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Session 55 PD

A Brave New World: Accounting Standards

Track: Retirement Systems Practice Area, Smaller Consulting Firm, Financial Reporting

Moderator: Jeremy Gold

Panelists: Trevor Harris
Michael Walter Peskin
Jeremy Gold

Coordinator: Kevin J. Shand

Summary: What is the future of accounting? Have the current standards of practice failed us? Is one global standard the answer? Should the current rules-based approach to corporate governance that is used in the United States continue or should the standards be principle-driven? Has financial economics influenced any of the direction being taken by standard setters?

MR. JEREMY GOLD: This is Session 55. It's the first in the Brave New World series, which runs all day. We're talking about the theoretical accounting issues as they apply or may apply in the future to defined benefit (DB) plans.

Our first speaker is Trevor Harris and Trevor is managing director at Morgan Stanley. He joined the firm in mid-2000. He heads the global valuation and accounting policy team in equity research. Prior to joining the firm, Trevor was the Jerome A. Chazen professor of international business and chair of the accounting department at Columbia University, Columbia Business School at, of course, Columbia University. He is co-director of the Columbia Center For Excellence In Accounting And Securities Analysis, CEASA. I suspect you will hear more of that in the next couple of years, although probably not in the next couple of minutes.

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NOTE: All handout materials are available through the link on the table of contents.

Trevor received his doctorate from the University of Washington in 1983 and has published widely on valuation and accounting issues. He's made presentations at more than 100 conferences at institutes and universities around the world.

MR. TREVOR HARRIS: I'm going to do something a little different. I just have three bullet points rather than a bunch of slides because I thought it would make more sense for us to have somewhat of a conversation. I am going to start off by talking about how the world has changed in terms of how analysts and investors are actually looking at pensions and other postemployment benefits, essentially the DB side of the world.

I think that a group like this may be surprised at how much things have changed because there's a lot of discussion about accounting issues, which I have been actively pushing and have been involved in for quite a long time. But I think in some ways it's almost, unless things change very quickly, going to be superfluous because essentially the market is going to take care of it. And that's something that I think may just be worth spending a few minutes on, so that's sort of the first two bullet points.

The last bullet point, though, is to give you a sense of how much the regulatory stuff is changing. I sit on the Standards Advisory Council of the International Accounting Standards Board and the User Advisory Council of the FASB, so I have a lot of interaction with the people who are actually making accounting standards.

And the other point I should make is I think the state and local issue as opposed to the corporate issue is also going to be important because you got the Government Accounting Standards Board, which is probably the most archaic in the way that they're looking at these things. And I guess I should be careful what I say seeing this is being recorded.

If we think about it from the starting point in terms of analysts and investors, I make a few distinctions. When we looked at this, I started looking at the whole pension issue in 1992 when I was on a group looking at the rate-making process and regulatory process around the U.S. Postal Service. The U.S. Postal Service by law is required to break even, but they reported a \$1 or \$2 billion dollar deficit at that point in time, which for them is breaking even given the three-year rate-making cycle. The trouble was that after the analysis what I realized and what was in our report was they actually had an \$80 billion dollar deficit, and this was in the 1990 financial report that the U.S. Postal Service had.

The largest asset was something called the third pension expense. It was around \$30 billion at the time. And the trouble was there was almost no one on the Board of Governors who knew it wasn't an asset. And the other thing was this health care, which was all off balance sheet, no one was reporting it, and there was about a \$40-50 billion hole. And if you go and look today I would imagine, I haven't looked at it in the last year, but we're almost in the same position. So what that alerted me

to was the fact that there's a lot of confusion about what's really going on in this area. And then I came to the investment world, and I've been talking about it since then.

At Morgan Stanley in 1997 I started a series called Apples-to-Apples where we looked at global evaluation issues. And the first one we looked at was the auto industry and, clearly, pension is not exactly an irrelevant item in that particular area. The reaction by investors at that point was, this is sort of arcane accounting, and it really doesn't affect us that much. I can tell you today, we're in a completely different situation. So that seven-year period between 1997 and today is completely different. The accounting, obviously, hasn't changed very much, but the way investors look at it is fundamentally different, and that's both on the sell side—people like those I work with and me—and on the buy side.

When you think about the catalyst of change, there are a few things. First, is, who's in the investor group? It used to be primarily sort of long on the multi-year institutional investors with large funds where the consultants would go in and suggest what assets would be allocated and so on. We shifted from that to a very aggressive group of hedge fund investors. That is a long-short where they're willing to actually take very long-dated positions, either on the long or the short side, and they make their money by digging deep into the issues and trying to highlight where there are anomalies. Among those anomalies is the pension issue. So there's a lot of attention being paid to this by people who are trained much better in how they think about this, and they've made a lot of money out of doing that. So there's a lot of incentive from that group to actually focus on this area and highlight a lot of those issues. Therefore, the long on these funds sort of moves in the same direction.

The other part of this is that you've got the debt side. What's always been astonishing to me is that in the debt world people think of earnings before interest tax appreciation and amortization (EBITAA) as a measure of cash flow, which it is not. They do a debt to EBITAA calculation, and they ignore pensions for a long period of time because partly the credit rating agencies were doing the same thing, and there were a lot of covenants that were written in the same way. That's fundamentally changed in recent times.

The other part of the impetus to this was people made some serious mistakes. They were paying multiples of operating income based off of expected returns on plan assets, which were being, in effect, generated. And even if they were, it's a mutual fund business, an asset management business, not a telecom equipment, computer orders, whatever piece of the particular sector it is. They realize that they were actually making an investment mistake when everything unraveled. Of course, that's on the debt side and on the equity side. So you've got this morass of things changing all, in some sense, simultaneously, and then going from a great surplus to a great deficit suddenly.

We're projecting for the end of this year, unless there are massive new contributions, we're projecting for the S&P 500 a worse aggregate deficit than we had at the end of 2002. So everyone who said, well, we came out of it in 2003, everything is fine again, that's absolutely not the case. The markets have to come back heroically in the last two months of the year in order for there not to be much more serious problem again, and that's without some of these airlines who were in the S&P 500 a few years ago that are not now. So this is a problem that's coming back, and will, in our minds keep coming back until we finally make the changes. The focus in terms of the risk is definitely still there. There are a lot of structural things going on, which have given investors and analysts the incentive to do it, to actually make some changes.

