

Report of the Public Interest Committee on Disclosure of the Market Value of Assets and Liabilities by Public Pension Plans

Summary and Recommendation: It is the consensus of the members of the Public Interest Committee (PIC) that it is in the public interest for retirement plans to disclose consistent measures of the economic value of plan liabilities and assets. The PIC recommends that the Academy's Board of Directors (Board) approve a resolution asking the Actuarial Standards Board to take expedited action to consider, develop and adopt appropriate standards of actuarial practice to address this issue. The PIC does not recommend a public statement by the Board at this time supporting the disclosure of the market value of assets and liabilities by public pension plans.

Background: On May 21, the Board voted to ask the PIC to determine whether it was in the public interest for public pension plans to disclose the market value of their plan liabilities (MVL) and assets.

The committee subsequently held calls on July 1, July 22, August 11, and August 18. A subgroup of the committee met on August 14 to finalize plans for the public forum. The full committee met in-person on August 5.

On September 4, 2008, the Academy held a forum in Washington at the Ronald Reagan building. The following members of the PIC were in attendance:

Steve Lehmann, Chair
Alfred Bingham
Larry Bruning
Arthur Panighetti
Bruce Schobel
John Schubert
Kenneth Steiner

The PIC listened to testimony from three panels of experts who had been selected by the PIC from those who indicated a desire to speak at the Forum.

The first panel consisted of individuals generally not directly associated with public pension plans or actuaries for public plans. The first panel members were Barry Kozak, Associate Director of the Graduate Employee Benefits Programs and Adjunct Member of the Faculty, The Center for Tax Law and Employee Benefits at the John Marshall Law School, Steve McElhaney, representing the Academy's Public Plan Subcommittee, Girard Miller Senior Strategist, PFM Group and a former member of the Government Accounting Standards Board, Christian Weller Senior Fellow, Center for American Progress and David Wilcox Deputy Director, Division of Research and Statistics, Federal Reserve Board. Each speaker indicated that the opinions that they expressed

were their own and did not represent the opinions of their employers or organizations to which they may belong.

In general, the speakers in this group (and the speakers in all three panels) either strongly supported disclosure of MVL by public pension plans or were strongly against such disclosure. In this panel, Messrs McElhaney and Miller and Dr. Weller opposed disclosure of MVL, while Dr. Wilcox favored such disclosure. Their written testimony (as well as testimony from all panel members) is attached as Appendix A.

There was much discussion in this panel about how exactly the MVL should be determined. Dr. Wilcox indicated that basic economic theory provides that projected cash flows should be discounted with an interest rate that was consistent with the risk of payment of the benefit. Dr. Wilcox argued that since public pension plans were generally expected to make good on pension promises and that state and local governments are not at risk of going bankrupt, their obligations made are more secure, not less, and therefore implies that they should be discounted at rates that are appropriate for safe cash flows, not risky cash flows. He went on to argue that this implies that the obligations are free of credit risk and liquidity distortions. However, the obligations should reflect the timing of the cash flows, and therefore we should resist the notion that we should be thinking about a single interest rate and embrace the yield curve concept. Under current requirements promulgated by the Government Accounting Standards Board, public plans generally disclose their funding target, which is typically determined by discounting the portion of projected benefits assigned to service to date (including future pay increases) by an interest discount rate equal to the assumed rate of return on plan assets. By comparison, there was general agreement among Dr. Wilcox and the three panelists on the third panel that the market value of liabilities (MVL) or economic value should be based on benefits accrued to date and discounted using an interest rate (yield curve rates) consistent with the level of risk inherent in the benefit promise.

The second group generally consisted of individuals directly associated with public pension plans or actuaries who consulted with public plans who were opposed to disclosure of MVL. This panel consisted of Beth Almeida, Executive Director, National Institute on Retirement Security; Paul Angelo, Senior Vice President and Actuary, The Segal Co.; Norm Jones, Chief Actuary, Gabriel, Roeder, Smith and Co.; Nancy Kopp, Maryland State Treasurer; Ron Mulvihill, Employee Benefits Specialist, American Federation of State, County, and Municipal Employees; and Karen Steffen, Principal and Consulting Actuary, Milliman. A summary of the arguments made by those opposing disclosure of MVL is shown below.

The third group consisted of actuaries who were supportive of disclosure of MVL for public pension plans. This panel consisted of Robert North, Chief Actuary, New York City Office of the Actuary; Michael Peskin, Managing Director, Morgan Stanley Investment Management; and Mark Ruloff, Director, Asset Allocation, Watson Wyatt Investment Consulting. A summary of the arguments made by those in favor of disclosing MVL is shown below.

