

# **National Actuarial and Accounting Issues**

**TEXPERS**

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# Issue 1

## Market Value of Liabilities (MVL)/ Economic Value of Liabilities (EVL)

### Difference of Opinion Among Pension Actuaries

- What is MVL (EVL)?
- Comparison of MVL (EVL) with Your System's Actuarial Accrued Liability
- Significant Differences of Opinion Among Pension Actuaries
  - What actuaries support disclosure and funding?
  - What actuaries oppose disclosure and funding?
- Reasons MVL/EVL Should Be Disclosed
- Reasons MVL/EVL Should Be Funded
- Current Status of MVL/EVL Debate
- Prediction of Future Outcome

## What is MVL (EVL)?

- A Present Value of Accrued Benefits Discounted at a Risk Free Rate
  - Accrued benefit – Benefit based on pay and service at a current date
  - A plan termination benefit
  - Risk free rate – A U.S. Treasury Bond rate
- Term “Market Value” is Incorrect – There is No Market for this Liability
- EVL – A Theoretical Amount
- Example Closest to EVL – Cost to Buy Annuities from Insurance Company

# Comparison of MVL with Your System's Actuarial Accrued Liability

- MVL (EVL) Would Usually Be a Higher Amount Than Your Plan's Actuarial Liability
- Which Means a Higher Unfunded Actuarial Liability
- Which, If You Fund It, Would Mean Either a Higher Actuarial Required Contribution or a Longer Amortization Period

# Significant Differences of Opinion Among Pension Actuaries Financial Economics (FE) Actuaries vs. Public Plan Valuation (PPV) Actuaries

## What FE Actuaries Believe

1. Strongly Support MVL Disclosure
2. Many Support MVL Funding
3. What is Good for Private Plans Would Also be Good for Public Plans
4. Public Employer Taxpayers are Like Private Plan Shareholders
5. Public Plan Trustees Take Too Much Investment Risk with Total Return Strategy
  - Prefer “Risk Free” Investments
  - 8% Investment Return Too Risky
  - 4% Investment Return Preferred

## What FE Actuaries Believe (cont.)

6. Little or No Experience as Public Plan Valuation Actuaries
7. Many Support Use of Market Value of Assets as Actuarial Value of Assets for Contribution Determination
8. Often Consider Public Plans as if All Contributions Made by Employer and None by Employees
9. All Plans (Public and Private) in Canada and Europe use MVL
10. Some Believe PPV Actuaries
  - Pander to Clients (Trustees and Employees)
  - Are Not Objective
  - Afraid to Give Trustees Bad News
  - Do Not Understand Financial Economics

## What FE Actuaries Believe (cont.)

11. Live and Work in Northeast – with Highest Percentage in New York City Area
12. Many Represent Views of Wall Street
13. Much Smaller in Number than PPV Actuaries
14. Hold Key Positions in American Academy of Actuaries
  - Board of Directors
  - Pension Practice Council
  - Pension Committee
  - Joint AAA/SOA Pension Finance Task Force
15. Often Quoted in Press – Particularly New York Times and Wall Street Journal
16. Jeremy Gold, New York City – A Leading Spokesman for FE Actuaries

## What PPV Actuaries Believe

1. Most Strongly Oppose Being Required by Actuarial or Accounting Profession to Disclose MVL
2. Support Individual Actuaries', or Their Clients', Right to Disclose MVL
3. Even More Strongly Oppose MVL Funding
4. Believe Public Plans are Different than Private Plans
  - Taxpayers are not shareholders
  - Government employers are different from private employers
  - Significant employee contributions in public plans – usually none in private plans
  - Significant differences in “guaranteed” benefits in different states and cities
  - U.S. PBGC does not guarantee any public plan benefits
5. Accept Total Investment Return Strategy and 8% Actuarial Investment Return Assumption, Net of All Expenses

## What PPV Actuaries Believe (cont.)

6. Significant Public Plan Valuation Experience Makes Them the Leading Experts on Public Plan Issues in the U.S.
7. Most Support Use of a Method of Smoothing Past Market Value of Assets as Actuarial Value of Assets
  - 5-year or 3-year
  - With or without corridor limits (limits on difference between AVA and MVA)
8. Some Believe FE Actuaries
  - Lack experience with public employers and public plans
  - Accept financial economics as “gold standard”
  - Primary method taught to young actuaries by Society of Actuaries
  - Arrogant – believe they should speak for actuarial profession instead of PPV actuaries, who are the specialists in this field