So with that, the question is, how are we actually looking at this today? Another important point I should make here is investors more and more are focused on separating out the operating from the financing components of the business and pensions blurs this—at least pension accounting blurs that distinction. We also know and, clearly, we're seeing it right now, that there's increasing regulatory oversight over the assumptions that are being made. People, as they dug deeper into the pension issue, began to understand that companies were quite free to make a lot of assumptions that could actually be used to not necessarily manage earnings, but at least boost various reported numbers at the operating level in particular and, certainly, lower down in that.

The last point on this is people have gotten very uncomfortable with accounting and accrual accounting. Academics sort of push people—just go to cash flow and you solve the world's problems, at least the accounting programs, and that's completely untrue. And it's particularly untrue when you think about things like pensions. My favorite example is General Motors. If you go and look at the actual—I'll get to the service and the operating numbers in a second. But if you look at the cash, they went from '99 very little, about \$1 billion. And in 2000 it was \$5 billion. 2001 was almost nothing. These are the actual contributions. 2002 was about \$6 billion, and then last year they raised a lot of debt and put most of it into the pension fund or health, or other postretirement benefits and that was about \$19 billion.

Now if you think about someone who is focused going forward and thinks they can use cash flow, there's no way that you can think about debt as any kind of predictive cash flow. And then, of course, what is that cash flow? Is it operating? Is it part of your operating cash flow, your free cash flow, or is it debt financing? That's where, suddenly, people started asking a whole bunch of questions that they never really asked before. And, of course, as much as we talk about pensions, the health care issue is that much more problematic for people because there's so much uncertainty.

And just to give you a sense of that, the S&P 500 has embedded in its estimates, the companies that have postemployment benefits, particularly health care a 5 percent health care clustering rate within five years or five and a half years on average. The market's consensus expectation for the health care sector is a 13

percent growth rate over the next five years. That is a huge disconnect between what people are expecting on the supply side and those on the demand side—at least the companies. Somehow that has to converge. Obviously, 5 percent is probably too low and 13 percent is probably too high, but those are huge numbers and, frankly, that's part of why I think the SEC is paying so much attention to this right now.

So how do we actually look at it? The service cost is the operating cost. So for General Motors that's been around \$2 billion dollars a year for the last five years, more or less. The recorded cost in operations right now has varied a lot and it's all varied because of the difference between the interest costs and the expected return on plan assets. That's where all the variations are concerned. So what we're actually doing is we're treating that as financing. And when I say we, it's not just us at Morgan Stanley, this is what the market is doing more and more. That's the separation that's taking place; service cost price. Service cost is another operating number.

But then we get to this one big lump that no one really knows what to do with called actuarial gains and losses, or unrecognized actuarial gains or losses, and people, including myself, have no idea how to deal with that. When you think about that, the essence of where you want to go is just treat everything on a mark to market basis. Get rid of those actuarial gains and losses because they're only confusing everything. They're not one time because they keep happening, and they tend to get smoothed out, but there's no economic foundation in our minds to know how to work with it.

One of the things that's so important is markets hate risk and uncertainty. What we've seen is increased risk and uncertainty around this issue, and people will run away and over-discount risk and uncertainty. So transparency becomes more and more important in this kind of an issue. You saw a lot of companies in 2002 giving you tons of information. This is really the impetus to the FASB going to this new disclosure route; get rid of some of that risk and uncertainty. Help people understand what's going on so that you can actually create more visibility, and notice that's all on the income side.

When we get to the debt side or the asset and liability side, it is absolutely now in the case of projected benefit obligation. I know Jeremy and Michael will comment on that, although I would tell you that I think today the difference between accumulated benefit obligation (ABO) and projected benefit obligation (PBO) is just academic. For most companies today, the difference from an investor's point of view is too small to really worry about. It's obviously not uniform, but in many cases, at least on a reported basis what we can see—because in 2003 we can now see that difference again. It's actually not that big in most cases, so it's not as much of a debate in real terms as it is in conceptual terms. So we do a mark to market for the balance sheet even if we don't know how to flow that through very easily in terms of the income statement and how we value it.

The other thing that's sort of important in terms of thinking, actuaries, as I perceive what you do, I like to think about it as sort of long-run expected returns and that's the number that you like to use. The problem is that because a lot of users don't really know how to interpret that you have to think about what Standard & Poor's did. Standard & Poor's created this thing called core earnings and in that they said we will penalize companies for the gap between the actual return and the expected return when it's negative. It will give them no benefit when it's positive so it's a totally asymmetric application of actual return relative to expected return, which is counter to the way you would think about it, or we would think about it, frankly, from an economic point of view. So part of what happens when you get this uncertainty and this difficulty is people often don't do logical economic reasoning very well. They're on the side of conservatism, particularly if you think about it from a credit point of view as opposed to an equity point of view.

Mark to market and retreat pension obligations and, in many cases, although not uniformly, the health care is debt. And I understand that there are a lot of arguments around that, but it's just too confusing to worry about. So the last part of the sort of first couple of sections is so what are we actually doing about it? At Morgan Stanley we've created a product called ModelWare. All our analysts globally now have to fill out a sophisticated pension template, which has historical and projected information, and does all the separation. So all operating income measures will take out expected returns and interest costs.

Standard & Poor's and Moody's are doing the same thing. Some of our colleagues at other firms have bought sophisticated templates to give to clients to actually put in whatever assumptions they want to deal with. One of our institutional investor clients bought a 14-year model of pensions to try and sort out what was actually going on. The key to all of this is the market is adjusting and trying to deal with the information they have and not relying on the accountants to do it for them. This whole issue has become too big and too important in terms of getting reflected into the stock prices for people to ignore.

Let me give you one other anecdote. Every year I go to one of the largest institutional funds and spend somewhere between four and seven hours training the new analysts and associates about these accounting issues. This year when I went and I talked about the pension issue, the director of research turned around to this group of people and said, "Now let me tell you what Travis is talking about right now. If you walk into a portfolio manager's office today and that company has a pension issue, if you can't explain what's going on, you're in trouble." I can tell you when I started doing that four years ago, that was not a statement that would have been made. So we've seen a sea change in the last few years in how this all works. And, again, the cash flow is probably the hardest thing to deal with.

Let me quickly move to where we are headed in terms of accounting regulations. I'm going to talk about it somewhat generically and I'm going to talk about it

specifically with regard to this whole area. Bob Herz heads the FASB. Bob was a senior partner in an accounting firm for a long time and he is a very conceptual thinker. He understands financial instruments and everything extremely well. He used to be on the International Accounting Standards Board. One of the reasons Bob took the position is he believed we needed a fundamental change in accounting regulation. That's very hard to do in the political environment in which we operate, but he believed it was necessary. Part of what we learned from the debacle of before, and the SEC has endorsed this as well, is that you have to move from a rule-based system to a more principle-based system.