Summary of Major Arguments Against Disclosure of MVL

1. MVL relevance has not been fully developed and it is premature to issue a statement encouraging that it be disclosed. Examples include issues regarding whether to use a risk-free discount rate or some other rate and whether to base the valuation on a liquidation measure or to include future anticipated salary increases.
2. MVL would be layered on top of the funding target numbers required under GASB and would be confusing and perhaps viewed as the “true number.”
3. The ASB is the proper vehicle for issuing actuarial standards of practice. Let the ASB decide this issue (with due process), not the Academy Board.
4. There is not a demonstrated need for disclosure of MVL, and the information is not useful. Public plans are not being asked to provide MVL by users of their financial statements.
5. MVL is too volatile.
6. Comparability can be achieved through other approaches that don't involve MVL
7. Disclosure of MVL could have many unintended negative consequences affecting funding, plan design, investment decisions.
8. Other approaches such as stochastic modeling may be a preferable approach to measuring risk involved in current asset investment strategy.
9. MVL is misleading to legislators, politicians, and the public and will lead to needless abandonment of defined benefit plans and overstatement of liabilities of the plans which will mislead anyone lacking technical expertise into believing that the program is in far worse financial condition than is actually indicated..
10. MVL is not correct because it is based on accrued benefits and not projected benefits
11. It is wrong for the Academy to take an advocacy position on this issue, as an Academy statement would have the same force as a Standard of Practice.
12. The Academy should rely on the judgment of the public plan experts in this area who almost universally oppose disclosure of MVL.
13. Public plans are not like private plans in that there is virtually no liquidation risk and MVL is essentially a liquidation type of valuation.
14. The risk free rate of return is too low for a variety of technical reasons.
15. This is purely an accounting issue that should be handled by GASB.
16. This is a technical issue which should be decided by experts in the pension field.

Summary of Major Arguments in Favor of Disclosure of MVL

1. There is a disconnect between the economic value of a stream of payment generally accepted by economists and taught to first-year MBA students and the present value of the same stream of payments determined by actuaries using the expected rate of return on assets that may be used to pay such benefits. The economists argue that the economic value should be independent of how the

- assets are invested. This disconnect creates a potential credibility problem for the actuarial profession.
2. Disclosure of funding targets results in inconsistent measurement of the economic value of plan liabilities and can under-price the cost of the promised benefits.
 3. The potential under-pricing of the economic value of plan liabilities can result in poor decisions with respect to plan design, funding and investment of plan assets, and may not provide an accurate measure of this component of compensation paid to plan participants.
 4. Use of a measure other than MVL may understate the cost of current benefit accruals or plan changes.
 5. The change in the unfunded MVL provides a measure of the relative burden of the benefit promise on the various generations of taxpayers.
 6. Disclosure of the market value and the funding target provides a measure of the amount of risk assumed under the current asset investment strategy.

PIC Meeting of September 11, 2008

The PIC held a follow-up telephone call to discuss the Forum and next steps. There was general consensus of the PIC on the following items:

1. Dr. Wilcox and the third group of actuaries made a compelling argument that actuaries may be under pricing retirement plan liabilities by discounting projected plan benefits with interest rates developed based on the expected rate of return on the plan's assets, particularly if the interest rate assumption is optimistic. Continuing to discount projected plan benefits with expected rates of return could damage the profession's credibility with economists, financial experts and others.
2. There are many members of the Academy who passionately oppose disclosure of the MVL for the reasons discussed above. The Academy's Public Plan Subcommittee voted 13-2 against disclosure of MVL and indicated that MVL relevance has not been fully developed. One of the panelists produced a petition signed by 177 members of the Academy voicing their opposition. Others argued that a statement of opinion by the Academy encouraging plans to disclose MVL would be construed as imposition by the Academy of a standard of practice without going through the standard setting process. The Public Plan Subcommittee testified that the ASB is the proper body to be looking into this issue, not the Academy Board. The ASB is in the process of re-examining ASOP 27, which is a relevant standard to this issue.
3. Many of the arguments raised by the opponents to MVL disclosure seemed to be at least somewhat refuted by the five years of experience of disclosing such an amount by the Robert North in his annual valuation report for the City of New York Retirement System.
4. The market value concepts expressed by Dr. Wilcox and the third group of actuaries applied not only to public pension plans, but to determination of the economic value of any cash flow stream and thus has a much broader application than the somewhat narrow focus that the PIC was charged.

5. There is some concern within the PIC about how MVL should be determined for different types of plans or different risks associated with the benefit promise. For example, how MVL should be determined for an underfunded cash balance pension plan sponsored by a corporate employer or how MVL should be determined for a well funded pension plan that offers lump sums determined using the corporate bond rate structure specified by the Pension Protection Act. There was also concern that MVL's use of a risk-free rate might produce an overly conservative valuation of plan liabilities
6. Opponents of disclosure implied that the profession needs to become internally coordinated on this issue. Simply by raising this issue, there is an implication that plans that are disclosing their funding target in accordance with GASB standards are doing something wrong and fiduciaries are not providing the "true number." The public entities are relying on the profession to give them the correct numbers and we believe it would be in the public interest to provide a consistent benchmark for plans to use as part of their disclosures to the public. Thus, it is important that this issue be resolved and resolved expeditiously.
7. There was consensus within PIC that developing and disclosing a consistent measure of the economic value of retirement plan assets and liabilities is in the public interest, but because of a lack of agreement on how a consistent measure of economic value for public pension plans should be determined, and the desire to make sure the profession "gets the science right", PIC recommends that the Academy's Board of Directors charge the Actuarial Standards Board with consideration, development and adoption of appropriate standards of actuarial practice to address this issue.

General Agreement of PIC from Meeting of September 11, 2008

In light of both the polarity of the membership on this issue and some of the concerns expressed above and other concerns, the undersigned members of the PIC believe that the Academy should not issue a public statement at this time, but instead should encourage the Actuarial Standards Board to expeditiously consider this issue and draft an appropriate standard of practice addressing this issue. The undersigned members do believe that it is in the public interest for retirement plans to disclose consistent measures of the economic value of plan assets and liabilities in order to provide the benefits promised by plan sponsors.

This Report is unanimously agreed to and presented by the members of the Public Interest Committee:

Steve Lehmann, Chair

Alfred Bingham

Teresa Dalenta

Bruce Schobel

Kenneth Steiner

Larry Bruning

Arthur Panighetti

John Schubert