Comments to the Public Interest Committee of the American Academy of Actuaries

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In addition to being a professor of management science in the College of Business Administration at California State University, San Marcos, I am a member of the California Public Employees' Retirement System (CalPERS) Board of Administration. CalPERS is the largest public pension fund in the U.S. We administer retirement benefits for more than 1.5 million active and retired California government employees and their families on behalf of 2,600 government employers in California.

I represent California state employees on the CalPERS board and am directly elected by the members I represent. As such, I am closely attuned to the needs of my constituents.

I want to share with you some deep concerns I have about the negative impact on public pension plan members of the proposal to adopt a statement supporting disclosure by public pension plans of the *so-called* "market value" of liabilities – the value of liabilities based on risk-free or near risk-free discount rates.

The question before you is whether a statement supporting such disclosure is in the public interest. I would argue that such as statement would be misleading, would be harmful to the members of public pension plans, and would not be in the public interest.

The term "market value of liabilities" is misleading. The market value is the value at which a willing buyer and a willing seller would elect to transact. The term implies that a market exists in which these obligations are traded, which is untrue. The public believes that a market value is a value that can be observed – and is usually printed in the newspaper – rather than a theoretical calculation that has never been compared to an actual market to determine if the theory has taken into account all of the factors that would affect buyers and sellers. Actuaries should not be misleading the public and professional actuarial organizations should not be advocating a reporting scheme that does so.

The overarching question is "who is going to benefit from this additional disclosure?" This question has not been satisfactorily answered. Proponents suggest several possible interest groups would benefit, but none of the arguments is persuasive.

Proponents of the proposal suggest members will benefit by knowing the "real" value of their pension benefits. From someone who is close to and represents plan members, let me assure you that they know the value of their pension benefits. Real value is demonstrated by receiving a secure retirement benefit, not by disclosure of an artificial, misleading number that members will not understand.

Proponents also argue that taxpayers will benefit. In this scenario, government policy makers would try to extract greater concessions from employees in the collective bargaining process if the "real" value of their benefits is known. This displays a misunderstanding of how the collective bargaining process actually works in government. Rather than the salutary scenario

painted above, it is more likely that collective bargaining would break down due to a misunderstanding of the meaning of this number. In reality, the number has no affect on the level of required funding unless it leads to a change in the way assets are invested. However, if participants in collective bargaining misunderstand and think the higher MVL figure requires a higher level of employee or employer contributions, it will lead to needless deadlocks in the bargaining process and taxpayers will suffer from the resulting disruption of services.

Finally, it has been argued that purchasers of government bonds would benefit from this disclosure. This is the weakest argument of all. Bond buyers care about government's ability to make the bond payments when due. While required employer contributions to its pension plan could impact a government's ability to make bond payments, it is the level of required contributions and the volatility of future payments that are of concern to bond holders. The MVL does not provide this information; no point estimate will provide such information. More useful information to bond buyers would be a stochastic analysis of future contribution levels such as that presented to the CalPERS board at our regular asset-liability workshop.

A companion question to who benefits from the proposal is who will be harmed by this additional disclosure. The answer will vary from jurisdiction to jurisdiction. The disclosure of an additional, different liability number will confuse some policy makers, which could result in poor policy decisions. This outcome will depend on the politics of the jurisdiction and the financial sophistication of key decision makers in the jurisdiction. Under these circumstances, it would be more prudent to leave the decision as to whether or not to disclose this additional liability measure at the local level rather than supporting disclosure for each and every pension plan.

The politics in the State of California are such that a new, higher liability figure would be interpreted (or exploited) by many as meaning that higher contributions are required. Most proponents of financial economics say this interpretation is not accurate, but it would still nonetheless provide fuel to those who want to ban defined benefit pension plans in the public sector. Eliminating defined benefit plans would result in governments having to rely on less efficient defined contribution plans for their employees, harming both taxpayers and government employees.

I also have serious concerns about the process used for consideration of the Committee's statement. I am told that key stakeholders such as the public pension systems themselves are not being permitted to speak at the forum and, further, that none of the members of the Public Interest Committee are public plan actuaries.

This seems highly curious. It seems highly inappropriate for a committee of actuaries with no experience or expertise in public pension plans to be developing guidelines for public pension plans – especially when most public plan actuaries oppose the proposed statement. It would be like a committee of dermatologists at the American Medical Association developing a public interest statement on brain surgery over the objection of the brain surgeons.

Clearly, the interests of public plan members and the general public would not be well served by the Academy advocating for disclosure of the so-called "market value of liabilities."

The adage "if it's not broken, don't fix it" applies here. Nobody has put forth any compelling arguments that our current public pension reporting system is broken and needs fixing. Therefore, I urge you not to issue the proposed public interest statement. It will cause a lot more harm than good to the people who elected me and whom I represent, the members of the retirement system.