

Williams and Markopolos Were Proven Right:

MBTARF was underreporting its unfunded pension liabilities just as the whistleblowers said in their 2015 report

By Greg Sullivan

How many times have you read an article where two opposing views are stated with equal conviction? As a reader who may have a thousand other things to do, you may be left scratching your head as to who is right. And given that too often in today's 24/7 news cycles, reporters do not often have the time (or desire) to go back and fact-check the claims of the people they quote, well, people get away with some pretty big misrepresentations.

When Boston University Professor Mark T. Williams and Bernie Madoff whistleblower Harry Markopolos issued an alarming critique of the MBTA Retirement Fund in June of 2015, they claimed that it was underreporting its unfunded pension liability in three specific ways:¹

1. By exaggerating expected future investment returns;
2. By using an outdated mortality table that underestimated how long its retirees would be expected to live and receive pension benefits; and
3. By “smoothing” actual returns to downplay poor returns and lower its reported unfunded liability.²

After the Williams and Markopolos June 2015 report made headlines, MBTARF fired back by asserting that the whistleblowers were wrong, that its “stochastic modeling” was right, and that investment returns, mortality rates, and asset smoothing technique were reasonable and appropriately applied. But subsequent events have demonstrated that Williams and Markopolos were the ones who were right after all. Records show that the three claims made by Williams and Markopolos correctly identified a total of \$280 million in understated MBTARF unfunded liabilities.

...you may be left scratching your head as to who is right. And given that too often in today's 24/7 news cycles, reporters do not often have the time (or desire) to go back and fact-check the claims of the people they quote, well, people get away with some pretty big misrepresentations.



PIONEER INSTITUTE
PUBLIC POLICY RESEARCH

Gregory Sullivan is Pioneer's Research Director. Prior to joining Pioneer, Sullivan served two five-year terms as Inspector General of the Commonwealth of Massachusetts and was a 17-year member of the Massachusetts House of Representatives. Greg holds degrees from Harvard College, The Kennedy School of Public Administration, and the Sloan School at MIT.

Claim 1

Williams and Markopolos' first claim was that MBTARF's investment return assumption of 8.0 percent was too high, thereby understating its unfunded liability. Records show that just three months after it loudly and publicly refuted Williams and Markopolos's claim, MBTARF quietly and privately reduced its expected returns to 7.75 percent for years 2014 and 2015, and later to 7.5 percent for years 2016 and 2017, doing exactly what Williams and Markopolos had said should be done.³ With no fanfare and no apology to Williams and Markopolos, MBTARF was thereby forced to acknowledge that its unfunded pension liability had been understated as a result of the exaggerated investment return assumption called out by Williams and Markopolos. According to MBTARF's 2017 Comprehensive Annual Financial Report, a one-half percent reduction in MBTARF's investment return assumption translated to \$123.7 million.⁴ This means that the first of Williams and Markopolos's claims had correctly identified **\$123.7 million** in understated unfunded pension obligations.

Claim 2

Williams' and Markopolos's second criticism was that MBTARF was underreporting its unfunded pension liability by using an outdated 1994 mortality table that underestimated how long its pensioners would be receiving retirement payments. Williams and Markopolos stated that the MBTA was the only major transit agency retirement plan that was using this outdated mortality table. MBTARF loudly and publically refuted Williams and Markopolos, claiming that the 1994 mortality table was reasonable and appropriately applied. But just as it had happened with respect to the Williams-Markopolos' criticism about exaggerated investment assumptions, MBTARF quietly acknowledged, behind the scenes, that Williams and Markopolos had been right. In 2015, it abandoned the 1994 mortality table and adopted a 2000 mortality table in its 2015 and 2016 actuarial valuations. The Society of Actuaries estimates that the financial effects of updating a mortality table can be considerable. Updating from the mortality table most commonly used currently (a 2014 table, used by the Commonwealth of Massachusetts State Employee Retirement System) to the proposed 2016 table will result in increasing liabilities from 2 to 5 percent.⁵ This translates to an increased MBTARF liability of more than **\$60 million**, considering that today, in 2019, MBTARF is still using an outdated mortality table (the 2000 table) and needs now to update twice, from the 2000 table to the 2016 table, a double cost jump.

