JAMES KENNEY

Saving Private Pensions

The recent financial crisis has demonstrated clearly the fallacy of transferring investment risk to employees in retirement plans. The law of large numbers, the fundamental principle of actuarial science, simply does not work on an individual level. While younger employees may have time to outlast the huge drop in their 401(k) accounts, workers close to retirement have seen their "retirement security" turn to ashes and their dreams of golden years turn into a nightmare of endless poverty.

Even more insidious is the likelihood of unexpected longevity draining retirement accounts prematurely, turning what should be a blessing into a curse.

These are the drawbacks of a retirement system based on an account balance approach. On the microeconomic level, it means insecurity, anxiety, and risk, at a time when the individual is least able to bear such risk. On a macroeconomic level, it means a nation forced to choose between abandoning its elderly to poverty or developing expensive new programs to lift them up again.

This is the dilemma into which the demise of the private pension system has led us. The 401(k) plan will not, and cannot, lead us to national retirement security. One leg of the famous three-legged stool has been sawed in half.

But how can we possibly reverse the flood of forces that have led companies to replace their defined benefit plans with 401(k) plans? What company in its right mind would establish a new defined benefit pension plan in the current environment?

I suggest a simple change to our tax code could reverse this trend. I propose that contributions to defined benefit plans be deductible at 125 percent of the amount contributed. This would provide an incentive for corporations to take back the investment and longevity risks from their employees. Consider the extra 25 percent deduction as a "risk premium" paid to employers by a nation eager to return to a more secure retirement system, in order to avoid the problems that would be created by massive numbers of impoverished retirees.

Someday this particular crisis will be over, but the lessons to be learned will endure. Putting the security of a generation of workers at risk due to economic factors beyond their control is not only poor public policy; it simply doesn't make sense from the fundamental principle of the law of large numbers.

Editor's Note: The opinions expressed in this column are those of the author and do not necessarily represent the views of the Academy. JAMES KENNEY*, a pension consultant in Berkeley, Calif., is a contributing editor to the* EAR.

Spring Forward to Summer

In the summer issue of the *EAR*, former Academy Pension Fellow Ron Gebhardtsbauer will analyze current pension law and offer his own suggestions for how to fix the private pension system.

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in early 2008, is likely to follow after that.

In addition, actuaries should expect to see a revised version of Revenue Procedure 08-67 that will identify in better detail the material the IRS wants in regard to an actuarial certification that a plan qualifies for so-called "automatic" amortization extensions under Internal Revenue Code 431(d). The IRS indicated that approvals were starting to flow in by early March, but some of the applications do not cover the full range of items that are needed. Actuaries are encouraged to submit comments on the current revenue procedure so that they can be taken into account in the new version.

The IRS also made it clear that additional instructions will be provided to enable actuaries to properly complete some of the new items on Schedule M-B to the annual Form 5500 filing, specifically the determination of whether a plan is making the scheduled progress in a funding improvement or rehabilitation plan. Finally, the subcommittee was asked to consider whether, given the stark economic situation, regulations may eventually be needed under the Section 418 reorganization provisions of the code. (Comments may be submitted to Jessica Thomas, the Academy's pension policy analyst, at thomas@actuary.org.)

Academy attendance was high for the meeting, as members came out in full force. Representing the Academy were 11 subcommittee members (including four by conference call), as well as Academy Senior Pension Fellow Frank Todisco and Thomas. From the IRS, Harlan Weller, James Holland, Marty Pippins, David Ziegler (all Academy members), and three attorneys participated. The subcommittee hopes to continue these meetings in the future.

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