## What PPV Actuaries Believe (cont.)

9. Live and Work throughout the U.S. – largest number in California, Texas, Florida, Michigan, Washington State, Illinois and Georgia
10. Many Represent Views of Main Street
11. Much Larger in Number than FE Actuaries
  - 177 PPV actuaries signed a position paper opposing MVL disclosure
  - Many in audience at Academy's Public Interest Committee hearing in Washington, DC were PPV actuaries
12. Have Limited Political Influence in American Academy of Actuaries – Majority Only in Public Plans Subcommittee
13. Not Often Quoted in Press
14. Paul Angelo, San Francisco – A Leading Spokesman for PPV Positions

# Should MVL (EVL) Be Disclosed?

## Arguments For Disclosure

1. MVL (EVL) Should Be Independent of How Assets are Invested
2. Traditional AAL, Determined by Plan's Actuary, May Understate Cost of
  - Current benefit accruals
  - Plan changes
3. Disclosure of MVL (EVL) Provides Measure of Risk of Current Investment Strategy
4. Better Measure of Relative Burden of Cost on Various Generations of Taxpayers

# Should MVL (EVL) Be Disclosed?

## Arguments Against Disclosure

1. Public Plans Not Like Private Plans
  - Virtually no termination risk
  - MVL (EVL) essentially a termination valuation
2. Misleading to Legislators, Politicians and Public
3. Too Volatile
4. No Demonstrated Need for MVL (EVL)
5. An Accounting Issue – Refer to GASB

# Should MVL (EVL) Be Funded?

1. Many FE Actuaries Say Yes, Because
  - Plans are understating costs and
  - Passing high tax burdens to future generations of taxpayers
2. PPV Actuaries Say No, Because
  - Funding MVL (EVL) would overstate costs, and
  - Make current generation of taxpayers pay too much (higher contribution rate) and future generations of taxpayers pay too little (lower contribution rate)

# Current Status of MVL/EVL Debate

1. October 2008 – AAA's Public Interest Committee Recommended That AAA Board Refer the MVL/EVL Issue to Actuarial Standards Board (ASB)
2. August 2009 – ASB Considering This Issue
3. October 2008 – AAA Board Created a Special AAA Public Plans Task Force (PPTF)
4. August 2009 – PPTF Will Issue Final Report in December 2009
5. August 2009 – GASB Will Discuss MVL/EVL, and Many Other Public Plan Accounting Issues, at Public Hearings in Norwalk, CT and Washington, DC
6. Spring 2010 – GASB Will Issue an Exposure Draft of GASB 25/27 Changes Which May Include Recommended Reporting of MVL/EVL

# **My Prediction of Future Requirement of MVL/EVL Disclosure and Funding**

## **Actuarial Standards Board (ASB)**

ASB Will Not Include MVL/EVL Disclosure as Part of an Actuarial Standard of Practice

## **AAA's Public Plans Task Force (PPTF)**

PPTF Will Not Recommend MVL/EVL Disclosure, But Will Recommend That Actuaries Do More to Advise Clients of the Effect of Risk Related to Investment Policy on Actuarial Condition of Plan

## **Governmental Accounting Standards Board (GASB)**

In Spring 2010, Exposure Draft May or May Not Include Required Reporting/Disclosure of MVL/EVL

## **Issue 2 – Accounting Issue**

# **Governmental Accounting Standards Board (GASB) Project**

## **Should GASB 25/27 Be Changed?**

1. GASB 25 is “Financial Reporting for Defined Benefit Pension Plans...”
2. GASB 27 is “Accounting for Pensions by State and Local Government Employers”
3. Project Began in October 2007 with 4 Workshops of 16 Persons with Diverse Backgrounds Participating
  - New York – Actuary Larry Wilson (GRS) and Jeremy Gold
  - Chicago – Actuary Norm Jones (GRS)
  - San Francisco – Actuaries Paul Angelo (Segal) and Ron Seeling (CalPERS)
  - Austin – Ronnie Jung of TRS and Actuaries John Crider and Bob May (Rudd and Wisdom)
4. December 2007 – GASB Surveyed Public Plan Actuaries for Their Opinions on Various Issues

