Public Pension Finance Symposium

Discussant Comments
Session 5

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Comments on Session 5

By David B. Wescoe

I, too, have a disclaimer to make: the intellectual robustness of this conference will be suspended for the duration of my remarks. Don't laugh: I was the only person in the room yesterday who thought that Heisenberg was a blimp.

Speaking here today reminds me of Woody Allen's movie *Annie Hall* where Woody's character is standing with Annie in a movie line in front of a Columbia professor who is going on and on about Marshall McLuhan's theories, driving Woody nuts. So, Woody goes off camera and returns with the real Marshall McLuhan who tells the professor that he doesn't understand his work at all. Woody then turns to the camera and says, "Boy, if life were only like this!"

I am in a room full of "real" Marshall McLuhans, e.g., Jeremy Gold, the City of New York's actuary and many others. What can I possibly add to this distinguished group?

To say that I have been dreading this conference would be an understatement. When I told my colleagues that I was spending two days in Chicago with a bunch of hard-partying actuaries discussing stochastic modeling, market value of liability, and liability durations, they said I was crazy. But they were wrong. In fact, Dmitry and I had dinner last night, and it was a blast. Indeed, I can recount the complete conversation to you: "Yes. Yes. No. No. Yes. No." Then, dessert came, "No. Yes." And, when the check came, Dmitry simply said, "No." I'm looking forward to our next meal together.

It also occurred to me that you might also have the wrong Wescoe as a discussant. My wife, who has been married to me for 33 years, is a child psychiatrist and mother of four. Her theory is that the key to happiness is low expectations. That would put her in the market value camp.

My thoughts on the papers will be short and simple, just like me.

The first, "Communicating Risk in Public Pension Plans," discusses communication and not underestimating the intelligence of pension board trustees. While I am in awe of the trustees that I serve, who are very bright people with a lot of common sense and experience, they are not statisticians.

Therefore, your goal should be to make sure you communicate it in a way trustees can understand. For example, I implemented the "Zoe" rule after I got to SDCERS. (Zoe is my daughter and was 12 at the time.) I said that SDCERS will not communicate anything unless Zoe can understand it. We must communicate complicated topics in an understandable way. Actuaries discuss very complex subjects at board meetings, but you must do so in a way that non-actuary trustees can understand what you are saying. Public pension boards, city councils, mayors, and citizens must clearly understand what you are talking about it. Zoe must understand it. If your constituents cannot understand you, your message is irrelevant.

Another important point of the paper was the discussion about the range of error. (My idea is to sell pension "error bars" in San Diego. I think that they would be a big hit.) The point the paper makes is that we need to talk about risk and volatility. It is very important that trustees and plan sponsors fully understand the risks they are taking.

Indeed, by the time the issue of risk is discussed by a pension board, it may already be too late. Actuarial conversation must happen with the policy makers, e.g., the city councils, the mayors and the chief executives of our communities. They are the ones who decide what the benefit levels are. By the time they finish their work, the horse is out of the barn. (I am from Kansas, and I can say that with a straight face.) After those policy decisions are made, it is the pension boards that are faced with implementing the plan sponsors' benefit promises.

What I most enjoyed about the paper, however, was its final comment about "bring[ing] to this a sense of playful exploration." If you want "playful exploration," just come to San Diego and mention public pensions. Then, you'd better duck!

The second paper, "How Much Investment Risk Can a Government-Sponsored Pension Plan Afford?," highlights a critical issue: "Insufficient consideration seems to be given to the difficult risk characteristics of pension plans and the implication of those risks with the plan sponsor's ability to shoulder the risk." That is perfectly put. What is the plan sponsor's ability to shoulder the risk? (I will disagree with Mark here. I have never heard a SDCERS investment committee member, investment consultant or any trustee say that SDCERS should take more investment risk because of under funding. In fact, the SDCERS board did just the opposite, when it recently reduced the system's discount rate from 8 percent to 7.75 percent.)

The third paper is "Public Plans: Using Risk Profiles to Manage Funding Goals." Yesterday, a discussant put up a slide of the "elephant in the room." I think the elephant in the room here is the current level of benefits. The underlying issue here is really the expense of benefits. Again, this highlights the need for the decision makers in our communities to fully understand the risk they're undertaking when benefit increases are being considered. Actuaries can make their greatest contribution at the front end of the process instead of at the backend of the process. The key point in the paper to keep the focus on the risk profile is an important one.

Now, I would like to share some personal observations with you. The first thing that struck me when I got here is where are the investment consultants? This is a wonderful conference; there has been a robust intellectual discussion. The ideas and creativity in this room are phenomenal. But, I believe it would have been even better if investment consultants had been present because it's the investment consultants who discuss investment return assumptions and risk volatility with plan trustees.

Recently, I was talking to a San Diego city council member, and I said, "SDCERS is in the 70-year investment business. When a 30-year old starts their city employment, they might work for the city for 30 years, be retired for 30 more, and may leave a continuance lasting 10 years to their spouse." With this time horizon, an investment professional will likely advise you that you can take more risk. But the problem with this analysis is that San Diego's city council

does *not* have a 70-year time horizon. Theirs may only be 18 months, because that is the time frame one very down year can impact their ARC.

There has been a lot of discussion about disclosure here. As a former SEC lawyer, I think more disclosure is generally helpful. However, even if you disclose various discount rates, a decision still has to be made about which one discount the plan sponsors' ARC will be based on. That is the key issue. So, I applaud the voluntary disclosure initiatives in New York, but, at the end of the day, a plan sponsor still has to pay its ARC calculated on one discount rate.

Finally, I want to challenge you. This morning I was reading an article about current litigation between a plan sponsor and an actuarial firm. Testifying in the case, the defendant actuary said, "A good actuary responds to what their client is looking for, and in this case, that was number one." May I suggest that this actuary had it wrong? In my view, a good actuary responds to what their client *needs*, not just what the client *wants*.

My challenge to you is to bring intellectual honesty to the table. Respect your clients, but understand they need intellectual honesty from you in order to make the very important decisions that they face. If you come into the room thinking that client retention is more important than being intellectually honest, then you are letting your profession, your client and yourself down.

So, don't give your client what they want. Give your client what they need, which is your best professional advice and integrity above all else. Sometimes clients need to hear things that they don't want to hear. If you don't do it, who will?