National Report
for
THE UNITED STATES

1. The Actuarial Profession

The U.S. section of the International Association of Consulting Actuaries as of June 30, 1984 consisted of 120 members. As of that same date, the Society of Actuaries had 5,059 fellows whose employment broke down as follows:

• Insurance Companies	-	2,769
• Consulting	-	1,615
• Insurance Departments	-	33
• Other Governmental Employment	-	62
• Organizations Serving Insurance Companies	-	39
• Universities and Colleges	-	30
• Miscellaneous	-	66
• Unemployed or Retired	-	445

The percentage of actuaries in consulting has risen slightly from approximately 30% two years ago to 32% today.

2. Economic Background

The last two years have seen an improvement in general economic conditions. Inflation and unemployment have both declined significantly.

For investors, the period can be broken into two significantly different phases: the period from mid-1982 to mid-1983, and the period from mid-1983 to mid-1984. The table below shows the interest rates available on 6 month Treasury bills and long term (twenty year) government bonds as of April of each of the three years. As can be seen, the rates decline significantly from mid-1982 to mid-1983 and have risen a good deal since then, although still not back to the 1982 levels.

	6 Month T-Bills	Long Term Government Bonds	S&P500
Mid-1982	12.9%	13.6%	111.88
Mid-1983	8.3	10.6	162.39
Mid-1984	9.8	12.6	150.55

The equity markets exhibited corresponding behavior. The S&P500 as of the end of May in each of the three years is shown in the table. There was a 45% increase from mid-1982 to mid-1983, followed by a 7% decline from mid-1983 to mid-1984. Overall, however, the equity markets increased 35% over the last two years. This has clearly helped the funded status of pension plans.

Although the U.S. is still in the midst of an economic recovery, concern has been expressed about the impending deficits in the several hundred billion dollar range. What will be done to deal with these remains to be seen.

3. Social Security

In April of 1983, major amendments were made to the Social Security system in the United States. The following is a summary of the major changes:

- The normal retirement age will be raised in two steps from the current age 65. The normal retirement age will be increased in two month increments from 65 in 2003 to 66 in 2009 and, subsequently, from 66 in 2021 to 67 in 2027.

- Beginning with January 1985, a stabilizer provision, which bases the calculation of the automatic cost of living increases on the lesser of the change in the Consumer Price Index or the Average Wage Index, becomes effective if the balance of the Social Security Trust Fund as of the beginning of the year is less than 15% of the expected system outgo during the year. Subsequent COLA make-ups will be paid when the Trust Fund exceeds 32% of expected annual outgo.

- Beginning in 1984, some Social Security benefits will become taxable for individuals whose "combined income" (adjusted gross income plus non-taxable income plus 50% of their Social Security benefits) exceeds a specified base amount. For an individual, the base amount is $25,000, and for couples filing a joint return it is $32,000. Income taxes will be paid on the lesser of one-half of Social Security benefits received or one-half of the excess of combined income over the base amount.

- Social Security tax increases scheduled for future years were accelerated. The 6.7% tax rate paid by both employers and employees in 1983 was increased to 7% in 1984, 7.05% in 1985, 7.15% in 1986, 7.51% in 1988, and 7.65% in 1990.

These amendments were widely hailed as preserving the financial integrity of the Social Security system into the next century. While this may be true for the pension part of the system with which the amendments dealt, the Medicare system is in much more desperate straits and solutions for that have yet to be addressed.

Agreements continue to be negotiated and signed between the United States and various other countries providing for the totalization of Social Security benefits. Although details differ, each bilateral agreement eliminates the necessity of dual coverage for expatriates and provides for the determination of an overall benefit for individuals who have had coverage under the systems of the two countries involved. In this latter area, the emerging trend is to count years of coverage under both systems for eligibility purposes but have each country calculate and pay separately the amount of benefit (with pro-rata adjustments when necessary) based on coverage under its system.

For understandable reasons (totalization costs money), progress has been slow but during the past two years agreements have been finalized (or nearly so) with Belgium, Canada, Norway and the United Kingdom. The Canadian agreement, which has just recently become effective, is particularly important because of the substantial number of employee transfers between the two countries.