## **Should GASB 25/27 Be Changed? (cont.)**

5. 2008 – GASB Staff Attended
  - Academy’s New York Roundtable on MVL Issues (February)
  - Academy’s Public Interest Committee MVL Hearing in Washington, DC (September)
6. March 31, 2009 – GASB Issued an “Invitation to Comment” (ITC) on Various Possible Changes to GASB 25/27
  - July 31, 2009 – Deadline for written comments
  - August 26, 2009 – GASB public hearing, Norwalk, CT
  - August 28, 2009 – GASB public hearing, Washington, DC
7. Spring 2010 – GASB Probably Issues Exposure Draft of Proposed Changes
8. Spring 2011 or Spring 2012 – GASB May Issue Final Amended GASB 25/27
9. Spring 2015 – My Estimated Amended GASB 25/27 Effective Implementation Date

# Majority Opinion of 43 Public Plan Valuation (PPV) Actuaries Certain GASB Issues

- Amortization Period (for Unfunded Liability)
  - Closed – decreases from 30 years to 0 years over a 30-year period
  - Open (version 1) – resets at 30 years with each annual valuation
  - Open (version 2) – employer contribution rate is fixed (same each year), so amortization period increases or decreases each year based on plan experience
- Open Amortization Period Plans
  - Initial amortization payment at least equal to interest on unfunded liability, i.e.,
  - No negative amortization, which means a maximum amortization period of about 18 years

# Majority Opinion of 43 Public Plan Valuation (PPV) Actuaries Certain GASB Issues (cont.)

- Closed Amortization Period Plans
  - Maximum amortization period of 20 or 25 years, i.e.,
  - Some negative amortization is OK
- Different Maximum Amortization Periods Should be Set for Different Types of Changes in Unfunded Liabilities

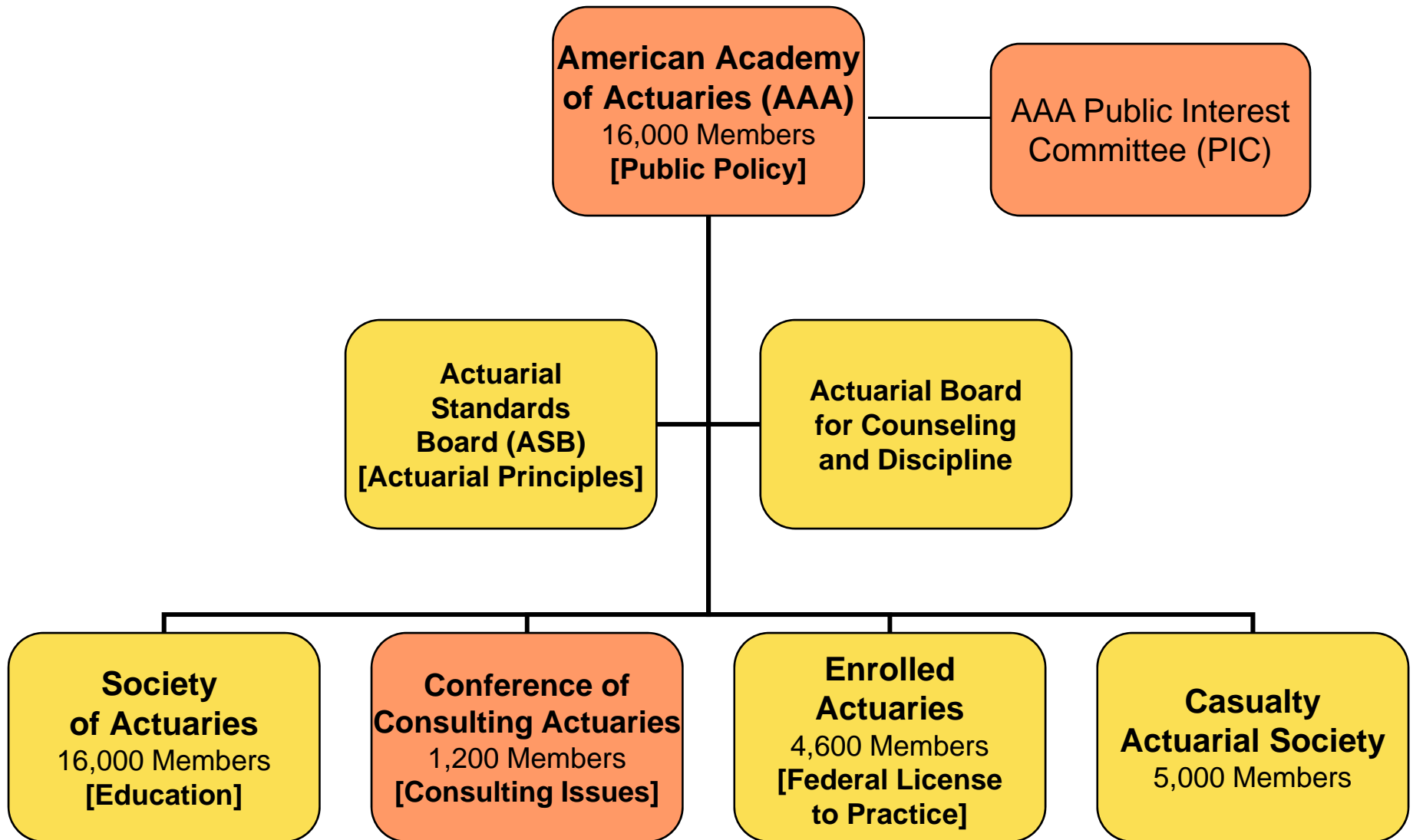
# Minority Opinion of Public Plan Valuation Actuaries (May and Fenlaw)

