

August 29, 2008

American Academy of Actuaries Public Interest Committee

Sent via electronic mail: picpubplanswritten@actuary.org

Dear Members of the Public Interest Committee:

We are writing on behalf of the members of the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR) in response to the committee's invitation for comments from stakeholders in the debate over the disclosure of the market value of assets and liabilities in public pension plans. Together, members of these organizations administer retirement systems sponsored by state and local governments in the U.S. and its territories that provide pension and other benefits for more than two-thirds of all working and retired employees of state and local government in the U.S., and hold in trust more than \$2.0 trillion in defined benefit plan assets.

We believe that requiring disclosure of the so-called market value of liabilities for public pension plans is inappropriate because such disclosure:

- is not relevant to the public pension operating and legal framework;
- would mislead some stakeholders;
- would cause confusion and permit misuse of the measure; and
- could lead to negative outcomes affecting public pensions while providing no countervailing benefit.

A fair analysis of the adequacy of retirement funding in the U.S. paints a dismal picture:

- The precipitous decline in pension coverage for non-public employees continues: today, fewer than one in five private sector employees participate in a traditional pension plan, compared to 90 percent of employees of state and local government.
- This decline in DB plan coverage has been accompanied by a rise in defined contribution savings plans. Yet the pitfalls and inadequacies of these plans are well-documented: countless studies of retirement savings for those without a pension benefit have found that most workers are woefully unprepared for retirement.
- Retirement plans for federal employees are funded on a pay-as-you-go basis, portending growing liabilities with no assets set aside to pay for them.
- Without meaningful reform, the projected gap between Social Security's revenues and obligations in the coming decades will force an unsavory combination of federal budget cuts, benefit reductions, and tax increases.

Standing in sharp contrast to this sorry picture of retirement benefits in the U.S. are those for employees of state and local government. As a group, these plans are in reasonably good condition, they have been and are positioned to continue paying benefits to millions of retired workers and their survivors, and their cost to employers (taxpayers) is surprisingly small, particularly when compared to the financial, economic, and social benefits these plans

produce. For decades, public pension plans have provided cost-effective retirement benefits for millions of working and retired public employees.

In the aggregate, public pensions are funded at around 86 percent. Employer (taxpayer) costs for these benefits are around nine percent of pay, a figure that has held steady and even declined in recent years. A recent study by the Government Accountability Office found that an increase of 0.3 percent of pay would bring these plans into long-term actuarial balance. As a percentage of total government spending, outlays for pension contributions have declined during the last decade.

Public pensions distribute more than \$150 billion annually to some seven million retired public workers and their survivors. Not only do these benefits promote financial security for retired public servants, but they also serve as an important source of economic stimulus for every city and state in the U.S.

Public retirement systems hold in trust some \$3 trillion in real assets, not IOUs, invested by professionals in diversified portfolios that include stocks, bonds, private equity holdings, real estate, cash, and other asset classes. These assets are largely the product of investment strategies that are consistent with the long-term (essentially perpetual) nature of the plans themselves. The investment earnings generated by public pension funds account for nearly two-thirds of their revenues. Employer (taxpayer) contributions make up less than one-fourth of their cost.

The predominant investment return assumption used by public pensions is 8.0 percent, and the median real rate of return assumption (net of inflation) is 4.5 percent. For the 10- and 25-year periods ended in 2007, the average median public pension investment returns were 8.67 and 11.06 percent, and it is reasonable to expect public pensions to continue to generate long-term future investment returns that are consistent with the assumptions currently in place.

The inflation and investment return assumptions used by many public pensions are not static; many plans have adjusted these assumptions in recent years to reflect changing economic expectations. Of the plans that have made such changes recently, the vast majority of changes have been reductions in inflation or investment return, or both.

Required MVL disclosure likely would lead to significantly more conservative asset allocations, lower investment earnings, higher costs, lower funding ratios, increased volatility of costs and funding levels, and ultimately, because of these outcomes, the abandonment in many quarters of pension benefits altogether, replaced by self-directed retirement savings schemes whose track record for providing adequate and reliable retirement benefits is abysmal.

Also, many stakeholders are likely to view MVL as a termination figure that reflects the pension liabilities of an entity that may be acquired or declare bankruptcy. These contingencies are virtually nonexistent in the public sector. Moreover, state constitutional or

statutory frameworks, and case laws, guarantee the ability of public employees to receive the benefits they've been promised, and, in most cases, to continue to accrue those benefits.

MVL is based on the corporate operating and legal environment, and focuses on pricing pension liabilities. Yet the purpose for measuring public pension liabilities is not to *price* them, but to *fund* them. Because some may view MVL as reflecting a plan's termination as of some past date, for entities that are not terminating, and that are required to continue honoring service accruals and salary growth, this measure holds little value for public sector plans and threatens to mislead and confuse stakeholders.

For these and other reasons, requiring MVL disclosure for public pensions would represent the triumph of process over substance, form over function, and politics over merit, and should be rejected by the Public Interest Committee.

Sincerely,

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