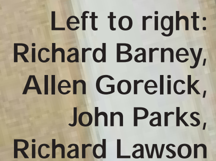
Academy visits to Capitol Hill are not only about winning hearts and minds; they're about making sure those hearts and minds have the right information when it comes to drafting legislation and setting public policy.

Mr. Parks Goes to Washington



Left to right:
Richard Barney,
Allen Gorelick,
John Parks,
Richard Lawson

By John P. Parks

WE MEET AT THE PRESS AREA NEAR THE STEPS OF THE U.S. CAPITOL. Twenty of us. The Washington sky is deep blue and spotted with intermittent puffs of low-level clouds. A crisp breeze compels alert and lively conversation. Diligently posing for the mandated photographs, we cheerfully and perhaps a bit nervously anticipate the events of the day.

Our purpose is Hill visits. We are four teams, each consisting of Academy members and one staff employee, and we're scheduled to meet with 16 Senate and House staffers. My team, Team D, includes Heather Jerbi, Dick Barney, Allen Gorrelick, and Rick Lawson. Of the four visits earlier scheduled, one is cancelled just moments before because of the recent release of the president's proposed budget. It's going to be a busy day on the Hill.

Actually, it all begins at 0700 that same morning with breakfast and a training session at Lowe's L'Enfant Plaza hotel, not far from the Capitol. What we would really like to talk about today is the dangerous inadequacy of 30-year Treasury bills in funding defined benefit (DB) pension plans. This is an important issue to the Academy and to pension actuaries across the country.

Photography by David Hathcox

But we know it's a highly technical, arcane subject for non-actuaries—and there are very few (if any) actuaries on Capitol Hill. And we also know that, at the moment, most of Congress is focused on the meltdown of Enron and the resulting scandals. And while what happened at Enron may have some long-range impact on how consultants do business in the future, the issues surrounding Enron aren't actuarial.

So our task is this: How can we get the legislators we meet with today to forget Enron for a moment and focus on something a little more difficult to grasp but equally important to millions of participants in American DB plans?

The 30-Year Treasury Problem

The Internal Revenue Code (IRC) currently requires the use of the 30-year Treasury rate in several defined benefit pension plan calculations. The American Academy of Actuaries' Pension Committee believes that the 30-year Treasury rate is no longer an appropriate rate either for determining current liability of under-funded plans or for determining premiums paid to the Pension Benefit Guaranty Corporation (PBGC). This is because the 30-year Treasury rate is currently extremely low and is unrelated either to corporate bond returns or annuity rates. In addition, the Department of the Treasury no longer even issues 30-year Treasury bonds, and has ceased publication of the rate.

The Pension Committee also believes that in determining a replacement rate, it's important to recognize that any anticipated rate of return reflecting stock returns can be quite high and subject to much variability and difference of opinion. For that reason, policy-makers might prefer a tighter selection inside these rates, such as the interest rate for determining annuity prices or a corporate bond rate.

The interest rate is one of the most important assumptions involved in determining pension plan funding contributions. In general, the lower the expected future investment earnings, the greater the required minimum contribution to the pension plan. For many years, federal law permitted pension actuaries to use an interest rate that reflected their expectations of future plan experience. But in 1987, the Omnibus Budget Reconciliation Act (OBRA 87) modified pension plan funding rules by requiring the use of the 30-year Treasury rate in determining the "current liability" of under-funded plans, which is used to determine annual minimum funding contributions.

Specifically, OBRA 87 established the permissible interest rate range as a 10 percent corridor on either side of a 4-year average of 30-year Treasury rates. In specifying this range, Congress intended to establish an interest rate "consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan."

The Academy's Pension Committee continues to assert that the required use of the 30-year Treasury interest rate in certain pension plan calculations is causing many employers to contemplate terminating their plans, and discouraging other employers from starting new defined benefit plans. The use of the 30-year Treasury rate is causing dramatic and unreasonable increases in minimum contributions to underfunded plans, and

Left to right:
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Chester Andrzejewski
Heather Jerbi
Allen Gorrelick
David Kass
John Parks
Lawrence Johansen
Ron Gebhardtsbauer
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Daniel McCarthy
Christine Mahoney
Bridget Flynn
Lawrence Sher
Todd Tuten
Richard Barney
Edward Burrows
Brian O'Konski
Richard Lawson

also requires some plans that are well funded using PBGC's interest rates to pay unnecessarily large variable premiums.