- Open and Closed Amortization Period Plans
  - Maximum amortization period of 30 years – present GASB standard OK as a minimum contribution standard
  - Annual amortization contribution – at least level as a percent of payroll, i.e.,
  - Negative amortization OK because contributions are at least level as a percent of payroll, which is a more important objective
- 30 Year Amortization/Level Percent of Pay is Permitted by Texas State Pension Review Board Guidelines and Has Not Caused a Problem of Plans Being Underfunded in Texas
- No Studies Have Been Made in the U.S. to Demonstrate That Negative Amortization Has Caused a Problem

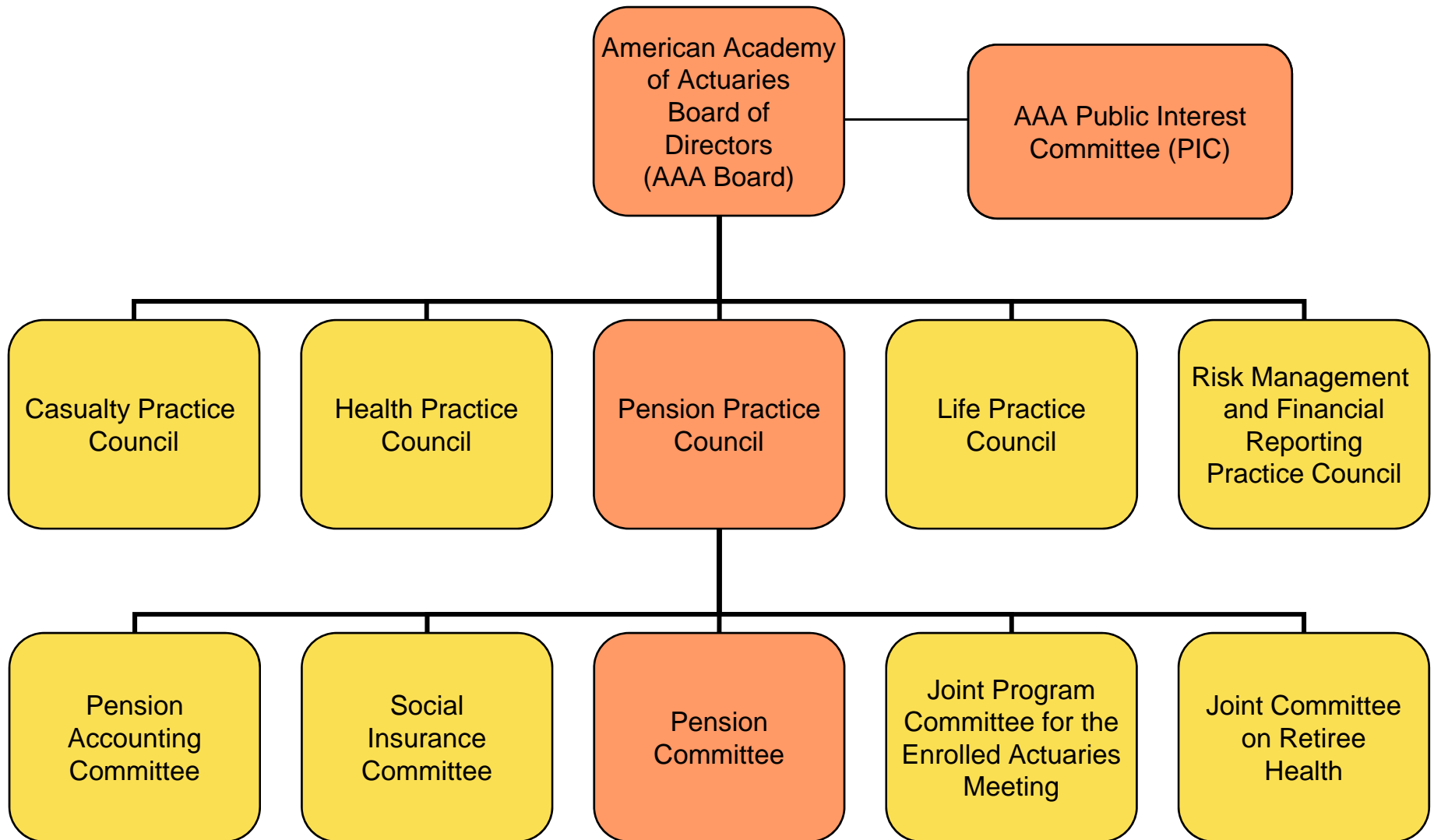
## **Minority Opinion of Public Plan Valuation Actuaries (May and Fenlaw) (cont.)**

- GASB Survey – 76% of 144 Large Plans Use Level Percent of Payroll Method – Most Have Negative Amortization
- One Maximum Amortization Period of 30 Years is OK for All Types of Changes in Unfunded Liabilities
- While We Support 30 Years as a Minimum GASB Standard, We Recommend 20 to 25 Year Amortization Periods to Our Clients