What does that really mean? And it's a very blurry line, but what it means is you cannot say, on this side of the line you have an accounting treatment one way, on this side of the line you treat it another way. So can you establish what the right uniform discount rate is? No. Can you say what the right expected return number is and dictate it for everybody, which is what some people would like? They will try as hard as possible to never do that. Their objective is to say here's the economic situation, deal with it. Tell people what you're doing and then let the market adjust accordingly.

That means that there's going to be, as you've seen in the last set of disclosures, much more information about the classes of investments you're investing in.) What is your strategy is in terms of how you want to allocate those assets, and then look at what your expected return assumptions are within that. The market will decide if you're too conservative or too aggressive or whatever. So it's not a problem. If you're 100 percent in equities, you can have a higher expected return. You're clearly taking on more risk.

That will also, and there's a lot of debate about it, give you much more in terms of where's the risk. It's not just that point system, but what kind of distribution is there around that? And that, again, is this notion of more principle-bases than rule-based. It's very hard to figure out where to draw the line because the auditing profession, the corporations, and to some extent the litigation protection, encourages more rule-based accounting. But the thing that, or the area that most encapsulates the problems with that is lease accounting, which I know is not the topic here. But if you think about lease accounting there are very bright lines and there are about 500 pages of rules just on lease accounting.

The United States has more off-balance-sheet obligation from leases than anywhere else in the world. So what happens when you draw these rules is everyone finds a way to avoid what they're going to want to show. So it actually works counter to what they're really trying to do.

Let me talk about the International Accounting Standards Board. There is an intent to converge international accounting standards and U.S. financial accounting standards. Now that does not mean that everybody is going to move to the United States. It means convergence. Now I would not say that everything is going to

move tomorrow or next year. But what's important in the pension area is they have joint meetings and they're establishing joint agendas. 2005 is a critical year for international accounting standards because the European community, with some very interesting exceptions, is moving and all listed companies in Europe are required to apply international financial reporting standards as of January 1, 2005. So the International Accounting Standards Board has been totally focused on that date.

From that date forward, they create a new agenda and they're working with the FASB on joint items. They haven't agreed to it yet, but they've indicated three particular areas that they want to move forward in; one of which is pensions. So right now they're dealing with what they call convergence issues, which is just cleaning up some of the small things, so, in effect, international is going to get more of the kinds of disclosures we have. What's happening on the bigger front is they're going to the international financial reporting standards and U.S. GAAP, rethinking pensions.

So what does rethinking mean? The head of the International Accounting Standards Board (IASB) is Sir David Tweedie. Sir David was the head of the U.K. Accounting Standards Board who created the U.K. FRS 17 that I think Jeremy will talk about. So you know where it's going. I don't think there is ambiguity in anybody's minds when the accounting regulators choose to take up the pension issue again, and this could be announced in 2005 once they decide on their joint agenda because they've already given you indications about that, we're going to mark to market. So that's the future. I can't tell you exactly when. I thought it would have happened by now, frankly, but that is the future of where we're going in the pension world, with all the implications that that may bring.

The last aspect of that is the accounting regulators—right now we have what we call a mixed model, which means some things are already in historical costs, some things are in fair value or mark to market. It creates all sorts of chaos. Insurance companies, as you all know relatively well, is a classic area where you have this mix between fair value on one side and historical cost on another. The accounting regulators are working hard to get to fair value for everything. If you think about long-run objectives, their long-run objective is everything has to go to fair value. So, again, you think about that with the FRS 17 and it's just a trend. It's just a path that we're going down. The timing is an issue, but the path is definitely there.

In the meantime, it's going to be principle, so if you think you can't measure it because you don't know what fair value means, they're going to tell you to disclose more so that everyone can understand. They are going to try to avoid as much as possible giving you specific rules on this transparency fair value principle base. Why don't I stop here and hand it over?

MR. GOLD: Thank you very much, Trevor. (See Gold Slide 2, Page 1)

For all purposes throughout my discussion, CICA 3461, FAS 87 and IAS 19 are virtually identical.

(See Gold Slide 3, Page 2) FRS 17 is clearly an important step toward a financial economics approach to accounting because it values assets and liabilities at market. It immediately recognizes gains and losses and vested benefit improvements, and it separates operating costs, which appropriately receive a price/earnings (P/E) multiple from financing results that are properly recognized without a multiple. But FRS 17 is not the last word and I call your attention to John Exley's article, "The Trouble With FRS-17" in the April 2002 issue of *The Actuary* (U.K.).

(See Gold Slide 4, Page 2) We need three more steps to bring FRS 17 and, therefore, perhaps the future of accounting worldwide into line with what financial economics teaches.

- 1) We need to eliminate the expected asset returns. I think there is unanimity among accounting standard setters on that score.
- 2) We need to eliminate expected pay increases.
- 3) To discount liabilities, we need to use a corporate yield curve for accounting purposes—but not for funding—we will talk about funding this afternoon. Note that I reference the paper, "Reinventing Pension Actuarial Science" here. We need to adjust for the default risk that the participants face, so we adjust for the existence of collateral, which is the assets held by the fund. We also need to adjust for the credit quality of the promise maker. That is particularly important for poorly funded plans.

Lastly, I want to point out that the yield curve gives us a property that may not be instinctive to actuaries who would like to substitute a single number. But a yield curve makes your benchmark hedgeable, and that's very important to the capital markets.

And with that, I am done and I will introduce Michael. I have known Michael for 25 years. Michael heads Morgan Stanley's global asset liability strategies team in the capital markets area. He has been at Morgan Stanley for 14 years. He ran his own company for three years. He was at First Boston for a year and Buck Consultants for 10 years. And Michael wants me to tell you he's almost as old as he looks. (Laughing.)

MR. MICHAEL PESKIN: They haven't given me too much to talk about, but fortunately there's enough in here. I'm going to repeat some of what they said, but in a different way. Because I'm on the banking side of the wall, I can't talk about any company specifically if I give you the name, but I have spoken to many CFOs and CEOs of corporations where the pension plan is large. The pension issue has become a CEO/CFO issue because they recognize that it's structured wrongly. And while they always try to get things into the firm as lower level as it can be dealt with, the pension issue is going to remain with the CFO for some time to come until these issues get resolved.