Claim 3

Finally, Williams and Markopolos' third criticism was that MBTARF had underreported its unfunded pension liability by quietly adopting a new actuarial valuation method by changing from the five-year moving average of market values method to the five-year phase-in smoothing method. The change had the magical effect of instantaneously reducing its reported unfunded pension liability by **\$96.34 million**.⁶

Thus, the scorecard for the Williams and Markopolos' criticisms is that they correctly identified three instances of MBTARF's underreporting of unfunded pension liability adding up to \$280 million (\$123 million for exaggerated investment return assumptions, \$60 million for outdated mortality tables, and \$96 million for its revised smoothing method.)

Williams and Markopolos Scorecard

Criticism	Correct	Understand Pension Liability
1. Exaggerated investment return assumption of 8.0 percent	✓	\$123.7 Million
2. Outdated 1994 mortality table	✓	\$60.0 Million
3. 2013 revised asset smoothing	✓	\$96.3 Million
TOTAL		\$280 Million

In 2015, Pioneer Institute wrote that

“the MBTA's Fiscal and Management Control Board (FMCB) should commission an independent audit and actuarial valuation of the Massachusetts Bay Transportation Authority Retirement Fund (MBTARF) in the wake of red flags that were either ignored or dismissed in a report commissioned by the MBTARF Board of Directors after a 2015 study by Bernie Madoff whistleblower Harry Markopolos and Boston University Professor Mark Williams raised concerns about the fund, according to a [new study](#) published by Pioneer Institute.”⁷

Given the fact that Williams and Markopolos concerns have proven right — \$280 million in understated liabilities were uncovered and now verified — Pioneer reasserts its call for the FMCB to conduct a full independent audit and actuarial valuation. Swiftly doing so is imperative, especially given Massachusetts taxpayers and MBTA commuters are on the hook for 75 percent of MBTARF's unfunded (and rapidly growing) liability.

Endnotes

1. Several other troubling red flag concerns were detailed in this report including the likely overstatement of alternative assets reportedly held in the MBTA Pension. These and other red flag items have not been resolved and are worthy of further independent examination.
2. Markopolos-Williams issued a 14-page Powerpoint presentation dated June 26, 2015 (Markopolos-Williams Powerpoint) retrievable here: <http://www.bostonglobe.com/rw/Boston/2011-2020/WebGraphics/Business/BostonGlobe.com/2015/06/tpension/t-pension.pdf> and published by The Boston Globe in a story written by Beth Healy on June 27, 2015: <http://www.bostonglobe.com/business/2015/06/27/whistle-blower-markopolos-questions-pension-fund-accounting-shares-report-with-authorities/O5KCbBOdn3g50IHLLVjqWP/story.html>. The story explained that Markopolos-Williams had presented “a 103-page report on [the preceding day, June 26 2015] to officials from the US attorney’s office, the FBI, the Securities and Exchange Commission, and the Massachusetts inspector general’s office.”
3. https://mbtarf.com/wp-content/uploads/2018/06/2017_CAFR_web.pdf; <https://mbtarf.com/wp-content/uploads/2016/05/2013-AR-updated.pdf>; MBTA Pension Update presented at FMCB Meeting June 27, 2016. Page 16. https://www.mbta.com/uploadedfiles/About_the_T/Board_Meetings/MBTAPensionUpdateFINALFMCB6272016.pdf
4. https://mbtarf.com/wp-content/uploads/2018/06/2017_CAFR_web.pdf
5. <https://www.soa.org/pd/events/2017/annual-meeting/pd-2017-10-annual-session-027.pdf>
6. <https://mbtarf.com/wp-content/uploads/2016/05/2013-AR-updated.pdf>
7. <https://pioneerinstitute.org/featured/report-calls-independent-audit-actuarial-valuation-t-pension-fund/>