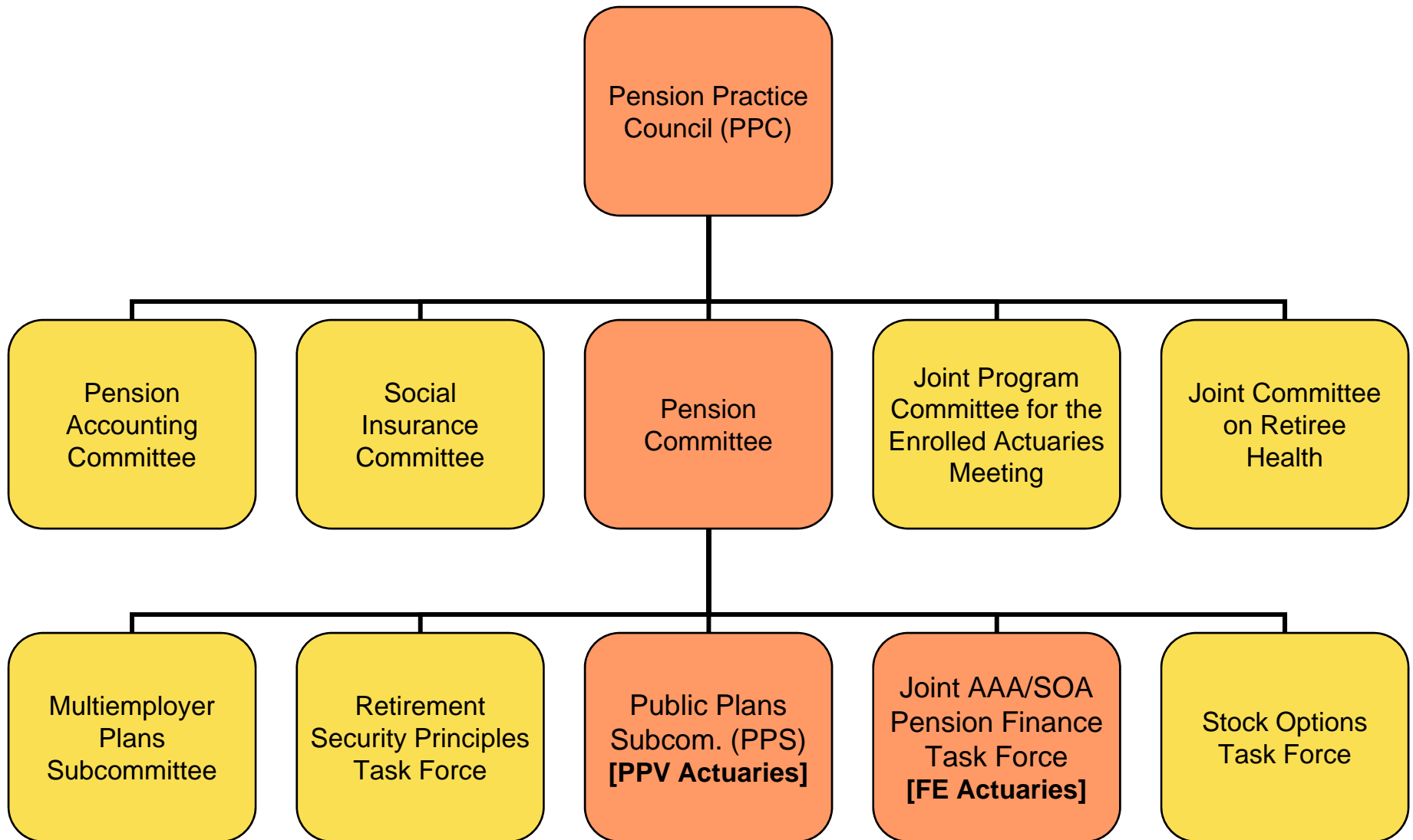
# Actuarial Organizations in the U.S.



