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August 29, 2008

Public Interest Committee
American Academy of Actuaries
1100 Seventeenth St., NW
Washington, DC 20036

Dear Committee Members:

I write on behalf of the California Public Employees' Retirement System, the largest retirement system in the country, with approximately 1.5 million active and retired members.

Our position is that a statement advocating the disclosure of the market value of liabilities for public pension plans is not in the public interest.

We would like to focus on three reasons why that is the case:

- The choice of terminology;
- How the information will be used; and
- How this will distract attention other, more important and urgent concerns.

Reason #1 – The Choice of Terminology

The term “market value of liabilities” is a poor choice and will mislead the public.

The classic definition of “market value” is the value at which a willing buyer and a willing seller would elect to transact. By definition, if there is no market, there can be no market value. While the “market value of liabilities”, as is currently being pushed by certain individuals, may be an estimate of the market value, there is objective evidence that the estimate is flawed – a point that the Canadian Institute of Actuaries has acknowledged in its recent exposure draft on a revised standard of practice on pension commuted values.

The term “market value of liabilities” is likely to mislead the public – the public is likely to believe that the market value is an observed value rather than a calculated value. Rather than attempting to understand what this new number means, the public is likely to assume that it knows what it means and not ask questions.

The term is not necessary. The IAA recently issues “A Note on Financial Economics” discussing relevant issues for actuaries. In that document, they did not, as far as I have been able to determine, use the term “Market Value of Liabilities”. If the term is not needed and could be misleading, we should not use it.

There is still some uncertainty as to how this should be calculated. For example, the Canadian Institute of Actuaries recently issued an exposure draft of a revised standard of practice for pension commuted values that includes a proposed adjustment for liquidity. There are substantial differences between the liquidity of a pension and fixed income instruments. Before a particular value can be called a market value it should at least take into account all of the factors that usually impact the market value of other instruments.

This issue could be fixed by an appropriate choice of terminology and such a change would be a substantial improvement in any proposed statement.

Reason #2 – How the Information Will Be Used

Prior to issuing a public statement on the topic of pension plan disclosures, it is important to consider how the information contained in such a disclosure will be used. Exceptional care should be taken if it is likely that the information could be used to mislead the public.

The preeminent issue in public plan financial disclosure is the required contributions. Great care has been taken by most public systems to ensure as level a pattern of funding as possible – witness the widespread use of the entry age normal funding method. This is because management of their budgets is a critical factor for every government organization. The first question that any change to financial reporting will engender is “how will this affect the required contributions?”

Given the focus on the level of required contributions, any disclosure on a basis different from the funding basis is likely to lead to confusion about whether it will impact contributions. Even people who have a fairly good grasp of these issues will occasionally confuse funding and disclosure. For example, a May 21, 2008 article in the New York Times stated, in reference to this issue: “The difference ‘is going to come out of services, and the services are for the working poor,’ Mr. Gold said.”

Given the high potential for unintentional misunderstanding and the very real potential for deliberate misuse, it would be most appropriate to leave the decision as to whether or not to disclose the liabilities based on a risk-free discount rate to the actuary, plan or plan sponsor. They are in the best position to evaluate the specific circumstances the plan and determine if such disclosure is likely to be used to mislead other parties.

It is not clear if this issue could be addressed by an appropriate wording of a public interest statement. It could be appropriately addressed by a well developed practice note where the potential for misunderstanding and for misuse could be discussed at greater length and a more nuanced approach used.

Reason #3 – Distracting Attention from More Important Issues

The biggest concern facing public plans is governance; if plan sponsors do not fund the required contributions, it does not matter how the liabilities are calculated. Disclosing an

additional value of liabilities will just confuse decision makers and distract attention from the more pressing concern.

A statement about the disclosure of the market value of liabilities will distract the attention of plans, plan sponsors, actuaries and legislators from the more pressing issue of governance – not as it relates to the plans but as it relates to the plan sponsors.

The issue of the plan sponsor not contributing at least the amount recommended by the actuary is at the root of the problems that have plagued the retirement systems in San Diego and New Jersey. This issue is where the actuarial profession should be focusing its efforts if it is really interested in serving the public interest.

This issue cannot be addressed by changing the terminology of the proposed statement. If the issue of the disclosure of the liabilities on a risk-free or almost risk-free basis were to be addressed in a practice note, it may still distract actuaries but would not distract plans, plan sponsors or legislators.

Conclusion

For all of the issues outlined above and for the other issues that we were not able to elaborate in such a short statement, CalPERS feels that it would not be in the public interest. It would be far preferable to focus on governance as a possible public interest statement and leave the issue of additional disclosure to an appropriate practice note.

Sincerely,

A handwritten signature in black ink, appearing to read "Ron Seeling". The signature is fluid and cursive, with a large initial "R" and "S".

Ronald L. Seeling, Ph.D., FCA, ASA, MAAA, EA
Chief Actuary