I'm going to start with a war story just to illustrate how wrong FAS 87 is and why it causes such terrible practices. We met with a company whose pension plan was more than twice the size of the corporation. Oddly enough, this is a healthy corporation with only a slightly unhealthy pension plan. But because the pension plan is so big relative to the corporation, the potential for the pension plan to bankrupt the corporation was enormous. So, of course, we pointed this out to the company and ended up spending the entire day with the CEO because this is such an important issue. And the CEO really understood what we were saying—that economically the risks they were taking in the pension plan with the traditional kind of mix in the pension plan were absurd for the size of the company that he had.

But then he gets caught in a dilemma. The economic risk is high, but what happens if he de-risks the plan? De-risks the plan means matches the liabilities, which means because they had so many inactive liabilities, high long bond contracts, much lower equity exposure. Well, it means that the way that FAS 87 works, he would have to report a much lower earnings and a much higher expense for the pension plan because the expected return on the long bond portfolio would be a lot lower than the expected return on the equities. So immediately he's confronted. He's got a tradeoff. If he takes the right economic risk, which is a much lower risk, then he has to report that he doesn't meet his earnings expectations.

Well, it turns out that while a lot of companies might say, or the first response he might get if they manage to economics and not earnings, don't believe it. And that's partly because the earnings have become a game that is played in the investment arena. It's almost a signal, and I can't know this for certain, but this is certainly how most CFOs view it; that they don't want to miss their earnings target roughly set by the analysts and sometimes trying to guide the analysts as to what the earnings will be because if they miss the earnings, while economically it might mean absolutely nothing, it's taken as a sign of weakness by many investors or at least many CFOs believe that if the company can meet its earnings it will. It will find some way of meeting its earnings target.

And if it can't meet it, it means the company has run out of ammunition. They have nothing more to do and it's in trouble. So they're ready. The CFO is confronted not just by earnings versus economics, but also by economics versus economics because they've got a long business plan. If the company misses its earnings target, the CEO may not keep his job, which means they can't keep the company going on the path that they intended and you get a clash between economics versus economics.

The other risk; this was a courageous year, so he took the next step. He said, all right, let's say I can explain to my investors why I'm de-risking this plan. Let's figure out what it takes to actually de-risk it and what the numbers are. Well, lo and behold, when we looked at what sort of bond portfolio he can actually buy, and you compare it to what he's reported as his liabilities, the liabilities are understated.

Why? Because he, like everybody else, used an index. They used a AA index and this particular AA index, very popularly used at that point in time, only had 17 or 18 bonds in it, and many of them were callable. What yields were used and why everybody migrates to this index is because the yield is actually quite high. People want to report lower liabilities, but that means if he actually did de-risk it, then the amount of assets he needs to contribute is much higher than what he's reported in his liabilities.

At this point, you have to take a hit to earnings, not meet his earnings target and explain to the market why his number for the liabilities wasn't right and, in fact, now when he de-risks that number is much higher. At this point, he threw up his hands and they are still running with a high equity exposure with a potential of bankrupting a very strong corporation. –And there it is in a nutshell of what I thought was just a great example for what is wrong with FAS 87.

What are the implications of having a broken accounting system? One, equity exposure is too high. Pretty much all companies have got too high an equity exposure. What does that mean? That means they're putting the companies more at risk than they would otherwise be. It puts the PBGC at risk, which is other sponsors or taxpayers because they're taking a risk of assets versus liabilities. It is causing risk budgeting that the firms to be wrong because a firm can only spend so much on risk budgeting. And if they take a lot of risk in the pension plan, they can't take as much risk in the corporation, which is presumably where they're going to get a better return.

Two, pensions are mispriced. Pensions are underpriced because they're priced in the accounting. They're using the equity premium in the pricing, which means that they increased benefits beyond what they would have had they been corrected price in the first place.

Three, interest rate risk is not hedged. It's not hedged because of all the smoothing that takes place. It looks like the value of hedging interest rate risk is small in the accounting numbers when, in fact, economically it's enormous to pay off for hedging. It means the yield curve is too steep because there's not enough buying at the long end and because there's not enough buying at the long end, there's also not enough issuance at the long end. When the Treasury stopped issuing at the long end under Peter Fisher's watch, his rationale perfectly sound; was that when he looked over long periods, the cost of borrowing at the long end was higher than the cost of borrowing at the short end. So why borrow at the long end? It's absolutely sound logic, but wrong in the sense that had pension plans been matching assets and liabilities there would have been a lot of buying at the long end. The yield curve would have been much flatter and the Treasury would have continued issuing, so we dug ourselves a double hole because of the bad accounting.

Pensions are not designed to be more hedgeable and there is a price for non-hedgeability. Trevor mentioned how risk is not perceived well by the market. It's

priced by the market. Well, risk exists on the liability side as well. If you've got liabilities that can be hedged in the capital market's space, they look like capital markets instruments, that should cost less than a liability that doesn't look like the capital markets. If you can't hedge, there's a price attached to that risk. And we've got liabilities designed almost on purpose to be non-hedgeable. I give you cash balance plans.

Call it better accounting. What do we mean? We mean no anticipation of expected returns. And everyone's mentioned that. I'm repeating it because hearing it again doesn't do any harm. No smoothing. No smoothing of assets. Just use market prices. No amortization of gains, losses and benefit improvements. Everything marked to market as best as you can. And I know that there is no market value for the liabilities. It doesn't matter. You get as close to it as you can and, in fact, because you can't get to a market value, that points to a problem in the liabilities, which should increase the liabilities rather than decrease them.

Liabilities should be measured at market rates, and I agree with Jeremy's point. I'm going to reiterate it. You should use a full yield curve. You really should, and this goes back to what Trevor was saying when they go to fair values they ask the accountant, which means, for instance, the funds of a corporation would be measured using the borrowing cost of the corporation. That's how you would get back—if a company issues a bond, they have to pay 12 percent because they're a poor credit risk. If you discount those bond cash flows at anything other than 12 percent, you're going to get a different number to the amount that they borrowed. Twelve percent would be the right discount rate from the equity holder's perspective for those bonds.

The same is true on pension liabilities. They're a bond. They're a collateralized bond. The rules force you to collateralize the bonds. Consequently, some of the bonds should be measured at the collateralized rate, which would be very close to Treasuries. That's the ABO portion, particularly if it's well funded. Its assets are much greater than the ABO. It's very close to Treasury rates, the swap curve, plus or minus something.