4. Tax Equity and Fiscal Responsibility Act

In August 1982, the Tax Equity and Fiscal Responsibility Act of 1982 was enacted. This act had a significant effect on a wide range of employee benefits. Following is a list of some of the major provisions:

- The maximum pension payable under a tax qualified defined benefit pension plan was reduced from $136,425 to $90,000. Further, actuarial reductions are required for early retirement prior to age 62. The maximum annual addition to a tax qualified defined contribution plan was reduced from $45,475 to $30,000.

- The automatic indexing of the dollar limitations on pensions from a defined benefit plan and annual additions to a defined contribution plan were suspended until 1986.

- A provision was put into the law to codify an existing IRS revenue ruling. Plan sponsors are not allowed to anticipate future cost of living changes in the maximum benefit limitations in funding their pension plans. This obviously retards significantly the funding of many pension plans.

- An individual covered by both a defined benefit and a defined contribution plan may not receive the maximum benefit under each of the plans. The aggregate maximum in the past has been equal to 140% of the limits permitted; for example, an individual receiving 80% of the limit under the defined benefit plan could only receive 60% of the limit under the defined contribution plan. This new law limits total benefits to 125% of the sum of the reduced maximum dollar limitations.

- Retirement plans are considered "top heavy" if a disproportionate percentage of the benefits are going to "key employees." The law provides detailed calculations to determine whether a plan is "top heavy." If a plan is found to be top heavy, it must meet the following requirements:

- accelerated vested schedule,
- minimum accrued benefits,
- the combined benefit limit is reduced from 125% to 100%.

- The exclusion for premiums paid by an employer under a group term life insurance program from a key employee's income for Federal income tax purposes will continue only if the program is (1) non-discriminatory as to eligibility to participate, and (2) non-discriminatory as to amount of life insurance.

5. Accounting Requirements

The Financial Accounting Standards Board (FASB) has been studying the accounting by employers for pension costs. In late 1982, the FASB released a document setting forth their preliminary views on this accounting. If adopted, these views would have significant and profound effects on retirement plans in the United States. The proposed FASB requirements are quite controversial and have been the subject of broad-based opposition.

The FASB requirements would do two things:

- Accounting for pension expense would be done on a single method -- the projected unit cost method. The amortization of the unfunded accrued liability under this method would be at a rate spelled out by the FASB and related to the average remaining future service of covered employees. Actuarial gains and losses must also be amortized.

- The liability for pension benefits would become a balance sheet item. The assets held in the trust fund or elsewhere for these benefits would be an offsetting asset. In addition, a temporary fictitious asset would be created to avoid widespread bankruptcies due to the introduction of the accounting requirement. This fictitious asset would be written off over the remaining service lifetime of covered employees.

The FASB conducted a field test to determine the effect of the proposed accounting requirements. Forty companies supplied data for this test; the FASB published the results for a selected twenty of them in early 1983. Since that time, the FASB has been engaged in further study of the pension accounting issue.

The FASB has also been concerned with how employers account for other post-employment benefits -- especially life insurance and medical benefits to retired employees. Many companies adopt a pay-as-you-go accounting procedure for such plans. The FASB is leaning in the direction of requiring them to be expensed during the employee's active working lifetime.

On July 3, 1984 the FASB issued an exposure draft of a proposed statement on post-employment health care and life insurance benefits. This proposed statement would require the following disclosures:

- A description of the benefits provided.
- The cost of such benefits included in net income for the period.
- A description of the current funding and accounting policies with respect to those benefits.

6. The Norris Decision

In July of 1983, a Supreme Court decision was handed down which ruled that the provision of optional benefits from a retirement plan on a basis which differentiated by sex was illegal under Title VII of the Civil Rights Act. This decision did not deal with the benefits offered by insurance companies on the free market, but rather required that, when employers establish retirement plans for employees, any and all benefits provided under those plans must be on a basis which does not differentiate by sex. This decision has prospective application from August 1, 1983 only. However, for benefits based on contributions made after that date, all benefits and option factors must be on a unisex basis.

7. Casualty Insurance

The following are some of the major developments in this area in the last two years:

- Along with the many debates over unisex pricing in the life and pension areas, the casualty area has received almost equal publicity in connection with automobile insurance rate differentials between males and females. Women would be adversely affected if this is ruled to come under unfair practices, since they generally pay lower rates at the younger ages than their male counterparts.

