

Really Smart or Merely Shrewd?

After 40 years as a naturalized Mediocristani and Platonification expert, the Black Swan calls into question the intrinsic economic value of the time I have spent—long a repressed concern.

Gerry Smedinghoff’s charming, informative review (“Black Swan or Black-Scholes? The Crisis of the Actuarial Profession,” May/June 2008) challenges the actuarial ego’s professional certainty in dealing with uncertainty. Juxtaposed in *Contingencies* with Mindlin’s article on financial economics (“In Support of the Weatherman”), it exposes the question, “Are we really as smart and valuable as we think we are?” Or maybe we are shrewd entertainers with a tad of self-deception. Certainly, the charade has bought some groceries for this Black Swan/prestidigitator, and few of my species look beyond that.

Kudos to *Contingencies* for these articles.

THOMAS H. SHELBY III
DALLAS

Despite his persistent framing of arguments in the context of “the actuarial world opposes this,” I enjoyed the broad point made by Gerry Smedinghoff in his Black Swan article in the May/June 2008 issue of *Contingencies*.

The fact that actuaries are at great risk of failing to anticipate the unexpected (and that they are among those experts who “after long delay and a sudden unexpected Black Swan event” are eventually parted from their money) is often ignored or at least insufficiently addressed by our profession. The challenge to conventional thinking that this article presented to those of us consumed by our daily grind is why I read *Contingencies*.

I am concerned by the image the author presents of the profession: that actuaries do not honestly admit and address errors. While tongue in cheek, it is a bit disturbing to suggest that a suicidal response to an error of assumption is somehow honorable. Hopefully, we can find a way to acknowledge risks and errors (or the failure



to identify all risks) without losing full credibility as individuals or as a profession (and certainly without losing our lives). That seems to be a challenge worth embracing.

WES EDWARDS
LOUISVILLE, KY.

What Do Employees Want?

In “The Real Truth About Defined Benefit Plans” (May/June 2008), there are many untruths and exaggerations with regard to DB versus defined contribution (DC) plans. I do not have time to address all of the issues that Eric Cerling brings up, but I want to respond to his comment when he writes: “The not-so-obvious issue is that of ‘wasted dollars.’ If the primary purpose of plan sponsorship is to provide employees with a source of retirement income, any benefits distributed in the form of cash payments before an employee attains retirement age (i.e., lump-sum distributions paid to terminating employees) are wasted dollars.”

I am content to repeat myself from my letter to the editor in the March/April 2008 issue: “Let us be clear about why companies provide any sort of employee benefits: because they want to attract and retain good workers for the period of time that they will be useful to the company.”

The company does not care what people use 401(k) money for once they leave

the company. If a person uses the money to tide themselves over between jobs instead of rolling over into an IRA for retirement 30 years later—why should Acme Corp. care? What the employees do with the money once they get it is their own business.

The only way in which the money employers spend on retirement benefits (whether for DB or DC plans) is wasted is if it doesn’t do its duty in attracting and retaining the employees they want. Some types of employees value the flexibility of 401(k) plans more than the benefits of DB plans (including employees who have experienced mergers, outsourcing, and downsizing time and again). I can see DB plans being useful in attracting older workers with years of experience when one has a talent crunch due to demographics. Pretending that DB plans will be equally valuable to all employers and employees is ignoring the reality of a very fluid job market.

MARY PAT CAMPBELL
NEW YORK

I read Eric Cerling’s piece, “The Real Truth About Defined Benefit Plans,” which was, at least partially, a response to my earlier commentary on the demise of traditional defined benefit (DB) plans (July/August, 2007). Eric raises many valuable and accurate points but, in my opinion, doesn’t address the real issue—

that employers are the ones selecting plans, and defined contribution plans better serve the needs of employers in today's financial and regulatory environment. Whether the DB model is better for the financial security of the individual is a worthy argument, but it's not a driving force in the employer's decision. Without some significant regulatory changes, it is unlikely that the traditional DB plan will regain traction anytime soon.

MARK SHEMTOB
FLORHAM PARK, N.J.

I was very pleased to read Eric Cerling's article in which he promotes defined benefit (DB) plans over defined contribution (DC) plans.

I have been retired for over 12 years. As a former consulting pension actuary, I have been dismayed by the apparent disappearance of traditional DB plans. I hope that I am wrong, but I foresee a possible

retirement disaster in this country in about 20 to 30 years. At that time, I assume most workers will have solely 401(k) accounts at retirement. There will be very small balances in most of those accounts as they will have been depleted by employees prior to retirement. Such retirees will be looking to rely on Social Security at a time when the government may be attempting to lower Social Security benefits because of the deficit between tax income and benefit outgo.