This is especially true now, because Treasury rates are around 200 basis points below corporate bond rates. That means an average employer could be required to put 25 percent more than would ever be needed into their pension plan. A research paper by Victor Modugno sponsored by the Society of Actuaries suggests that insurance companies, which generally must invest in corporate bonds, pass on to the annuity buyer a return equal to the corporate bond rate reflected in the Bloomberg index for A3 bonds minus approximately 70 basis points. Therefore, now that Treasury rates are 200 basis points lower than corporate rates, they would produce a present value greater than the price of an annuity.

Why is the Treasury rate no longer even close to annuity rates or corporate bond rates? Over the past few years, the spread between the 30-year Treasury rate and both corporate bond rates and annuity rates has grown because of debt reduction and buy-backs from 1999 through 2001, as well as the flight to safe investments over the past year.

What should the mandated interest rate be, if not the 30-year Treasury rate? The Academy doesn't take a position on exactly what rate should replace the 30-year Treasury rate, but we can suggest a range of options and analyze the consequences of each. This is something we want to convey to people we meet with on Capitol Hill.

Another important message we want to make sure we leave with policy-makers on the Hill is that the Pension Committee believes that Congress should work to establish a level playing field between DB plans and defined contribution (DC) plans. The federal tax code currently places DB plans at a disadvantage relative to DC plans. Defined benefit plans, however, provide a guaranteed stream of income for life and are critical to Americans' retirement income security.

While the Academy believes strongly in the importance of defined benefit plans, we believe that defined contribution plans also serve a critical role in the employer-sponsored pension system. Neither type of plan should be placed at a disadvantage to the other, and both types of plans should be encouraged.

Finally, as the public policy arm of the U.S. actuarial profession, the Academy provides independent, objective analysis to policy-makers and regulators. Academy members use their actuarial expertise to contribute to the public debate on a range of major issues, from Social Security and Medicare to pensions to health, life, and property/casualty insurance. We want to use our visit to the Hill to encourage staffers to contact the Academy's public policy department with any requests for analysis or input.

Face Time

The four teams split up, and we're off to our first visits at the various Senate and House office buildings. Team D's first visit

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is in the Rayburn House Office Building with the tax counsel for the ranking member of the House Ways and Means Committee. (All our meetings this day are with staffers; meetings with actual members of Congress are relatively rare and really not always necessary. The staffers are the ones who do most of the homework that members rely on, and the Academy is there to help provide the study materials.)

Rather than simply shaking hands, taking photos, and showing us the door, the tax counsel spends nearly an hour with us. As expected, the first topic of conversation is Enron. She admits that the Enron problem is more about accounting standards and fraud than about pension reform, but she thinks Enronmania could possibly spark more of an interest in the need for pension security.

Left to right:
Todd Tuten, Dan McCarthy,
Brian O'Konski, Bridget Flynn, Ed Burrows

From her perspective, the problem is pension security. The growth of defined contribution plans has outpaced government's ability to regulate them, while at the same time the restrictions of ERISA have made defined benefit plans less attractive to employers. She sees cash balance plans as a possible alternative.

She also understands the problem with 30-year Treasuries. Though she believes a short-term fix is imminent, a permanent solution isn't likely to happen soon. She does, however, express interest in any materials the Academy has on alternatives to 30-year Treasuries, as well as information on cash balance plans.

Outside, we're greeted by a blustery wind and quarter-sized snowflakes—both in shocking contrast to the blue skies that greeted us just 90 minutes earlier. It's a graphic demonstration (as if we needed one) of how fickle the winds of political change can be, especially in our nation's capital.

We reconnoiter and lunch with our fellow teams at Barolo's on Pennsylvania Avenue. We review the morning's visits with the members of the other teams and prepare for the ones to come. We all compare notes about how our meetings went. In the process, we lose some of the nervousness that accompanied us throughout the morning.

Team D's second visit is once again at the Rayburn Office Building, but this time with the tax policy adviser for a Southern Republican. Once again, we're greeted by someone who is unusually savvy about pension issues, particularly the 30-year Treasury problem. She's sanguine about the possibility of pension reform this year, but she's apprehensive about the shape reform might take. Defined benefit plans are already being strangled to death, she says, and she hopes reform won't be encumbered by even more rules and extra layers of compliance.

Outside we're greeted by a blustery wind and quarter-sized snow flakes.

She, too, indicates interest in reading the Academy's analysis of alternatives to the 30-year Treasury replacement rate when it becomes available.

Our third visit of the day is with a staffer for a Republican senator from the Northeast. She's relatively new to the pension field, so once again we find ourselves talking about Enron and answering questions that have nothing to do with actuaries or pensions.

