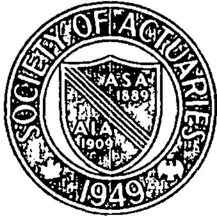

The Actuary

The Newsletter of the Society of Actuaries

VOLUME 1, No. 2 APRIL 1967

THE JAVITS BILL

The widely-discussed report of the President's Committee on Corporate Pension Funds published in January of 1965 recommended sweeping changes in the Federal laws and regulations. Various bills have been introduced in Congress to implement one or more of the specific recommendations, but none encompassing the major recommendations. The bill (S.1103) introduced by Senator Javits of New York entitled "Pension and Employee Benefit Act of 1967" would implement several of the major, and largely controversial, Committee recommendations.

The principal features are as follows:

(1) Coverage — The Act would apply to all private pension and profit-sharing plans covering 26 or more employees, except plans of any governmental unit, an exempt organization, a plan covering self-employed or an unfunded, unqualified plan.

(2) Pension Commission — There would be established a U. S. Pension and Employee Benefit Plan Commission to replace regulatory functions now performed by Treasury, the Labor Department and the S. E. C.

(3) Registration — All plans would be required to register with the Pension Commission and submit periodic reports. Registered plans would have to include certain minimum benefit and funding provisions. Triennial valuations by an actuary *certified* by the Commission would be required.

(4) Reinsurance — After registration for 5 consecutive years, the Plan would be covered by the reinsurance program to protect accrued benefits against loss by reason of plant shutdown, bankruptcy, etc. The annual premium would be 1% of the unfunded liability.

(5) Voluntary Pension Portability — A special national fund would be established to provide for the handling of vested credits for terminated employees, on a voluntary basis. The vested account could subsequently be transferred back to a private plan under certain conditions.

The Bill provides for certification of actuaries by the Commission. It also requires Commission approval of the actuarial bases used to determine lump-sum values of vested employee equities payable in cash. It is silent as to the extent to which actuarial assumptions and standard funding methods would be prescribed for (1) plan valuations to meet minimum funding requirements, (2) determination of the unfunded liabilities for purposes of the reinsurance premium, and (3) determination of the value of vested benefits for purposes of the "portability fund."

Although several features of the Bill follow the pattern of the 1965 Pension Benefits Act of Ontario, there are several differences. Perhaps the most important is in the extent of coverage. Ontario sets minimum standards for *all* pension plans, including those covering public employees; the Javits' bill applies only to private plans which, as a class, are the best funded.

This Bill may not be enacted in 1967, but may be indicative of future legislative patterns.

ACTUARIAL RESEARCH CONFERENCE AT ANN ARBOR

A seminar on Risk Theory and Selected Topics in Multivariate Analysis was held November 14-16, 1966, at the University of Michigan in Ann Arbor. The Society's Committee on Research and the corresponding Committee of the Casualty Actuarial Society were joint sponsors with the University.

Professor James C. Hickman suggested that individual risk theory be used in teaching life contingencies. This would promote continuity in actuarial education since many of the ideas from statistics would be used in a natural way in developing life contingencies.

Dr. Paul M. Kahn outlined the key idea in the Bohman-Esscher Report for evaluating the distribution function for total claims. The applicability of stochastic approaches developed in many other fields to collective risk problems was pointed out by Professor John A. Beekman. Mr. Donald Jones set forth a general model in which the total amount of claims was viewed as the sum of a random number of claims made up of random variables corresponding to the amounts of the individual claims. Mr. Robert Taylor presented a theory of the composite life insurance risk and also calculated stop-loss reinsurance premiums for two insurance portfolios and various retention and risk levels.

Risk theory in the context of various types of reinsurance was discussed by Mr. John C. Wooddy and experiences in this area were described by Messrs J. W. Lincoln and William A. Drew. An application of collective risk theory to group insurance experience was presented by Mr. Dwight K. Bartlett, III.