I would suggest two possible additional reasons for the recent move from traditional DB plans to DC plans:

1.) Soaring year-to-year increases in group medical benefits, which employers have attempted to offset by turning to what they believe to be lower cost DC pension plans.
2.) A misguided government bureaucracy that, following the enactment of ERISA, used regulations to limit the amount of benefits payable to high-level executives

from the companies' qualified DB pension plans. Top executives now receive most of their pension benefits from nonqualified excess plans. I am sure current consultants don't experience, as I did once, a meeting with the benefit manager that was also attended by the company president. The president wanted to make sure his future benefits would be well-funded. He authorized a maximum contribution to the company's DB plan for that year.

WALTER MCLAUGHLIN
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Comparing Health Care Results

I read with great interest Donald M. Armstrong's article, "A Prescription for the Future of Health Care in the United States," in the January/February 2008 issue of *Contingencies*. I would like to take issue with some of Mr. Armstrong's assumptions and conclusions, particularly:



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› Life expectancy and infant mortality are meaningful ways to compare outcomes in different countries;

› Administrative costs are lower in the Canadian system than in the U.S. private system.

I believe that Mr. Armstrong's discussion of outcomes is misleading. He shows that the U.S. ranks worse than five other countries for infant deaths per 1,000 live births and for total life expectancy and concludes that U.S. health care outcomes are worse than outcomes in these other countries.

Life expectancy is not a meaningful measure of health care outcomes in two disparate populations. Factors such as obesity, smoking, drug abuse, and violent crime, to name a few, play a much larger role in life expectancy than does health care. These factors are so distorting that if you correct for homicides and accidents, the U.S. rises to the top of the list for life expectancy, according to a 2006 study for the American Enterprise Institute.

Comparisons of infant deaths per 1,000 live births are also problematic. The U.S. puts a high value on positive outcomes for high-risk pregnancies. Very low birth weight infants have a much better chance of being brought to term in the U.S. than virtually anywhere else. Even with the best technologies, some of those babies die soon after birth, which results in a higher infant mortality rate. In many other Western countries, those high-risk, low birth weight babies are not included in the calculation of infant mortality.

An alternate way to think about health care outcomes is with regard to specific diseases. From cancer to heart disease, pneumonia, or AIDS, the chances of survival are higher in the U.S. than in other countries. For example, the mortality rate for breast cancer is 25 percent in the U.S., 28 percent in Canada, and 46 percent in the U.K. The mortality rate for prostate cancer is 19 percent in the U.S., 25 percent in Canada, and 57 percent in the U.K. (National Center for Policy Analysis, 2003).

Administrative costs of the Canadian health care system are largely hidden. In particular, one must take care to treat the



cost of collecting the premium or taxes consistently for public and private insurance. Patricia Danzon of the Wharton School of the University of Pennsylvania estimates that, with all costs included, overhead in the Canadian system is 45 percent of claims and less than 8 percent of claims for U.S. private insurers.

In addition to financial costs, Canadians pay significant costs in terms of wait times. In 1997, an estimated 20 to 30 percent of all patients on waiting lists in Canada were expected to die before getting care (NCPA, 2003). Wait times increased 50 percent from 1997 to 2006 (Fraser Institute, 2007).

Certainly, the U.S. health care system is in need of some improvements. However, moving to a Canadian-style system would not be an improvement.

GAYLE BREKKE
PARKVILLE, MO.

that make the market value less for me?

Unlike gold, the pension annuity market is a private market with a limited number of transactions. However, the pricing can be estimated using high-quality bond rates. The argument that annuity prices are "too conservative" because insurers invest in bonds, are regulated, have reserve and capital requirements, or make profits has been put forward by those who wish to use a higher discount rate based upon assumed future returns on equities. They ignore the cost of guaranteeing the benefits. If a fund invested in equities is set up based on an assumed rate of return and the fund earns less than the assumed rate, the benefits will not be paid. Annuity pricing is reflective of what a financially responsible entity would charge to guarantee pension payments.

VICTOR MODUGNO
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Complicating a Simple Concept

Daniel Moore's commentary in the March/April 2008 issue of *Contingencies* ("The Market Value of Pension Liabilities") complicates a simple concept of market value as the price at which a willing buyer and seller would exchange a liability. There is an active market for pension liabilities in which several highly rated insurers compete for business. That only a small portion of pension liabilities are actually settled, or that plan sponsors consider annuity prices unattractive, does not affect the market value. If I think gold is not worth \$930 an ounce and refuse to buy it, does

Contingencies always welcomes reader comments. The letters section offers readers an opportunity to share stories, ideas, and opinions.

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All letters are edited for grammar, spelling, style, and length.