The Future of Public Employee Retirement Systems

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Discussion of

Session #2 Papers

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Disclosures and Comments

- The views expressed herein are my own, not those of the Pension Research Council, the New York City Retirement Systems (“NYCRS”), the City of New York or anyone else
- These views also reflect my personal experiences over the last four years of publishing Market Values of Liabilities (“MVL”) in the Comprehensive Annual Financial Reports (“CAFR”) of the NYCRS
- I thank Olivia Mitchell for the opportunity to be a Discussant and I thank the Authors in advance for their patience with my forthcoming comments

Estimating State and Local Government Pension and Retiree Health Care Liabilities by Stephen T. McElhaney

- Paper addresses concerns being raised about pension and retiree health obligations of governments
- Paper discusses actuarial and accounting bases for the measurement of these obligations
- Paper describes certain ASOP, FASB and GASB rules and the differences between private and public enterprises
- Paper notes current actuarial and accounting practices in public sector allow ranges of results and make comparability difficult
- Paper provides estimates of outstanding level of pension and retiree health obligations based on reported numbers
- Paper then suggests tightening the ranges of certain permissible actuarial assumptions and methods

Estimating State and Local Government Pension and Retiree Health Care Liabilities by Stephen T. McElhaney

- Some Observations:
  - The basic actuarial and accounting rules, plus financial information on the current status of pension and retiree health obligations of public plans, are well summarized
  - The actuarial and accounting rules for private and public enterprises are compared in a useful way
  - The implications and certain weaknesses of the current reporting rules are noted but the suggestion that there be less flexibility in existing actuarial and accounting choices seems inadequate in an increasingly mark-to-market world
  - The current debate on mark-to-market disclosure is noted but lack of a position leaves an interesting question open

Public Pensions and State & Local Budgets: Can Contribution Rate Cyclicality Be Better Managed? by Perry Young

- Paper reviews recent history of PERS contributions, discusses issues of contribution volatility and offers observations on several techniques for amelioration, such as:
  - Increased asset smoothing ala CALPERS
  - Checks on benefit/liability increases using, for example, funding standards ala Georgia
  - Rate floors ala NYSLRS minimum 4.5% of salary
  - Automatic stability via fixed rates ala CALSTRS
- Paper concludes there will be volatility issues as long as asset allocations emphasize higher-risk, equity asset classes
- Paper notes that few may be willing to pay the price for lesser-risk asset classes and greater average contributions

Public Pensions and State & Local Budgets: Can Contribution Rate Cyclicality Be Better Managed? by Perry Young

- Some Observations:
  - Volatility is a property of markets
  - Economic and contribution volatility of pension plans arises primarily from mismatches of assets and liabilities
  - Pension benefits have bond-like characteristics
  - Economic and contribution volatility can be reduced by matching asset and liability characteristics
  - Price for reduced economic and contribution volatility is greater contributions (C + I = B + E) although these are not greater on a risk-adjusted basis
  - Question: If PERS and Plan Sponsors choose to take the benefits of risk to reduce employer contributions before the risk is borne, should they be required to measure and provide more economic information on the PERS?

Marking Public Pension Plan Liabilities to Market
by Jeremy Gold and Gordon Latter

- Paper asks three questions:
  1. Will future taxpayers have to pay for current services?
  2. How do funding levels compare amongst plans?
  3. What is the market value of benefits being earned each year?
- Paper addresses the employment relationship, principals, agents and the role of a pension plan
- Paper compares Financial Economics and Traditional Actuarial Practice, and sets forth mathematics for deriving market-related annual employer costs
- Paper describes Market Value of Liabilities ("MVL")
- Paper attempts to derive MVL from actuarial information currently reported and notes that no approximating techniques are as good as having the information prepared by the actuary
- Paper calls for PERS to measure and report MVL

Marking Public Pension Plan Liabilities to Market
by Jeremy Gold and Gordon Latter

- Some Comments:
  - The economic value of bond-like pension benefits change each year with:
    - Additional benefit accruals
    - Decreases for benefits paid
    - Changes in discount rates
  - The value of plan assets change each year with:
    - Additional contributions
    - Earnings on investments
    - Decreases in benefits paid
    - Changes in discount rates

Marking Public Pension Plan Liabilities to Market
by Jeremy Gold and Gordon Latter

- Some Comments:
  - It is logical to compare economic values of assets and liabilities in a consistent manner
  - Market Value of Assets (“MVA”) includes C + I – B – E accumulated to the valuation date
  - MVL (using MVABO) measures the value of benefits earned to the valuation date, discounted at market rates (i.e. consistent with the MVA calculation)
- Trend of MVA/MVL ratios is volatile over time if assets are not liability-duration matched

Marking Public Pension Plan Liabilities to Market
by Jeremy Gold and Gordon Latter

- Some Comments:
  - Explicit reporting of economic volatility is valuable
  - It provides decision-makers with additional economic information for explaining (as should be explained) Benefit, Funding and Investment Policy decisions
  - For example, choosing an Investment Policy that includes equities and an asset/liability mismatch does not add economic value but, in exchange for taking credit for future generations bearing the risk, results in lesser contributions today and an *expectation* of lesser contributions tomorrow (what have the children done for us lately)
  - Reporting MVL and addressing the implications it highlights helps build transparency and improves the odds for the survival of public-sector defined benefit plans

Summary

- Three significantly different papers
  - Estimating pension and retiree health obligations
  - Controlling contribution volatility
  - Marking liabilities to market
- Two address issues primarily from vantage point of traditional actuarial and accounting practices
- One reflects modern pension finance and its implications, and calls for such information to be provided
- All offer insights into the current world of public pension plans