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Committee on Ways and Means

Subcommittee on Select Revenue Measures

Hearing on Private Employer Defined Benefit Pension Plans

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Chairman Tiberi, Ranking Member Neal, and Members of the Subcommittee. Thank you for the opportunity to present my views with respect to private employer defined benefit pension plans. My views are my own and do not represent any other persons or organizations.

I am an independent consulting actuary and economist specializing in the financial aspects of pension plans.

I will address the measurement of liabilities and costs of multiemployer pension plans. My central message is that liabilities are understated by as much as 50% and annual costs are underestimated by as much as 100%. Good policies cannot be based on bad numbers.

Actuaries performing valuations for multiemployer plans have always been challenged by employers wanting lower costs and employees wanting larger benefits. Circa 1980, with Treasury bond yields in double digits, naturally conservative actuaries were discounting benefit promises at interest rates below 7%. By 2000, with equity markets soaring and Treasury rates in the neighborhood of 6%, actuaries were discounting at about 8%. Since 2000, although Treasury rates have fallen to about 3%, indicating a widespread decrease in interest rates and a commensurate sharp increase in liabilities, actuarial discount rates have, for the most part, held steady. The desires of employers and employees make it all but impossible for consulting actuaries, with the best of intentions, to lower discount rates accordingly. The result is that liability values are grossly understated, costs are underestimated, and actuarial assumptions have been too optimistic.

Once the deficit develops, once there is a hole in the ground, there are only two ways to fix the problem: smaller benefits for employees, larger costs for employers. The proposals being discussed are, very reasonably, some combination of these two approaches.

I am agnostic as to how much benefits should be cut versus how much additional cost should be borne by employers.

My message is this: unless accurate estimates of future cost are on the table and open for all to see, the combination of benefit cuts and employer costs will not reduce the deficit, will not fill the hole. On the contrary, the hole will get bigger unless two necessary steps are taken:

- first, get the right price for all future benefit accruals and make sure at an absolute minimum that these are paid, and
- second, accurately measure the deficit and decide when, how and who pays to fill the hole.

How can we get the right price? Actuaries trying to balance the needs of the employees and the employers cannot be expected to push valuations uphill when the interested parties want to go downhill. I believe that the concept of an independent consulting actuary putting a value on these benefits is irreparably flawed. The party setting the price must have very significant skin in the game and capital at risk. The party that sets the price must also guarantee the benefits and hold sufficient capital to make good on its guaranty.

The need to have capital at risk guarantying benefit promises implies something like insurance companies with actuaries whose primary obligation is to the company that puts up the capital, guarantees the benefits and employs the actuary. These institutions do not have to be insurance companies as we know them but they must combine capital, benefit guarantees and actuarial expertise.[1]

Summary

- Measure accrued liabilities and future costs accurately.
- Accurate measurements will be made only by parties with skin in the game combining capital, benefit guarantees, and actuarial expertise.
- To avoid making matters worse than they already are, plans must, at an absolute minimum:
    - Pay the full price for newly earned benefits or reduce accruing benefits to match available funding.
    - Pay the interest on unfunded accrued liabilities.

[1] A less robust but still adequate approach might be to require consulting pension actuaries to mimic insurance company methods and assumptions.