Mr. John M. Boermeester discussed a simulation experiment to obtain confidence limits for gross premiums for small groups. A simulation model of a life insurance company reinsurance pool was outlined by Mr. Russell M. Collins, Jr. This model is being developed to guide the choice of reinsurance agreement which will most effectively reduce the fluctuation from year to year in the individual total claim experience of the member companies.

The theoretical development of regression and multivariate analysis was reviewed by Professor Robert V. Hogg.

(*Continued on page 3, col. 2*)

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The Society is not responsible for statements made or opinions expressed in the articles, criticisms, and discussions in this publication.

EDITORIAL

The words "actuary" and "actuarial" are sometimes heard resounding through the halls of Congress. Members of the Society hearing them and recalling some past experience, may occasionally be skeptical as to whether they are being properly used or merely employed to lend a spurious air of authority to some project.

The introduction of Senator Javits' bill "Pension and Employee Benefit Act of 1967" (S.1103) strikes a professional note that the actuaries may wish to hear. An analysis of this bill is given elsewhere in our columns and incidentally our Canadian friends will be interested to know that the Definitions and Title I of the Bill are modelled upon the Ontario Pension Benefits Act of 1965.

In his introductory speech Senator Javits said that S.1024, the Yarborough Bill endorsed by the Administration, was "strictly a conflict-of-interest and ethical-standards bill" setting standards for plan trustees but not for the plans themselves, and ignoring almost all the recommendations of the President's Committee on Corporate Pension Funds. He went on to say:

"The President's bill, while it has some worthwhile features . . . would require audits of pension books by accountants, which is fine as far as it goes, but the key men in this field are the actuaries who can tell you, not just how much cash you have, but how much you will need 10 years from now to meet the benefits which will accrue in the meantime. My bill requires actuarial certifications at periodic intervals, not just accountants' audits."

The Bill itself provides for setting up a "U.S. Pension and Employee Benefit Plan Commission." Among other duties the Commission is required to establish standards for and issue certificates of qualification to ". . . persons performing services required by the provisions of this Act to be performed by actuaries . . ."

Comments on the vesting, funding and other provisions of the Bill should properly be made by others. We are heartened by the several specific references to the need for competent actuarial guidance in the Bill, in the introductory speech, and in the Explanatory Notes. These most welcome references to the actuarial profession will, we hope, bring Federal recognition of the American Academy of Actuaries.

—A.C.W.

TAX PROPOSAL IN CANADA

by J. Ross Gray

The major topic of discussion in Canada is the Carter Report, named after the chairman of the Royal Commission on Taxation. It is a review of the Canadian federal system of taxation, unfortunately in complete disregard of provincial and municipal taxation. More than just a revision of the Canadian tax system, it is a suggestion to reorganize our entire economic life.

The Report is so far-reaching that its recommendations may never become law, certainly not in their entirety. If they do, there are serious implications for the life insurance business.

It will be possible to pass money around within the family-unit of husband, wife and dependent children without paying tax, but any money which passes outside that unit in any way will be taxable in full at the progressive rates of income tax. The declared intention is to reduce the ability to pass money from one generation to the next. Finally, when a family-unit terminates by the last death, income tax must be paid by the estate and also by the heirs.

Everything which can be regarded as an increase in spending power is to be regarded as income and taxed. This includes wages, salaries, commissions, pensions, interest, dividends, gifts, bequests, subsidized employee benefits, etc. It includes these items whether received or not, as soon as the right to receive them has been created. Capital gains less capital losses are to be taxed when realized, at the income tax rates.

Investment in Canadian corporation shares is made attractive to Canadian residents, to the detriment of bonds and other interest-bearing assets. A Canadian resident will receive credit for the 50% rate of corporation tax, and will be taxed only at his own personal rate, but a non-resident shareholder will have no relief from the corporation tax and, in addition, will be subject to a 15% withholding tax. Non-residents of Canada might sell their shares in Canadian corporations to Canadians, and might be obliging enough to invest in Canadian bonds instead.

Permanent emigrants on pension from a Registered Retirement plan will be subject to a withholding tax of at least 30%, to make sure that Canadians do not leave the country for tax reasons.