- The subject of Combined Ratios (losses plus expenses) in casualty insurance can be considered a continuing major development because of the financial consequences at stake. Once considered chic, the cash flow rationale has had its ups and downs. It looks like we are presently in a "down" cycle, as witness the positions being voiced by several CEO's on the dire underwriting results. The situation has been steadily worsening, with combined ratios now exceeding 115% and climbing toward 120%. Investment income, as the other half of the balancing act, is just not supporting the results as well as it did a year or two ago.

- In its advocacy of considering investment income in the rate formula (in a formal manner) the NAIC would discard a sixty year tradition along with the 1921 profit formula (5%). While many insurers recognize investment income indirectly (through the lower rates that have been necessary to meet competition), they are not uniformly bound to reflect it in their rate calculations. For years the number of approaches suggested for handling the mathematics has almost equalled the number of people suggesting them. In one way or another, investment income is going to be included in the ratemaking formula.

- There has been much continuing discussion of applying an interest discount to casualty loss reserves during 1983 and

1984. One can argue that some actuaries are already discounting reserves in their calculations (e.g., self-insurance evaluations) or that discounting is "reflected" through lower final rates (again, to meet competition), but there is no uniformly accepted procedure yet.

- Workers' compensation benefits are continually changing in one jurisdiction or another. Of note is the addition of Louisiana as the second state (Florida was the first) to employ a Wage-Loss plan (instead of the typical schedule for permanent partial disability, benefits are paid only for lost wages after an accident). Results in Florida seem to indicate that it is working well there, in terms of keeping down rate increases. The thrust for bringing workers' compensation under the mantle of open competition has not died, but is still being fought by most of the insurance industry. The National Council on Compensation Insurance is opposed.

  Occupational disease remains a hot topic, with more recent focus on asbestos, but resolution of government or industrywide plans is still far on the horizon.

- Product liability reform is another of those talked to death issues over the last couple of years. It is unlikely that 1984 will see passage of a uniform product liability bill.

8. Life Insurance Industry

As in the pension and casualty areas, controversy continues in the insurance area in the U.S. regarding the use of sex-distinct premium rates. Although statistically justifiable, separate rating for males and females has been challenged as a form of sex discrimination. Public policy arguments may prevail over the theoretical arguments for separate rates.

On the federal tax side, new laws have been passed which will increase the insurance companies' tax burden. The taxation of stock versus mutual insurance companies has been a major point of argument.

Financial service companies continue to be formed, providing banking, investment, real estate and insurance services all under one roof. "One-stop shopping" appears to be the wave of the future.

In the life insurance area, the universal life policy continues to gain a larger share of the market. Life companies have been taking a closer look at the term life market, where high lapse rates and increasing reinsurance costs have led some companies to increase their term rates.

9. Asset Reversions

With the substantial rise in the market value of assets during the latter half of 1982, many pension plans found themselves in a position where the market value of assets was substantially in excess of the present value of benefits accrued to date. There was a temptation for some companies to then terminate their pension plan, provide all participants with their accrued benefits, and recover these surplus assets. A new defined benefit pension plan could then be established which would provide essentially the same benefits as the old plan had provided. (This is referred to as a "termination/re-establishment" strategy.) In the meantime, the employer would have recovered substantial cash amounts from the pension plan.

The Internal Revenue Service, the Department of Labor, and the Pension Benefit Guaranty Corporation were all concerned about this practice as it obviously eroded the security of benefits for employees. In May of 1984, the three agencies announced some interim guidelines under which they would process defined benefit pension plan termination involving asset reversions to the sponsor. Generally, these guidelines require:

- When an employer terminates a defined benefit pension plan, it may not recover any surplus assets until it has fully vested all participants' benefits and has purchased and distributed annuity contracts.

- An employer that terminates a sufficient defined benefit pension plan may establish a new defined benefit plan covering the same group of employees and granting past service credit for the period during which an employee was covered by the

terminated plan. The prior plan and the new plan, in combination, may provide benefits for each participant which are equivalent to those that would have been provided if the initial plan had continued without interruption.

- In the case of the so called "spinoff/termination" (where a portion of the plan is separated from the main plan and that portion only is terminated, with excess assets recovered from the terminated portion) generally no termination will be recognized and any attempt to recover surplus assets will be treated as a diversion of assets for purposes other than the exclusive benefit of employees and beneficiaries, unless the following conditions are satisfied:
  - the benefits of all employees, including those in the ongoing portion of the plan, must be fully vested as of the date of termination,
  - all benefits accrued as of the date of termination, even those in the ongoing plan, must be provided for by the purchase of annuity contracts, and
  - all employees must be given advance notice of the transaction.

