

Lowering Your Tax Levy Is Easier Than It Sounds

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As an actuary, I am frequently cornered by an investment advisor or money manager who asks me what my investment return actuarial assumption is for a particular fund. I generally confess that I don't remember, but then, I counter with a simple "why?". I am then told that this information is needed in order to construct the proper portfolio for the fund's investments.

Boy—do I feel powerful!! Just think, I can control millions of investment dollars simply by choosing a different interest rate. Consider what fear the Treasury Bond market must feel as we actuaries, clandestinely of course, meet to discuss the fate of our government's investment policy. If we assume 8% investment return, millions of dollars shift from one sector fund to another, a simple drop of 1% in our assumptions, and the federal prime rate could go up. No telling how the Dow or the NASDAQ will react as we actuaries toy with our economy. Greenspan—move over—the actuaries are in command!!

But in all seriousness, how many times has your investment advisor wanted to know the actuarial assumption for the interest rate for one of your municipality's pension funds? As if it really matters!

For years I have been advising my client funds that actuaries are reflective, not predictive, of the investment philosophy of their fund. A fund which is invested in equities *should* outperform a fund which is entirely in fixed income securities—despite what the actuary may assume. History tells us that the market travels in cycles and, therefore, on any particular day it is impossible to predict what will happen.

This creates an unusual dilemma for the actuary. Consider that the actuary chooses his investment return assumption based upon the examination of the pension portfolio on a single day, generally the end of the fiscal year. Of course, proper procedure tells us that actuaries should review the history of the fund's investments over prior periods to determine if there are trends apparent and they should also note the fund's investment policy to determine what is likely to happen—and most actuaries will do just that—but the fact remains that the actuarial valuation is performed on a single day and the value of the portfolio on that day can have a direct bearing on the actuary's calculations for tax levies and financial disclosure. For this reason, in performing the calculations, the actuary often supplements his investment return assumption by using an **"actuarial value of assets"** instead of full market value.

Actuarial asset values are essentially smoothing techniques which spread out the fluctuations in market value over a future period of time. By using this approach, some stability is added to the actuarial calculations from year-to-year.

Smoothing generally is over a three to five year period. Often only the equity portion of the portfolio is subject to the smoothing procedure. Other times the total portfolio is smoothed. Considerations include the size of the fund, the cash flow requirements and the portion of the fund's investments which are exposed to large market changes. In smaller funds, such as those found throughout the municipal system, a smoothing technique is almost mandatory or there will be large swings in tax levy requirements on an annual basis—especially during the current investment climate with a depressed market.

So look at your actuarial report (the method of valuing assets should be disclosed in the statement of assumptions section) and talk to your actuary about it. It's a lot easier than switching your investments to get an 8% return!!