MEDICARE REVIEWED AFTER EIGHT MONTHS

At a panel on "Medicare — An Analysis After Eight Months" held by the Chicago Actuarial Club on March 20, Dr. Ted LeBoy, Assistant Medical Director of Continental Assurance Co., commented on some changes that had been observed.

The average length of hospital stay for people in the Medicare age group in Illinois increased by 2.1 days according to a survey taken of 628 community institutions as of December 1966. A further increase appears likely so far this year. One reason for this rise is the additional medical problems discovered during hospitalization when the original diagnosis indicated only a limited stay.

Physicians whose fees have been modified to conform to the provisions of the law have not complained of the adjustments. This may be due to the fact that in a great many instances services are now being paid for where there was formerly a quasi-charitable attitude. Usual and customary charges formerly meant usual for the physician and customary for the area. With the Medicare definition of a prevailing charge for the area, both terms, usual and customary, are being used to describe charges by physicians. In the carriers' commercial business, reductions in payments for physician's services based upon an insurer's usual and customary clause are being resisted by physicians if the reason for the reduction is that their charge is in excess of the customary charge for the area.

Other panelists were Dr. C. L. Reeder and Messrs. William Love and William Cannon. The last two described the Medicare operations of insurers in Illinois and some of their problems. Questions from members elicited further comments.

Charges by physicians increased to the prevailing charge for their area when they learned what that was, with an obvious inflationary effect. Every bill submitted to an insurer must be examined; for example, deductible requirements must be satisfied and charges in excess of the usual and customary must be ascertained. The insurers are using this experience as an aid in paying claims for like cases.

Bills for a physician's services are first compared with bills he had submitted previously for the same procedure. They then are compared with the prevailing charge for the area. About 10 percent of the bills are questioned; this usually discloses that a more complicated procedure was performed than that originally described. Adjustments are made on about 2 percent of the bills.

Actuaries Club Meetings:

May 8, Michigan Actuarial Society, Detroit, Michigan

May 19, Hartford and Boston Actuaries Club, Boston, Massachusetts

May 25-26, Actuaries Club of the Pacific States, Ogai, California

May 26, Middle Atlantic Actuaries Club (Semi-Annual), Richmond, Virginia

Conference . . .

(Continued from page 1)

He made the point that the mathematical framework, which can be very general, represents merely a starting point for consideration of real problems. Professor Bruce M. Hill pointed out that the Bayesian statistician relies on a mathematical framework that permits combining subjective assumptions with statistical distribution functions.

Dr. Hilary L. Seal presented practical applications of regression analysis. In one case, where the loss ratio for automobile accidents was assumed to be equal to the product of four factors, a suitable transformation reduced the multiplicative model to a linear model.

Dr. Joseph G. Bryan, using a logarithmic transformation, developed the loss ratio for outstanding automobile bodily injury claims on the basis of an analysis of settled claims.

Mr. Gordon D. Shellard discussed a model for the loss ratio under Major Medical Insurance where the four major variables were age, sex, marital status, and duration. He developed separate formulas for each sex in terms of the three remaining variables.

Mr. Edward A. Lew discussed experiments with discriminant analysis to evaluate the underwriting significance of various characteristics of life and health insurance risks. No matter how good the separation might be, appreciable errors in classification are common, even in cases where the significant characteristics are reasonably well understood.

Digests of the papers presented at the conference may be obtained by writing to Professor Cecil Nesbitt, Department of Mathematics, University of Michigan, Ann Arbor, Michigan 48104.

LETTER TO THE EDITOR

Dear Editor:

In the March issue of *The Actuary*, you report that the preparation of a special form regarding pension costs was "revealed" at the March 7 meeting of the American Pension Conference. You indicate that this form "is being prepared to comply with Opinion No. 8" of the AICPA and that the form "is for auditors to use when requesting necessary information from actuaries with respect to pension plans."

