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Comments: My name is Daniel Moore and I'll be talking about the Holistic Discount Rate Approach. I am representing only myself, and not my employer, or any other organization.

There is a handout showing powerpoint slides, but I will depart from the powerpoint until near the end. Here's a hypothetical question. Say you have a brand new public pension plan with no assets. The first contribution to this plan will be made ten years in the future, and that contribution, plus subsequent investment earnings, will be sufficient to pay all plan benefits, with nothing left over. What discount rate would you use to calculate the plan's accrued liability and normal cost? I'd like to see a show of hands.

Would you use 1) the expected return on plan assets?

Would you use 2) the plan sponsor's borrowing rate?

Would you use 3) a discount rate which is a blend of the plan sponsor's borrowing rate for ten years, and the expected return on plan assets thereafter?

Choice #3 exemplifies the holistic discount rate approach, under which an expected return on assets is based only on assets that are in, or projected to be in the plan. Before the assets are contributed, a borrowing rate is applied. The expected return and the borrowing rate are blended to get a single discount rate.

There is a simplified example of how the blending works for the holistic approach on page 2 of my November 2014 comment letter.

A typical expected return on assets for a public pension plan is 7 – 8%, and a typical borrowing rate is around 4%. This difference has a huge effect on the magnitude of the liabilities calculated.

Under the holistic approach, all plans that expect future contributions would use a discount rate less than the expected return on plan assets. For well-funded plans, the holistic discount rate would be much closer to the expected return than for poorly-funded plans – and by well-funded, I'm referring to both the funded percentage and the size of the permanent contribution rate: both matter under the holistic discount rate.

The technical details of how you would calculate a holistic discount rate are covered in the first ten slides of the powerpoint. I will pick up the presentation at slide 11, which discusses the advantages of the holistic approach.

- The holistic approach provides vital information now missing about the sensitivity of the liability and cost to the contribution, and to the investment allocation.
- The holistic approach more accurately measures the cost of benefit increases, which are currently understated.

- The stochastic forecast which is part of the holistic approach is a needed tool for measuring the cost of gainsharing provisions.

How much would the actuarial accrued liability and the annual cost change if the permanent contribution rate were 1% higher? Under the holistic approach, the rule of "pay me now or pay me later" has an immediate effect in terms of the discount rate, and thus the calculated liability. This is like the disclosure on your credit card statement about how costly it is to just make the minimum payment. This is vitally important information that plan sponsors aren't getting now.

There is a double whammy for benefit increases under the holistic approach:

- The actuarial accrued liability and normal cost increase due to the increased future benefit cash flows;
- The discount rate is lowered because the present value of future contributions increases, but the assets don't change.

The current approach just has a single whammy, and so it understates the cost.
Two examples of gainsharing provisions handled well by the holistic approach, and often glossed over currently:

- Cost of living adjustments based on a plan's funded status or investment return;
- Interest on an employee account balance based on a plan's investment return

Possible uses of the holistic approach are:

- The next logical step in public pension plan accounting under GASB.
- I am asking the Actuarial Standards Board to accommodate the holistic approach for funding.
- The holistic approach could also be used for private sector accounting and funding rules.

Questions?