

# Are market values fair?

Jon Exley

These are personal views and do not represent those of my employer nor of the U.K. actuarial profession

## Agenda

- Why (and when) are fair values right
- Value added by simple benefits
- Value added by complex benefits
- Review of the case for providing pensions
- Conclusions

## Why and when fair values?

- Not necessarily an obvious choice
- Good accounting encourages good decisions
- Law of one price
  - Same cash-flows same value
  - Use asset pricing models for discrepancies
- Weaker than efficient markets

## Value added by simple design

- Key assumption is that risk exposures are marginal from shareholder perspective
  - Interested only in fair value of contract, not risk.
  - Value added is wage reduction minus cost
- Employee has different perspective
  - Not marginal exposure
  - Is it possible to provide cheaper than retail supplier?
  - How much does it cost to short unwanted exposure?
  - Are retail sales costs always wasted?

## Value added by complexity

- Shareholder can't value contract.
  - Frictional costs, mis-allocation of capital
- Employees can't value contract
  - Nor can they short unwanted exposure
  - Also particularly averse to default risk

## Missing value added ?

- Uniqueness of salary linked design
- Staff retention
- Bonding
- Private information
- Compulsion
- Intergenerational risk sharing
- Free rider problem

# Conclusions

- Fair values imposed by accounting, but will have impact on decision making.
- Analysis of value added by pension provision lacks a clear value proposition in this framework.
- Frictional and other costs likely to outweigh benefits, particularly for complex design.
- Existing theories do not appear to support existing provision.
- Impact of fair values in decision making will enhance economic welfare.