# Practice Councils of the American Academy of Actuaries and Committees of the Pension Practice Council

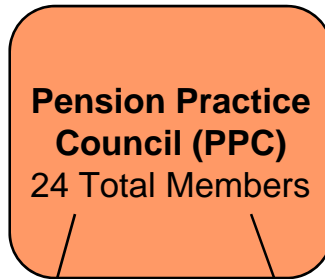


# Practice Councils of the American Academy of Actuaries and Committees of the Pension Practice Council

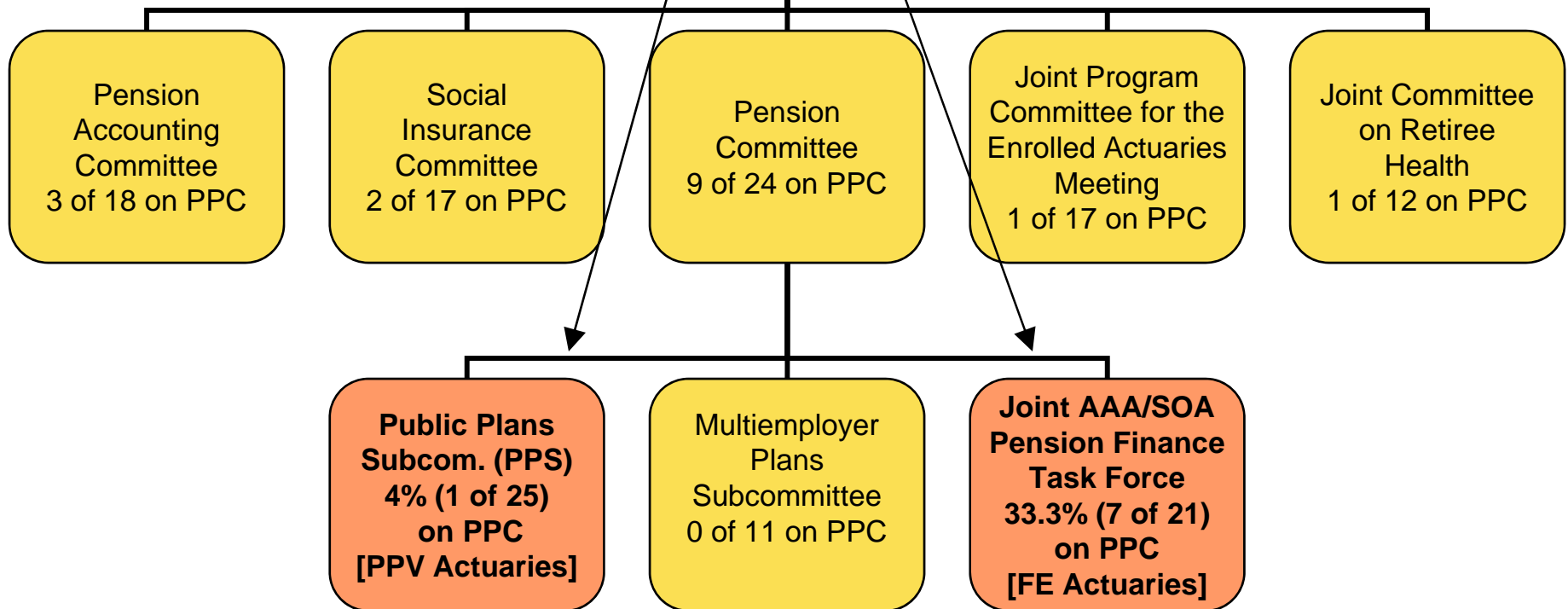


# Limited PPS Representation on Pension Practice Council

**1 of the 24 PPC Members (4%) is a Member of the Public Plans Subcommittee**



**7 of the 24 PPC Members (29%) are Members of the Joint AAA/SOA (Financial Economics) Task Force**



# **Actuarial Organization Problems for PPV Actuaries and Public Retirement Plans**

1. No PPV Actuary is on 28 Member AAA Board of Directors – Almost Got a Position on Board for November 2009 to October 2012
2. AAA 5 Person Executive Committee Supports FE Actuaries
3. AAA's Pension Practice Council Dominated by FE Actuaries (7 of 24 PPC Members) Compared to PPV Actuaries (1 of 24 Members)
4. Public Plans Do Not Have the Status of Being a Committee of AAA – They Are a Subcommittee of a Pension Committee of the Pension Practice Council of the AAA

# **Actuarial Organization Problems for PPV Actuaries and Public Retirement Plans (cont.)**

5. Education of Young Actuaries is in Financial Economics Methods, and Not in Traditional Actuarial Methods
6. Chairman of Public Plans Subcommittee Serves at the Pleasure of Chairman of Pension Practice Council – One PPS Chairman, Paul Angelo, Has Been Removed from His Position
