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An "ASOP' fable: The illusion of market value

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With apologies to Aesop, a fable seems to be unfolding on a fast track in the actuarial community with a moral that is still up for grabs. U.S. actuarial organizations have universally adopted a code of professional conduct. A quick read of Precepts 3 and 8 of the code together would lead one to conclude that actuarial services must satisfy applicable standards of practice and that actuaries must take reasonable steps to assure that their services are not being used to mislead other parties — both admirable objectives. Even though the code currently includes just 14 precepts, an argument can be made that they should add one more to be called Precept 22 (as in Catch-22). Specifically, what should an actuary do when firmly convinced that following an Actuarial Standard of Practice, or ASOP, will, in fact, mislead other parties? As you will see from what follows, this may not be an academic question.

Recently, the board of directors of the American Academy of Actuaries asked the Actuarial Standards Board to develop standards for consistently measuring the “economic value” of pension plan assets and liabilities. While the terminology they have used is remarkably vague, sorting through the related academic appearing documents prepared by the proponents of so-called consistency in economic value leads to one reasonable conclusion, at least as it relates to public sector pension plans. Specifically, by proposing a “consistent economic value,” they are essentially advocating a one-dimension approach to a multidimensional issue. They would treat the misleadingly labeled “market value of liabilities” as an end in itself, as a substitute for the historically used obligation that is a means to an end derived from several components. The actual end that should be targeted is intergenerational equity achieved through contribution rates that remain relatively level as a percent of payroll over decades of time together with reports that allow assessments of the extent to which that objective is being achieved through adherence to a responsible funding program.

Whether or not what is being advocated is proper for the private sector is arguable, but trying to apply it to the public sector “for consistency” is ridiculous. Once you strip away the trappings of rigorous analysis obfuscating what is being proposed, you end up with what is, essentially; (i) a plan termination-like obligation for a plan that cannot be terminated; (ii) information which is presumably needed by a plan sponsor that cannot go out of business so they can report what will happen if they go out of business; and (iii) amounts computed based on capital market expectations for markets that differ dramatically from the way in which plan assets are being prudently invested for the long term to offset obligations. (It may be worth reading the last sentence again — not that it will become any clearer, but it does point out the inconsistencies in what is allegedly being proposed for the purpose of achieving consistency.)

To their credit, the proponents of this inconsistent consistency have come up with interesting tactics for attempting to neutralize the opposing voices of the key staff spokesmen for the plans involved, and the actuaries who are retained to do work for those plans. They maintain that staff members are not really stakeholders but are rather “pass-through agents” for the plans and further maintain that the actuaries are simply shilling for their clients in hopes of continuing to be retained. I think the most interesting thing about this approach is their naivete in concluding that totalitarian tactics might actually work. However, their loyal opposition will not be bullied into silence. Facts that they would probably prefer not come into evidence include at least the following:

• Plan spokesmen are more than just pass-through agents. In addition to probably having the best grasp of the big picture, they are also taxpayers and plan participants who are very concerned about the sustainability of reasonable benefits at affordable levels. They recognize that public plan terminations would result in post-employment income security being provided by pay-as-you-go entitlement programs at a considerable multiple of the cost of responsibly funded retirement programs. (This is not to mention the negatives associated with such a shift in terms of being hamstrung in pursuing desirable and admirable personnel management objectives.)

• The actuaries who are being discounted by the proponents of market value of liabilities are simply demonstrating integrity. They actually read their Code of Professional Conduct and have clearly identified the potential conflict that would stem from being required to compute and report the MVL for public plans.

In an earlier op-ed piece on this subject, I borrowed from Ralph Waldo Emerson in calling the extension of MVL to public plans a "foolish consistency." In its entirety, Mr. Emerson said, "A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines." I don't think there is any way I could improve on the clarity of that with such brevity.

It is almost a certainty that the Governmental Accounting Standards Board will be approached by the proponents of using the so-called market value of liabilities for financial reporting (and possibly funding) purposes, arguing that the opponents are resisting transparency. Not to put too fine a point on it, but that's nonsense. Plain and simple, we are opposed to reporting misleading information. On the other hand, we are more than willing to address ways in which *relevant economic values* might be more meaningfully displayed.

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