If it's hedgeable then the price of the hedge is the price of the liabilities. Notice for hedgeable liabilities it's easy to get to what the right answer is. It's whatever they're hedgeable at. Un-hedgeability is an additional cost. Separate financing from operating costs. I can't even reach Trevor's level let alone add to what he said.

Provide sensitivity to all of the risk factors. These need to be in the accounting. They need to be in the accounting because analysts need to know not only what is the number that occurred last year, but what is the potential going forward for big variations in that number? Risk and pension plans is important. It's a highly leverage vehicle. There are sometimes companies that report very low earnings or earnings adjustments on their pensions, but it hides the fact that they're got a massive amount of assets, a massive amount of pension liabilities, and that's highly levered. That number can change very dramatically with any major change in

interest rates or equity returns.

Jeremy's hit on the PBO. Although I agree with Jeremy's point that it really should be ABO rather than PBO, I also agree with Trevor's point that it's not that relevant right now. With a possible caveat that had it been properly measured in the first place, you wouldn't have had nearly as many games played in benefit design, between PBO and ABO. So their bad accounting led to bad benefit design once more.

MR. GOLD: We've left plenty of time, as you can see, for questions. We haven't been quite so fortunate with the location of the microphone.

MR. LESLIE LOHMANN: Thanks very much. I really appreciated the talks. This is sort of a combination question for Jeremy and Michael. First of all, I think it's still in virtually all U.S. plans. The plan includes the provision, the plan promise, the sponsor promise is to the degree funded. And I'd like to know from Jeremy if the current FRS 17, in fact, is taking that aspect into account.

And then for Michael, I would like to assert that there is a market value of the liabilities because of this provision in the plan, which is legally the degree of assets insured, the market value of the assets.

MR. PESKIN: (Inaudible, not using a microphone.)

MR. LOHMANN: It's precisely because there are minimum required contributions that, in fact, that provision is permitted.

MR. PESKIN: It isn't just the funded amount. It's the funded amount plus the present value of future contributions required to meet the liabilities.

MR. LOHMANN: In an insolvency?

MR. PESKIN: In an insolvency, no.

MR. LOHMANN: That's the acid test of what's promised and what's not.

MR. HARRIS: From an investor's point of view, unless you're stopping and running down the business, which is not the way most people invest, the presumption that you actually carry on as a going concern. It is a liability unless you're going to get rid of your employees. So, you're talking technically, but the reality is, no one, at least on our side, in the debt world or the equity world, is going to presume that you don't have to meet that obligation because some contractual rule says in the case of bankruptcy that you may only have to go as far as your funding.

MR. LOHMANN: I think the pilots of the United States would have a real argument with you on this, U.S. Air, United Airlines. Practically no company in the United

States goes broke with any remaining assets. And the pension plan stands behind all unsecured creditors in that line. As a matter of fact, the PBGC has to do its calculation. The 30 percent or whatever it is these days is a smoke and mirrors issue. There is no money. The airlines, again, are my tangible example. So the reality is that when you're looking at creditworthiness leading to insolvency, any debt that appears on the balance sheet through the retirement plan disappears.

MR. PESKIN: I think you've repeated your statement effectively, and I think you've just repeated your answer again.

MR. LOHMANN: I have a question for Jeremy. How is FRS 17 recognized?

MR. GOLD: We'll come back to that in a moment.

MR. LOHMANN: Okay.

MR. GOLD: Don't leave your spot, but make room for Dave Gustafson.

MR. C. DAVID GUSTAFSON: I would like to correct the notion that there is no value to PBGC's claim in the bankruptcy. In fact, up until a couple of years ago we did recover 10 percent on the underfunding in bankruptcy. We do have some priority albeit not as much as we would like in bankruptcy. Those recoveries are now down to 5 percent historically, but we do have a claim on the assets of the bankruptcy estate that we do pursue.

MR. GOLD: Thank you, Dave. Les, you can pick back up with your question for me.

MR. LOHMANN: The question for you is how is the existing FRS 17, being the one that's going to come into play soon, recognizing what I call the gratuitous nature of the pension plan promise.

MR. GOLD: And I'm glad you clarified that because the answer is I don't know.

FROM THE FLOOR: (Laughter.)

MR. HARRIS: I can answer it for you.

MR. GOLD: Fortunately, we have an accountant with us.

MR. HARRIS: The answer is it currently ignores the point you're making. It treats it as these are expected cash outlays and it present values them. There is nothing in accounting that goes into financial reporting anywhere in the world that it is based on liquidation accounting. It's all a going concern.

MR. LOHMANN: One of my big issues is the divergence between the accounting statement, which recognizes the employment exchange of the pension plan promise and the actual legality that, in fact, it remains a gratuity. The insolvency rules have

not caught up with the change in the public's belief about pension plan promises really and truly being the first priority for existing employment.

MR. HARRIS: Let me try my answer in a slightly different way. If market participants were pricing on an assumption of insolvency, there would be no market. There would be no equity invested in the market if the presumption from the beginning was that insolvency will occur.

MR. LOHMANN: Well, an awful lot of people have been buying Continental and U.S. Air. But anyway, I don't want to monopolize this.

MR. GOLD: You may have been harking back, although I don't think you're old enough, to the pre-ERISA days when the limitations on the pension obligation were to the assets in the fund. I don't know whether that is what you had in mind.

MR. LOHMANN: Are North American plans now dropping that provision? That provision is still in virtually all U.S. plans.

MR. GOLD: Sorry, which provision?

FROM THE FLOOR: The sponsor's promise is limited to the assets already in the fund.

MR. GOLD: For what it's worth, we have a better example of that kind of issue in the revocable postretirement medical benefit area. Jeff Petertil will have a paper in the January NAAJ talking about how you might look at valuation. He's not particularly talking about accounting, but the valuation of irrevocable benefits. I recommend it to you all.

MR. NORTH: Bob North, New York City Office of the Actuary.

MR. GOLD: For whom are you not speaking?

FROM THE FLOOR: (Laughter)

MR. NORTH: I'm not speaking for anybody that knows me.

FROM THE FLOOR: (Laughter)

MR. NORTH: Or who has heard of me or whom I work for, or any of those people, maybe not even for myself. My first question is for Trevor. Trevor, you mentioned the Governmental Accounting Standards Board(GASB) and how those of us in public employment have accounting rules that are just plain archaic. But GASB 43 and 45 have been published on the postretirement medical using rules that are comparable to FAS 106. My first question for you is: do you believe for most municipalities and public plans that liabilities on that basis should be discounted at U.S. Treasuries, or

should they be discounted at general municipal debt rates?