Some attending the March 7 meeting were not aware that such a "special form" was revealed, and I think *The Actuary* exaggerates the importance of this particular form. So far as I am able to determine, this form has no official sanction and represents only the efforts of one or two accounting firms to think through and perhaps simplify the auditing problems that may arise under Opinion No. 8. We have been exposed to other efforts along the same line.

I also think the assertion that the form is for auditors to use "when requesting necessary information from actuaries" must contain an inaccuracy. Information can be properly provided to accountants by actuaries only at the request of the actuary's principal.

Since numerous aspects of Opinion No. 8 have practical significance only in special cases, completion of a form contemplating all of the ramifications of Opinion No. 8 would create unnecessary expense for most employers. I do not believe that practicing auditors wish to impose an excessive expense on their clients, and my guess is that no standard reporting form for actuaries will be developed under Opinion No. 8.

John Hanson
Chicago, Illinois
April 7, 1967

PROPOSED CHANGES IN SOCIAL SECURITY

by Robert J. Myers

Significant amendments to the Social Security Act recommended by President Johnson are incorporated in H.R. 5710 which was introduced by Chairman Wilbur D. Mills of the House Ways and Means Committee. Such introduction is, to a considerable extent, a procedural matter and does not necessarily represent full endorsement by the Chairman. Public hearings on this measure were conducted in March as the first stage in the legislative process.

The bill not only amends the provisions of the OASDI and Medicare programs, but also introduces restrictions on the Medicaid program (Title XIX). Furthermore, it would drastically revise the income-tax treatment of persons aged 65 and over.

The major changes in the OASDI program would be as follows:

(1) The present maximum taxable and creditable earnings base of $6,600 increased to $7,800 for 1968-70, to $9,000 for 1971-73, and to $10,000 for 1974 and after.

(2) An across-the-board benefit increase of 15%, with a minimum Primary Insurance Amount of $70; the present minimum is $44.

(3) A special higher minimum Primary Insurance Amount of $100 for persons with 25 or more years of coverage, with proportionate amounts for those with less coverage.

(4) A maximum wife's benefit of $90.

(5) An increase in the transitional benefits for certain persons aged 72 and over who do not possess regular insured status from the present $35 to $50.

(6) Monthly benefits for disabled widows under age 62 who do not have children in their care.

(7) An increase in the annual exempt amount in the earnings test from $1,500 to $1,680.

(8) An increase in the combined employer-employee contribution rates for OASDI to 9.0% in 1969-72 and to 10.0% in 1973 and after from levels of 8.8% and 9.7% in the present act.

(9) An increase in the allocation of the contribution rate to the DI Trust Fund from the present combined employer-employee rate of .70% to .95%, with a corresponding rise for the self-employment rate.

(10) Coordination of the Civil Service Retirement System with respect to individuals dying or becoming disabled with less than 5 years of service or separating from service after 5 years with no right to vested deferred benefits; effected by transfer of earnings credits, with CSR paying its proportionate share of any OASDI benefits eventually payable.

The Medicare program would be changed as follows:

(1) Both Hospital Insurance and Supplementary Medical Insurance would be made available to disabled beneficiaries (including disabled workers, disabled children, and disabled widows), with the SMI premium rate the same as for participants aged 65 and over.

(2) Payments would be made to Federal facilities for health services to Medicare beneficiaries.

(3) Outpatient diagnostic benefits would be moved from HI to SMI, and services of hospital-based specialists (such as radiologists and pathologists) would be covered under HI instead of SMI.

Part of the cost of the OASDI changes would be met from the existing favorable actuarial balance which amounts to .74% of taxable payroll on a level-cost basis (see *Actuarial Study No.* 63, Social Security Administration). The remainder of the cost increase would be met by the higher contribution rates and the savings to the system produced by the rise in the earnings base. About half of the increased allocation to the DI portion of the program is required to meet its recent unfavorable experience and the remainder takes account of the increased general benefit level. No change in the contribution schedule for the HI program is necessary because the additional income resulting from the higher earnings base is more than sufficient to finance the additional outgo.

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