Pensions in Inflationary Conditions: transferability, pension increases in deferment and in possession, etc.

Tuesday 15th June (afternoon)
Concurrent Session (1)

Chairman: Paul Jackson (USA)
Opener: Frank Robertson (New Zealand)
Closer: David Malan (South Africa)

Papers for discussion:

K. Heubeck (Germany):
"The adjustment of company pensions; a German Model — after years of discussion."

J. Hillhouse (Canada):
"Pension planning for an inflationary environment."

H. Langhorst (Netherlands):
"The difference between a pension and an annuity."

J. A. Jolliffe (UK):
"Real rates of return."

Abstract of the discussions

A strong impression left by the papers submitted and the discussions was the extent to which actuaries' views were influenced by the particular national framework as regards legislation and socio-economical attitudes and circumstances under which they were operating. It is not surprising that the actuary would devote more thought to those aspects that he could influence, rather than to those that are for him so entrenched that, for practical purposes, they had to be accepted as providing the parameters within which the best solution to each problem must be sought.

Some of the elements of the national situation mentioned in this regard were:

— Government policy in respect of price/wage control
— Government policy regarding interest rates and exchange rates
— Levels and conditions of social security provided
— Legislation enforcing funding standards, prohibiting internal or balance sheet funding, limiting investment freedom, etc.

Most of the discussion dealt with aspects of one basic conflict, namely, on the one hand, the need of pensioners to maintain, as near as may be, their standard of living in spite of rising costs, and, on the other hand, the means to satisfy such needs.

In relation to this conflict, points made include the following:

1. Every individual looks for protection against economic misfortune. Do the needs of pensioners justify priority over those of unemployed persons, active employees and employers?
2. If it is accepted that pension benefits constitute deferred compensation, is it the contribution of the employer that represents the deferred compensation or the ultimate benefits provided for in the pension plan?
3. Is it reasonable to place additional burdens on employers who contribute to final salary type pension funds, and ignore employers who either make no provision for pensions or contribute to pension funds providing less attractive benefits? Some speakers saw no unfairness in this situation if participation in a final salary type of fund is optional for the employer.
4. Assuming that the employer has made a contribution representing the estimated cost of benefits relating to a particular year, calculated responsibly on the basis of all information then available, can he be expected to make further contributions if, due to economic developments outside his control, the cost of the benefits keep on increasing beyond what was anticipated? Is the conclusion in this regard influenced by whether the contributions are paid to an insurer, an independent fund, an internally controlled fund or by way of a credit to a balance sheet reserve?
5. Do the needs of pensioners require increases in pensions proportionately to increases in prices, or to salary and wage increases in general, or to salary and wage increases granted by each pensioner's previous employer?

   To the extent that salary and wage increases are relevant, it should be borne in mind that three elements could be distinguished in salary and wage increases, i.e. merit increases, improvements in productivity, and depreciation in the value of money.

   The third element should certainly be taken account of. Perhaps pensioners should share to some extent in improvements in productivity, even though they no longer contribute to such improvements. The first element, i.e. merit increases, is certainly not relevant in considering increases in current pensions.
6. Considering the means of the fund specifically in relation to the need to increase pensions currently payable, reasonable concensus appeared that the "surplus interest" approach is the best available. Capital appreciation or depreciation should be taken into account, but unless smoothed out over a period, could lead to unacceptable fluctuations in pensions. The expression "surplus interest" implies the existence of some basic interest, the determination of which would still be subjective, and dependent upon the resources available to fund obligations calculated on this basic interest.
7. An important argument in favour of the "surplus interest" approach is that there is significant positive correlation between interest rates and inflation rates. Two points made in this regard were, however:
   — the market price of shares does not necessarily parallel the price of eggs
   — inflation increases the cost of vested benefits, where the corresponding assets may have been acquired under circumstances of low yields.
8. Surplus interest related to obligations in respect of contributing members should be used for improving benefits — or for funding indexed benefits — rather than to reduce the employer cost.
9. Some speakers supported the (notional) formation of a separate "pensioners' asset portfolio" for which a different investment policy might apply. Problems associated with this approach that were pointed out, include the following:
   — Should "old" assets, i.e. those acquired during the present pensioners' active life, be allocated at the original cost of acquisition?
   — Is it correct to apply short term considerations to such a "notional fund", which may well exist and continue to grow over an indefinite period?
10. Deferred pensions should be increased at the same rate as currently payable pensions.
11. Actuaries should hold on to the following principles in dealing with this subject:
   — pension funds should retain the freedom to design benefits according to their requirements

— early vesting of pensions and increasing deferred pensions increase costs, and should therefore be weighed against the maintenance or improvement of other benefits and not be granted unconditional priority
— the government should not increase the obligations of any party to existing arrangements.

12. In this age of consumerism the public demand that there should be no losers.

13. The application of probability theory and linear programming to economic elements such as inflation were of doubtful validity.

The closer stated that he considered the subject dealt with as one of the most significant ones facing actuaries at the time, and expressed the appreciation of the meeting for all contributions to the discussion, in particular for those members who had submitted papers on the subject.