MR. HARRIS: Well, let me start out by saying I don't think they should be on the pension side—I know that's not what you're asking—discounted at the expected return on the plan assets. So that's where I think we're sort of most far out.

Michael was talking about at the borrowing rate of the company, and to some extent the credit risk is factored in. I would go closer to the Treasury rate because to me, unless you are truly going to renege, which is sort of the question from before that the presumption would be you would renege. Unless you are expecting to renege, I think you got to think about what the replaceable amount would be. So it's a dangerous road to go down to saying the greater your credit risk the higher the discount rate because that presumes default in some sense.

MR. NORTH: I was actually thinking the other way. Some municipalities issue debt at rates lesser than Treasury.

MR. HARRIS: If you're talking about it because of the tax issues around it, that's fine. Then I would say it's at the lower rate. But to me the credit side of it is where you have to be particularly careful and, clearly, different municipalities have different credit ratings. So I think it's a truly fundable rate, or a fundable amount is what you really want to reflect—it's sort of a replacement cost notion.

MR. GOLD: That's on the settlement cost.

MR. HARRIS: Yes.

MR. GOLD: But you're not reflecting with the price that you would put on a brand new issue the municipal bond, say, a taxable municipal, which would contain at issue credit risk and credit premium in the interest rate.

MR. HARRIS: Yes, but the difference is you would have to borrow a much larger amount. So I think the real Tension here is between the rate and the amount. To me it's just a sort of simple present value notion. If I'm going to have to meet this obligation and I'm going to try and discount that at 12 percent in order to actually borrow sufficient to actually make this payment, the principal that I'm going to borrow is going to have a much higher rate. That's the way I look at it. And actually, let me add that the biggest stumbling block to the FASB moving to a fair value or a mark to market for liabilities is how to deal with this credit risk because it's significantly discounting to most, at least investors, to think that the accounting system should recognize a gain on a liability when, in fact, you're increasing the credit risk or as a result of increased credit risk. And that's sort of a disconnect with dissonance in the measurement process, which is what we're talking about, at least on the credit side of this where there is a huge stumbling block. And I think it's sort of thinking about it too much from the rate point of view and not enough from the principal. But I think you have another question.

MR. NORTH: Yes, for Michael. Michael, you mentioned use of swap rates on the curve versus spot rates, versus yields, versus a whole bunch of other things. When one goes looking for this stuff, can you give some suggestions as to some publicly available published swap or spot rates that you would consider useful proxies for the yield curve?

MR. PESKIN: (Inaudible, no microphone.)

MR. NORTH: Are you talking primarily accounting or are you mixing funding into your thinking right now?

MR. PESKIN: I think they would both be the same, so I don't think I'm mixing them.

MR. NORTH: Okay, so you would not recognize own credit risk either.

MR. PESKIN: (Inaudible, no mike.)

MR. GOLD: Consider a 20-year zero-coupon bond issued by GE and GM. Forget about rates. They each promise you \$1,000 20 years from now. Wouldn't you pay a different principal amount today for those two promises, and isn't that an immediate recognition of a higher discount rate and, in effect, a recognition of own credit risk on the balance sheet?

MR. HARRIS: I understand the conceptual foundation for why you would do that. I think that the essence of it is in those circumstances because, in some sense, the receivers of the final principal are taking on more risk. The notion of what you could borrow in order to actually fund the business changes. I think that's sort of the logic.

MR. GOLD: But it also changes the value of the liability by the same amount in the opposite direction.

MR. HARRIS: I understand. I kind of highlight that's where, I think, the tension is in this whole area.

There's another thing I want to comment on because it's been mentioned a couple of times. I've raised this particular issue with the accounting standards setters. My understanding, not of FRS 17, but of FAS 87 is that their expectation is that you do use the yield curve; that, in fact, it's not a single rate. It gets reported as a single rate, but you are actually supposed to be using the curve in the calculation. I'm not sure that's what people do, but at least from the regulators the sort of standard side that is what you are supposed to be doing.

MR. GOLD: To state the converse, I am sure that is not what they do.

FROM THE FLOOR: (Laughter.)

MR. GOLD: Bob, you're still there.

MR. NORTH: Trevor, any comments on where you think you see municipalities going once these numbers go on balance sheets?

MR. HARRIS: I have to be very careful of what I say in this. I was doing a presentation recently and a large client of ours was there, as well as their clients, which were the state and local pension funds. And the CIO of the state pension fund made a presentation and talked about how they're really only 70 percent funded, but politics won't let them do anything about it. I'm summarizing, but that was the essence of it. And, of course, that's at the expected return discount rate.

I sort of turned around and said, we live in a world where the regulators have realized conflicts of interest and various other things and there are lots of adjustments being made today. And hindsight is a wonderful thing. My guess is that for the municipalities and states, and we see what's happening in a city like San Diego, that there's going to be a lot of finger pointing and we're going to get to a stage where we have to default because it's unaffordable.

I go back to my postal service example. We had a discussion with various senate and congressional staffers at the time, and this is 1992. And one of them, I don't remember which part of the house they were from, said, "Well, if this happens." And I said, "No, no, you don't understand. There's no *if* here. It's *when* and *who's* paying for it." Okay, it may be \$70 billion or \$90 billion. And remember that was a present value number so the nominal number is a much higher number. And then the question is, is it the rate payers, the postal rate payers, the tax payers or the employees? And someone suggested it's probably the employees, but somebody's going to pay for that. And in a public municipality, state or whatever, I think it's much harder to renege on the employees. So I don't know where this all ends up, but to me it's not a pretty picture under any of these circumstances.

MR. GOLD: Mark.

MR. MARK RULOFF: Winklevoss Technologies. I'm trying to think about the timing of that management of these corporations should be making some decisions here. Michael talked about how, at least in the past, they were reluctant to make any sort of move because it hurt them compared to their peers. I'm also learning that I think the FASB announces things well in advance of when they act, and in the hopes that corporations will start moving before it comes to pass. I'm leading or pushing clients to start making moves now, but how can management be viewed in the best light? When should they be making this move? Should it be before FASB makes a decision, or should they wait and then say, well, we're forced to do something now?

