflation climate, would government step in and require some sort of indexing? That is a worry.

Pension actuaries can examine their roles of advisors and mentors and what they perceive to be a social responsibility. In this situation, it should be suitable to communicate their observations of pension adequacy and, if asked, to develop the benefit format and the "cost" to fix any problem.

Retirement... a dose of one's own *medicine*

After 45 years of actuarial work, the last 38 as a pension consultant, retirement is at hand.

Application forms, comparable to those designed for clients' use over the years, comprise the stack of papers at the right side of the desk. These still have to be completed.

Another pile includes Social Security material. Actually, the Social Security scene was not bad at all. A phone call to the local Social Security office produced a date (mid-August) and time for a telephone conference. This was held on schedule, and September 30 was set as the date of retirement. An application, completely filled in, requiring only the addition of a birth certificate and signature, came within a week. Two weeks later came a Social Security identification card for Medicare health insurance indicating dates of coverage by Medicare A (month age 65) and B (month of retirement). My experience is very different from my husband's three years ago when he retired before age 65. Of course, only time can tell whether the first check for $1,056 (I almost had a fit at that number before I realized it was net of Medicare B Premium) arrives around November 1.

Back to the right-hand stack of papers, which is essentially a procrastinator's dream (nightmare). It means decisions, decisions, and more decisions. Under the qualified defined benefit plan, I must elect a life benefit or some percentage joint and survivor annuity. Things to consider: my husband has his own pension; I'm healthy; the reduction factors are unisex and thus unfavorable to the female employee. Aside from the fact I think I'm immortal, what are the odds?

A reprieve under an excess benefit plan...no decision needed. The value is paid out over a five-year period certain...period, amen. Another sort of reprieve...no decision needed about retaining post-retirement medical coverage.

Then comes the defined contribution 401(k) etc. plan. A lump sum, a payout over five years, a rollover into an IRA — which should it be? The lump sum, for federal tax purposes, because of capital gains (pre-1974 service) and income averaging appears preferable. But there are state taxes, potential changes in federal taxes... who will win in November? What about the available yields (currently terrible) on invested (in whatever) monies.

And do not forget life insurance, issued at unisex rates and thus unfavorable for women...non par and expensive. (Keep the premiums, with interest at 5% net of taxes, and the face is available in 11 or so years.) How much does a healthy, age 65, person with a reasonably liquid portfolio need?

Oh, yes...another pile of reminders of procrastination (but no decisions). I am going to get those medical/prescription claims filed before September 30, so the new life starts without old tasks still incomplete.

Part of the dose of one's own medicine can be the rewards — the rewards of a satisfying professional career, of lifetime friendships, of participation in the actuarial organizations' activities, of a loving family, health, and adequate income.

Part of the dose of one's own medicine can be the rewards... of a career...friendships...organization activities...family... health, and adequate income.

But those decisions, decisions, decisions. By the time you read this, they will have been made. Only time will tell if they are right.