Presentation by Karen Steffen to the Public Interest Committee
September 4, 2008
Regarding Disclosure of Market Value Liabilities for Public Pension Plans

A. How is this information relevant or useful to the public?

When presenting information to the general public, terminology is extremely important. This is particularly true when reports and discussions are almost always presented in an open public meeting and you have no idea of the knowledge level of the audience.

The term “market value” is generally considered to mean: the value that a willing seller would offer to a willing buyer and is for the purpose of establishing a price. I believe the term “market value liability” (MVL), as it has been used, is misleading to the public since the public plan obligations cannot be bought or sold. There is no willing buyer for these obligations as there can be for the private plan obligations.

The proponents of the standard definition of MVL have failed to recognize the true nature of public benefit obligations in their simplified definitions. An accrued benefit does not reflect the continuation of the benefit obligation beyond the date of the valuation. Some recognition of the value of the future accruals is needed to present a fair representation of the value of the true obligation. This is because the **right** to future benefit accruals cannot be terminated in a majority of public plan jurisdictions and, in some states, is protected by constitutional provisions. Implying that the accrued benefit has a value that does not reflect this non-curtailment obligation understates the true nature of the public plan’s obligations.

B. What really matters to the public is the cost.

Taxpayers and government officials are concerned with taxes and budgets. Only the cost of paying for the benefits is of interest to them. The discount rates used in the MVL approach does not relate to funding and is not being used to set these budgets and taxes. Currently, funding of public plans is based on a reasonable expectation of future events both for future benefit payments and future revenues. Statistically, about 70% of all public pension benefit payment dollars come from investment returns.

To use a lower rate than that used to reflect the expected investment returns places an artificially high value on benefits. This MVL does not assist or inform policy makers in the budget decisions and would lead to overcharges to current taxpayers if it were to be used for funding purposes.

If the discussion of the discount rate is to define “investment return risk” then risk is a two-way street. It is wrong and misleading to tell a taxpayer: “Your ‘true liability’, or cost, should be more” when, historically, the Treasury bill rates are at the very low end of the investment return risk spectrum. If we are discussing risk with the public then we should be discussing the upside as well as the downside of risk. Terminology such as stating MVL is the “true liability” when it differs from the more traditional liabilities reported under GASB leads to confusion for the taxpayer. “True” implies that only one value is the right value, not two values. This leads to not knowing which number is the right one and increases the distrust of what actuaries are saying.

If the discussion is differentiating between a discount rate and the income from investments then this belongs to the ASOP 27 discussions.

The MVL will have more volatility in it than the normal pension value benefit (PVB) numbers. Volatility wreaks havoc with government budgets based on taxes. Providing two different liability numbers will lead to confusion for the policy makers, the tax payers, the politicians and the press.

C. No Silver Bullet

Some MVL proponents think that by merely disclosing the MVL it will be the silver bullet for certain plans' weaknesses. By advocating the MVL measure over the many other risk tools an actuary can use to explain risk, the advocacy position gives it a higher level of prominence than other tools in the actuarial toolbox. It implies a "one-size-fits-all" solution. It can also undermine the professional's ability to determine what is or is not appropriate for a particular situation.

What works for NYC using a Frozen Initial Liability cost method does not necessarily work for other plans.

D. Seek Better Solutions

I appeal to the PIC to address the concerns raised by the public plan consultants and to understand the differences between public and private plans. The profession can make the public plans even better if they help to advocate for better funding and stronger governance. The Academy's public plan subcommittee has begun a white paper on these issues and this will go a long way in promoting the profession's value to the public.

Let's stop spending our energy for or against the MVL number and encourage each professional to use all the tools available to have a real discussion of all types of risk – both up and down – as well as investment and demographic risks.

Let's work with the Financial Economics (FE) concepts and find a way to appropriately reflect the true nature of public plan obligations within the economic values. I have been told there is a sense of fear that someone other than actuaries will take over our roles – and do the numbers if we don't, but first let's discuss how FE principles are relevant to the public sector. Let's not jump onto a simple solution that worked for private plans just so we can be out there first or react out of fear. As professionals, let's create a solution that addresses issues from both sides of the table.

Lastly, and most critically, I want to express that many public plan consulting professionals and I feel strongly that there is a very serious risk that the **blanket endorsement** of MVL for all public plans will lead to misinterpretation and misuse. This is in direct conflict with our professional precepts regarding actuarial communications.