MR. HARRIS: That's a good question. When I talk to CFOs, CEOs, Boards of Directors and people who are making those kinds of sort of decisions Our former head of global capital markets and I have given a bunch of speeches on this. And what we say is why are you focused on short-term earnings? Why do you care about quarterly earnings? Because if you're in the business of using the market to raise capital, most of the sophisticated investors who are not trading around short-term use are sorting this stuff out. They didn't five or six years ago. I believe that CEOs and CFOs, more so, and to some extent treasurers are beginning to understand that the investors they want to attract are already doing this. Those are the ones who are rarely thinking about moving first.

If we had rates at 6 or 7 percent that would move right now independent of the accounting. I think part of it is the rates are low. So the point that Michael was making is, if you want to immunize, it's too expensive in some sense relative to what you're showing. A lot of companies have moved to at least on their PBO a 6 percent discount rate or 6.1 percent. If you had rates where they could actually get in that range, it's suddenly a much more attractive situation.

The second thing, again conditional on that, is when the FASB announces that they're going to do it, there are some of the nuances that Jeremy talked about, which are definitely going to be up for debate. It may not be precisely FRS 17. But those are the two things with very high probability that's going to happen. Smoothing is going to disappear and operating and financing is going to be split.

I did an analysis with the Committee on Investment of Employee Benefit Assets (CIEBA), which as many of you probably know, is the 110 largest defined benefit plans, with a colleague of mine and a bunch of other people. We asked the CIOs, not the CFOs and CEOs, the CIOs of the pension what would happen if the regulators got rid of smoothing, and a bunch of other questions. That was the one issue, and they all said that that would cause a significant shift out of equity.

Now I don't believe that people are going to wait for the final rule because everybody knows where it's heading. So I think that as soon as they announce this is a project, and people are trying to sort of read the tea leaves around that, you'll start seeing the move.

MR. EDWARD SCOTT MACTAS: I have a question around the plan design implications. Let's say we're in the mark-to-market world. Let's say on a range of A to Z where A is the proposition that defined benefit plans are the best things since sliced bread and everybody wants to put them in. If they have them, they keep them or even make them more generous. And Z is DB plans are dead. No one wants to put them in and they can't terminate them fast enough. Let's just imagine for right now we're at M, somewhere in between. I'd like each of your forecasts on the state, the popularity of defined benefit plans in a mark-to-market world, perhaps, starting with Michael.

MR. PESKIN: (Inaudible, no microphone.)...I think that society needs DB plans. Individuals need DB plans. I think DB plans are here to stay. However, the way they're structured, whether they exist as DB plans or as DB options in DC plans is a question mark. I think DB plans are definitely going to be with us. I think in a very different structure from how they currently exist.

MR. MACTAS: So, Michael, an example. Let's say you have a company today who has a traditional final pay DB plan and a 401(k) plan with a match. Could you give an example of the type of plan design you're talking about that this sponsor might move toward, being specific?

MR. PESKIN: (Inaudible, no microphone.) The rules forbid the right structure right now. I'm trying to be specific. Let's say within a 401(k) plan, there's an option that an employee can buy a deferred annuity. This is the ultimate deferred benefit that he can purchase. Obviously, the competition is going to force companies to start guaranteeing more and more. I can see something like that –emerging—an option to buy deferred annuities in 401(k)s. I think (Inaudible.)

MR. MACTAS: So in that example the accounting would be defined contribution accounting, correct? The charge to earnings would be the amount the company puts into the plan each year?

MR. PESKIN: Yes.

In fact, you could have a corporate DB plan that would work exactly the same way. It's just that the liabilities are funded and matched the moment they are accrued—no matter what, the benefit is funded and matched. Right now you would do that for all future benefits— and try and fix the regulatory problems in some different way, but there's definitely nothing wrong with that kind of design, either. What I personally believe is that we need a system in which those retirement dates are flexible. I think that's what's caught Social Security and Medicare.

MR. MACTAS: Oh, you get extra credit for that piece of an answer.

FROM THE FLOOR: (Laughter.)

MR. MACTAS: You're going beyond my question, but it's interesting. But let me come back to your design on defined benefit.

SOMEONE ACCIDENTALLY TURNS OFF THE LIGHTS

MR. GOLD: Do you feel you're in the dark, Ed?

MR. MACTAS: I'm in the dark.

FROM THE FLOOR: (Laughter.)

MR. MACTAS: I'm way out there all alone.

MR. PESKIN: (Inaudible, no mike.) What you could do is have a plan that gains based on inflation rate because those are hedgeable in the market. There are capital market instruments that can hedge inflation, TIPS. It's possible that if you wanted to do something based on general wages, the market again could come out with instruments linked to wage inflation. Tying it to specific wages, however, is not practicable.

MR. HARRIS: Michael and I went to a client some time ago where we talked about these generic issues. In that conversation the CIO turned around to the CFO and said, "Why are we doing this? This is not our business. Let's just pay whatever we have to pay, defease this and move on."

It wasn't the same client Michael was talking about earlier. The reason why I raise that is in thinking about that, they did a survey of their own employees and their employees argued that the defined benefit was a significant attraction to working with the firm and, in fact, their competitors had a richer defined benefit program. So for them to move away from defined benefit totally would have made them noncompetitive in that particular labor market. So I think that you have to look at this in totality. It's not just the specifics of the plan. It's what does it mean relative to the competition?

With that said, you know, one of the reasons we have the problem we have. It's all very well to blame the accountants and the accounting is part of the catalyst to this. The reality is service cost, the deferred compensation, is what should be funded. For many years, because people were enjoying the high actual and expected returns, people stopped funding and there were tax disincentives sometimes for doing that. That borrowing, in some sense, just went on. And, of course, everybody wanted to capture the excess so they started giving more and more promises without any contribution.

Coming to the specifics of your question, I think that if what we did was we took that deferred compensation, and that's what we treat as cash flow, by the way, is the cash contributed. If we took that and, in some sense, understood that you did have to hedge it—defease it—essentially from day one, the markets would treat that appropriately. And then it's what Michael was talking about. It's pricing this promise correctly and then defined benefit would be fine.

That's actually where I would turn to the actuaries because, in my mind, you are a big part of this problem. You have not priced this appropriately for the corporations because they don't know your business just like we in the accounting side have messed this up. They look to you to do, in some sense, the right pricing. And the finger pointing is going to be in this group of people as well at some point in time. We've already seen that in the U.K as people are looking at this.

MR. GOLD: We are now down to 15 minutes and so we will have shorter questions and answers—except for me.

FROM THE FLOOR: (Laughter.)

