Only Part of the Picture

We are the "other" actuaries living in Las Vegas, so we read the captioned article by Mr. Shackleford in the January/February edition of *Contingencies* with great interest. There have been similar studies done and as anyone—whether an actuary or not—living in Las Vegas knows, the payout rate is a subject of keen interest.

Mr. Shackleford analyzes slot payout rates from the casino owner's point of view. What occurs to us, however, is the fact that while this statistic is of great interest to the slot casino owner, it actually fails to capture the element most interesting to the slots player. The casino owner is interested in a payout rate that's an expected value concept, but the slots player is most interested in the large jackpots to be won, which is a variance concept.

As in most analyses, knowledge of the expected value without knowledge of the variance captures only a small part of the statistical picture.

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What Price the Social Fabric?

In the commentary "Options Strengthen Social Security" (January/February 2003), a change is proposed that would weaken Social Security rather than strengthen it. The option to take a lump sum of less than the full value of the Social Security retirement benefit and purchase a variable annuity with the diminished lump sum is presented as a winner for the government and for the people. The government wins because it has saved money, since people accept less than the full value of their retirement benefits. People win since they can have the "opportunity to maximize that income by investing in a mix of bonds and equities . . . . "

I have several concerns with such an option. First, while the option does provide the opportunity to maximize income, it also provides the opportunity to minimize income. In the example provided in the article, the option initially decreases the value of the investment by more than 26 percent. We are led to believe that investing in a mix of stocks and bonds will overcome this deficit. Sometimes it will and sometimes it won't. In order to "win," the basket of securities must realize a nominal rate of return equal to the AIR (5 percent in the example) + inflation + expenses of the private annuity. This is a tall order, and many will fail.

Second, the option is presented as a one-time choice. Consequently, while this does not affect the average result over the entire system, results for individuals will vary significantly. Those unlucky enough to choose the option at a market "top" will suffer, whereas the lottery winners who happen to choose the option at a market "bottom" may be handsomely rewarded for their gamble.

This brings me to the social insurance aspect of Social Security, which is ignored in the presentation. Social Security is designed as part of a safety net. Those with retirement assets in addition to Social Security have the opportunity to invest those additional assets in whatever manner they choose. Why do they need to tap Social Security as well? Those without additional assets can ill afford the risk of lesser benefits in the hope of possibly getting greater ones. If financially less secure individuals were to have the option proposed in this article and meet with unfortunate results, would government have to step in to mitigate the destitution Social Security was designed to help avoid? If so, then the "savings" to the government has been overstated. If not, what is the price to the social fabric of these United States?

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