But we're eventually able to steer the conversation in our direction. We start with the basics of the Academy—what it is and how it works—and segue into the issue of 30-year Treasuries. This is all foreign territory for her, so we provide basic background and outline the problem for her.

Though one's initial reaction might be dismay at the legislative assistant's lack of pension expertise, we view the encounter as a fortunate opportunity. Our meeting becomes a crash course in actuaries and actuarial issues. And before we leave, we've already established ourselves as a valuable resource she'll be able to use as her education advances.

Our teams on that day attended 14 out of the 16 scheduled Hill visits; a great ratio considering the dynamics of the arena. Team A talked not only with House and Senate staffers but with representatives of the General Accounting Office. The GAO updated the Academy on its current projects, including Social Security, benefit adequacy and coverage, and, of course, Enron.

The Hill staffers, in turn, asked for the Academy's opinion on guaranteeing DC assets and requiring some formula for as-

set mix in DC plans. In fact, the level of interest among Hill staffers in a DC plan with guarantees is striking.

Our first reaction is that providing a guaranteed stream of income in retirement is already possible through DB plans. It's clear from our visits, however, that rather than focusing on removing some of the barriers to DB plans, Congress' first impulse in the wake of Enron is to come up with an entirely new paradigm—a DC plan with guarantees.

From the Academy's perspective, however, it's simpler to level the playing field by removing barriers to DB plans than by adding a layer of regulation to DC plans. Clearly, these initial Hill visits will have to be followed up by regular contact throughout the year to ensure that policy-makers hear the Academy's voice in this discussion.

Teams B and C, in addition to meeting with House and Senate staffers (including the House minority leader), also met with a Treasury official who, not surprisingly, is well aware of the 30-year Treasury issue. He affirmed that a short-term fix was probably in the offing and that a long-term solution would take awhile. He also suggested that hearings on the problem of 30-year Treasuries were probably needed.

In January and February this year, more than 30 Academy members and staff representing the Academy's casualty, financial reporting, health, life, and pension practice councils visited 52 Capitol Hill offices, including aides to senators and representatives and officials from the Treasury Department, the General Accounting Office, the Congressional Research Service, and the Congressional Budget Office.

This is a tremendous service to Academy members, one that many actuaries cite as their main reason for membership. The recognition and respect for the American Academy of Actuaries on Capitol Hill is exciting to witness and a reward unto itself. That acceptance is a direct result of the efforts of the many volunteer members and dedicated staff.

Did we accomplish our mission on this blustery Washington day? I think so. We were able to cut through the distractions of the headlines and educate the policy-makers about the issues that are important to us. We became a part of the political process.

Does that mean we influenced anybody or changed any minds? Not at all. But that's not what we were there for. We were there to let them know that the problems facing us have several solutions, and each of those solutions has consequences. Part of the policy-maker's job is evaluating and analyzing those consequences, and the Academy can be an integral part of that process.

That's not only good for the process and the country as a whole; it's also good for the profession. ●

JOHN P. PARKS IS PRESIDENT OF MMC&P RETIREMENT BENEFIT SERVICES, A DIVISION OF THE BCI GROUP IN PITTSBURGH. HE IS ALSO VICE PRESIDENT OF THE ACADEMY'S PENSION PRACTICE COUNCIL.

THE ROSTER

Participating in the combined casualty, financial reporting, and life visits were Pat Teufel; Steve Lehmann, the Academy's vice president for casualty issues; John Purple, vice chairperson of the Academy's Casualty Practice Council; Paul Kneuer; John Kollar; and Alastair Longley-Cook.

Participating in the pension visits were McCarthy; Parks; Larry Johansen, the Academy's immediate past president; Ethan Kra, vice chairperson of the Academy's Pension Practice Council; Don Segal, chairperson of the Academy's Pension Committee; Chet Andrzejewski; Dick Barney; Ed Burrows; Allen Gorrelick; Dave Kass; Lisa Larsen; Christine Mahoney; Larry Sher; and Ron Gebhardtsbauer, the Academy's senior pension fellow.

Participating in the health visits on Feb. 12 were Geoff Sandler, the Academy's vice president for health issues; Jan Carstens, vice chairperson of the Health Practice Council; Al Ford, a member of the Academy's Board of Directors; Darrell Knapp; Jeff Nohl; David Shea; John Schubert; Rod Turner; Margaret Wear; and Cori Uccello, the Academy's senior health fellow.

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