MR. GOLD: On this particular question that Ed asked about the future of DB plans, it is *the* question for us for the next decade. I'm not going to make a prediction, but I do have a direction in which to point. First, I want to recommend an article, which was the lead article in the October 2003 issue of *The Actuary* I wrote it. It's very good.

FROM THE FLOOR: (Laughter.)

MR. GOLD: It's entitled, "What's Next? DB Plans For The Long Run" And it asks what value can DB plans offer to society so that society will provide the encouragement, e.g., tax favor, to keep them running. We really have never made that case, and that case calls for finding value-added, pie-growing activities, what economists call Pareto-enhancing activities.

Michael reflected, perhaps, the single most important and obvious advantage that can come out of DB plans, and it is annuitization, a pooling of longevity risk is societally beneficial. Mandatory annuities are much more in society's interest than are plans permitting lump sums. I see Les Lohmann, who obviously is far too rich, shaking his head.

FROM THE FLOOR: (Laughter.)

MR. GOLD: But for the rank and file of society, annuitization on a mandatory basis is a public good, and that has to be in some way at the core of our Pareto-enhancing, pie-growing claims for the value to society of DB plans.

MR. MACTAS: A couple of things on that comment. It's true. It's a good comment you make. In our experience, when plan sponsors look at retirement program design, they're obviously looking at tradeoffs between a number of objectives; one of which is expense volatility. On its surface, this would increase expense volatility. So all else equal, including societal impacts, tax advantages, annuitization, all of the other things that go into selecting a particular type of retirement program in and of itself, all else equal, this will slow down the formation of DB and it will lead to the conversion of DB to DC. And maybe that's okay, I don't know. I mean the equilibrium is probably not okay.

MR. GOLD: It's not okay for actuaries, but it may be good for society.

MR. MACTAS: Maybe, maybe not.

MR. GOLD: Maybe not.

MR. MACTAS: But if we follow that to its logical conclusion, it would seem that the only way the pendulum is going to swing back is if the sort of things you're talking about happen, which is that either there's tax liberalization or there is societal push back or something, which can be equally strong in the other direction, to overtake the increased expense volatility.

FROM THE FLOOR: The financial economic actuaries are not against defined benefit plans. I am for defined benefit plans. I just think saving them takes a different approach. Defined benefit plans have taken on too much risk and they suffered for that, and there's a call for mark-to-market accounting because of it. Now plan sponsors need to reduce the risk. They have two choices. They can go to defined contribution plans, which everybody knows they're doing. But we could sell them instead a defined contribution plan that hedges out the risk. It takes the risk out of the plan by going to more conservative investing.

Now actuaries' reaction to that is, well, that increases the contributions dramatically. That is correct. But if we understood more about financial economics, we would be able to make the arguments that that actually increases shareholders' value.

MR. HARRIS: Which was the essence of the point that I was making.

MR. GOLD: If there is a road to saving DB plans, it is through transparency, not running away from transparency. To quote the great Mark Ruloff, "The transparency train is coming down the track. It's going to be there."

MR. NORTH: There is this issue of disclosure and maybe getting some help with my auditors for Trevor. A little over a year ago at the preparation for the June 30, 2003 financial statements for the city of New York, I proposed adding to the standard disclosures something calculated as the market value of assets divided by the market value ABO, discounting ABO liabilities at the Treasury yield curve.

MR. GOLD: What some of us respectfully refer to as the "North ratio."

MR. NORTH: I prepared all the statements, sent them off to the auditors, who rejected the preparation of numbers on that basis as a violation of accounting standards and, in particular, in the light of Sarbanes-Oxley where people have used financial statements to disclose things other than GAAP accounting.

Subsequently, in the comprehensive annual financial reports of the retirement system, we fought the subject out again and I managed to include, because I had previously disclosed in something called the actuarial section, other numbers than just the GAAP approved numbers. I did introduce the ratio of assets at market value to the market-valued ABO and showed a trend over a period of years, which, of course, did not look quite as favorable as the standard 100 percent funding ratio

that I always show under GASB required accounting.

Do you have any suggestions for me for the next time I wish to try and engage my auditors in trying to convince them to allow me to expand a GAAP financial accounting statement to include what I believe to be a truer representation of the funded status of the retirement systems?

MR. HARRIS: You and I should definitely have that conversation, but probably not in this room. I was quoted recently in *Business Week* in an article called "Fuzzy Numbers," saying that the financial reporting system is completely broken. And one of the reasons is, and this is not financial standards setting, this is the system, precisely because of those kinds of reactions.

All I can tell you is if you were in the corporate public world, I am fairly confident that the SEC would encourage that kind of disclosure in something called the management discussion and analysis, the MD&A. That is exactly what we're all looking for in the MD&A. And the Office of the Chief Accountant of the SEC is definitely promoting that type of disclosure. And my guess is that the PCAOB, which is the branch coming out of Sarbanes-Oxley, would give the same answer.

You work with a different set of regulators, I understand, but I think that there is an impetus in the profession to start to rethink this. If you took from your auditor to a higher level of that particular audit firm, I think you could probably find a different answer if it was stated in the right way. So I'm sure we could find a way to help you work toward that goal.

MR. GOLD: Ed Mactas, you can have the last word. And while he's getting to the microphone, let me thank Michael and Trevor and all of you.

FROM THE FLOOR: (Applause.)

MR. MACTAS: Thanks, Jeremy. Not the last word, and don't take my comments as any sort of an attack. I'm really looking for a solution, honestly, which is how do we get to a point where, there's this sustainability of transparent accounting, which I agree is a good thing, and some way where a defined benefit pension meets corporate and participant objectives with the right design. The expense volatility doesn't knock it out of the box. Like can you comment—oh, it's the last word so I guess by definition we have no time, but...

MR. GOLD: I'll give you an answer. It's all bonds.

MR. MACTAS: It's all bonds, that's it.

MR. GOLD: That'll get rid of the expense volatility if we can rationalize the accounting. And since it also, under most Anglo-American tax regimes, adds to shareholder value, it's a win-win-win. The trick is getting there. Of course, the trick

to getting there is education. Starting here, we can only educate ourselves as actuaries, but the CFOs and analysts have to learn this, too. We may fail. We may not get all the education done.

MR. HARRIS: I'll give you a slightly more upbeat answer. The regulators would love to have a partnership with all sides to come up with the right solution. Part of the problem is a change in regulation often ends up with people fighting to protect the status quo. If people are willing to open up to change the status quo and come up with a creative right answer, I think you'll find particularly the current group of standards setters very open to that.