7. Meetings of AAA Board are Closed to the Public
8. Actuaries Who are AAA Members Can Attend Board Meetings, But are Not Allowed to Speak

# Hopeful Signs for PPV Actuaries

- A New Public Plans Committee (PPC) Has Been Formed in the 1,200 Member Conference of Consulting Actuaries
- 9 Member Steering Committee of CCA's PPC are All Experienced PPV Actuaries
  1. Paul Angelo, Chair – Segal – California
  2. Alan Milligan, Vice Chair – CalPERS – California
  3. Tom Cavanaugh – Cavanaugh McDonald – Georgia
  4. Flick Fornia – Aon – Colorado
  5. Ed Friend – EFI – District of Columbia
  6. Norm Jones – GRS – Michigan
  7. Bob May – Rudd and Wisdom – Texas
  8. Steve McElhaney – Cheiron – Virginia
  9. Karen Steffen – Milliman – Washington

# Hopeful Signs for PPV Actuaries (cont.)

- Three PPV Actuaries (Angelo, May and Jim Rizzo – GRS – Florida) Will Testify at GASB Hearing August 26 in Norwalk, Connecticut
- No AAA Leaders Will Testify at This Public Hearing
- PPV Actuaries Have Slowed or Stopped the Momentum of the FE Actuaries Toward MVL/EVL Disclosure
- The 43 Actuaries Who Signed the Majority Opinion Letter are All Members of the New PPC of the CCA
- CCA Leaders (President Lance Weiss and President Elect Larry Sher) are Very Supportive of New Committee; They Sit on AAA Board and Can Give Us Some Representation on Board