- In both the termination/re-establishment and spinoff/termination cases, accelerated funding would be required for contributions to the re-established or surviving plan, and IRS approval for the funding method for that plan will be required.

- In general, employers will not be permitted to engage in a termination/re-establishment or spinoff/termination transaction within fifteen years after the latest such transaction.

10. Flexible Compensation

Flexible compensation plans have become increasingly popular among employers. These programs, under which an employee is provided with an allowance of benefit credits, and is then provided with the opportunity to

select from a menu of benefit options, have now been implemented by over 100 large companies in the United States. A number of other major employers are seriously investigating them.

Flexible benefit programs are perceived as offering significant advantages to both employers and employees. For employees the program provides the individual with the opportunity to shape a benefit program which meets his or her specific circumstances. This has become increasingly important as the demographics of the workforce have become increasingly heterogeneous. In addition, the employee is able to pay for most benefit related items in pre-tax rather than after-tax dollars.

For employers the major motivation is cost containment. Many employers have begun to feel that the traditional programs provide them with inadequate cost containment tools. Under such traditional programs, wherein the employer had promised to his employees a specific benefit program, when the cost of the benefit program escalated from year to year there was little that the employer could do. Recent significant escalation in the rates of medical insurance heightened awareness of this limitation. Under a flexible compensation program, the welfare benefit promises are in effect recharacterized from defined benefit to defined contribution. The employee is given a specific allowance of credits. The price tags for the various options are generally allowed to rise as market forces dictate. Each year the employer has the opportunity to make an independent assessment of the extent to which he wants to increase his benefit allocation. Faced with higher price tags, employees either lower levels of coverage or have to make a contribution to continue the previously provided level of coverage.

The implementation of these programs requires the employer to make a significant investment in the development of the necessary administrative systems and communication materials. With the appropriate preparation, though, it has been shown that employees can understand the program and make reasonable choices.

The proliferation of these plans has caused some concern on the part of the government with regard to tax revenue erosion. Recent regulatory and legislative changes will prevent the more blatant abuses. While further changes in the legislative and regulatory environment are likely, these plans

are accepted by both employers and employees. Their continued growth and development is heavily dependent on near term future events.

11. Tax Reform Act of 1984

In July of 1984, the U.S. Congress passed a new tax bill which represented a "down payment on the deficit." This new bill had several provisions which affected employee benefits:

- The restart of automatic indexing of the dollar limitations on pensions from a defined benefit ($90,000) and annual additions to a defined contribution plan ($30,000) were delayed from the TEFRA date of 1986 until 1988. If this continued suspension of the indexing occurs, pension plans funding only the tax deductible amount will be seriously underfunded.

- Several changes were made to the tax treatment of contributions to 501(c)(9) trusts providing welfare benefits. The exact effect of these provisions is unclear at present, but they seem at a minimum to have erased all tax benefits for advance funding of medical benefits for retirees.

- Certain welfare benefit plans will be required to be non-discriminatory or key employees will have an excise tax imposed on them.

We will supply further details at our October meeting.

12. Impending Legislation

A bill, the Women's Pension Equity Act, has been before Congress for most of this year. There is no significant opposition in either house to the main provisions of the bill and it seems virtually assured of passage. It provides:

- A plan must offer a participant with ten years of service an opportunity to elect a reduced pension at retirement in exchange for providing an annuity to the participant's spouse

if he should die prior to retirement. This life insurance coverage will be presumed to have been elected unless the employee elects to the contrary and has notarized spouse consent.

- Currently, pension plans may exclude from participation employees below age 25. This will be reduced to 21.

- Courts will be allowed under divorce proceedings to direct a pension plan to make payments to a divorced former spouse even though the employee has not retired. The courts, in doing so, will be required to take into account prior court awards for divorces. The employer will be able to reduce the employee's benefit actuarially. This will give rise to some rather complex calculations and can mean in practice that the employee's benefit is reduced to zero because the divorced former spouse has elected early commencement of the spouse's part of the benefit while the employee retired late.