

DATE: August 29, 2008
TO: The American Academy of Actuaries' Public Interest Committee
FROM: Dimitry Mindlin, *CDI Advisors LLC*
SUBJECT: Market Value of Liabilities

Thank you for the invitation to submit comments regarding potential improvements in the financial and actuarial reporting for public pension plans. This area has been hotly debated lately, and the Academy's interest in this matter should be appreciated.

It is disconcerting, however, that the Academy appears willing to start a discussion without proper definitions of the objects under consideration. While the term "the market value of assets" is relatively uncontroversial, the meaning of the term "the market value of liabilities" is far from clear. It is unfortunate that the convention against pontificating about objects one has not yet defined doesn't appear to get the recognition it deserves.

As we all know, individual pension benefits are not currently traded on any market. In particular, active plan participants cannot obtain "the market value" of their pension benefits directly from the marketplace. This fact makes it difficult to define "the market value of liabilities" for on-going plans. At the same time, there is a market – however imperfect – for terminating plans. The cost of termination can be considered as "the market value of liabilities" and used along with the market value of assets for measuring the plan's solvency.

Since most public plans are on-going, "marking" their pension commitments to any "market" is a complicated task. There is little in the actuarial and financial literature about the term "the market value of liabilities" without the termination assumption. Some appear to believe that, in order to make pension liabilities "marked-to-market," public plans must use the Treasury yield curve to discount pension commitments to the present. I believe, however, that their arguments are based on a dubious economic foundation.¹ I am skeptical that a proper definition of the term "the market value of liabilities" for on-going plans even exists.²

It is imperative for the participants of this discussion to clarify the terminology and either replace the term "the market value of liabilities" with "the cost of termination" or provide a clear definition of the term "the market value of liabilities" for on-going public plans. There is no doubt in my mind that the participants would promptly realize that the latter is a major challenge.

The Academy should recognize that it is considering elevating the issue of solvency as the primary concern for public plans. To do so without acknowledging that public plans may have other vital objectives may not be the best way to get the Academy involved in this discussion. The other objectives include, but are not limited to, maximizing the safety of the pension benefits promised to plan participants and minimizing the cost of providing pension benefits in the best interest of taxpayers. In order to achieve these objectives, public plans need better risk management tools rather than another set of "riskless" numbers of questionable utility.

¹ For more details, see Mindlin, D., The Good, the Bad, and the Ugly of Pension Accounting, CDI Advisors Research, 2008, <http://cdiadvisors.com/papers/GoodBadUglyCDI.pdf>.

² For more details, see Mindlin, D., The Myth of the Liability Benchmark, *Global Pensions*, October 2006, http://globalpensions.com/data/GP_pdfs/features/feature_pdf_716.pdf

The disclosure of the cost of termination for plans that have no intention to terminate doesn't strike me as a great idea. In order for the Academy's guidance to be valuable, it is critical for the Academy to pay close attention to the views of the practitioners who manage and serve public pension plans – plan officers, public officials, actuaries, economists, researchers, and others. They are well-positioned to identify the most helpful improvements in the financial and actuarial reporting for public plans.

Feel free to contact me if you have any questions.

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