

National Public Pension Coalition

AFL-CIO ▪ American Federation of State, County and Municipal Employees ▪ American Federation of Teachers ▪
Change to Win ▪ National Education Association ▪ Service Employees International Union

Statement of the National Public Pension Coalition Submitted to the American Academy of Actuaries Public Interest Committee Public Pension Plan Forum September 4, 2008

Government employers design public pension systems to achieve a variety of goals – to provide benefit security for employees, predictable and reasonable costs for employers, and responsible use of taxpayer dollars. For more than 100 years, public pension systems using a defined benefit model have provided modest retirement benefits for a variety of public workers and have enabled public employers to retain and attract a highly skilled workforce at reasonable costs to taxpayers. As a coalition representing the interests of the beneficiaries of these plans, we note that traditional accounting methods have worked remarkably well in meeting the over-arching policy goals of public pension systems. We believe traditional accounting methods provide for an appropriate balance between the interests of employees, employers, and taxpayers. Unfortunately, the addition of a Market Value of Liabilities (MVL) approach would undermine public pension plans' record of achievement.

Proponents of financial economics seek to require state and local governments to measure and disclose the MVL of their pension plans. However, MVL reflects a pension plan's settlement costs – the amount a plan would owe if it were terminated and required to settle its liabilities with a so-called risk-free portfolio of bonds. Public sector entities, which have never defaulted on their pension obligations, rarely declare bankruptcy and, unlike corporations, are not subject to merger or acquisition.

The MVL approach eliminates the use of smoothing, which is an essential component of measuring the liabilities of public plans. Through smoothing, governments are able to maintain more predictable payment schedules and reduce contribution volatility, while also weighing the other important obligations that exist for the public treasury. By requiring higher contributions than are necessary, MVL would seriously undermine the funding of both public pension systems and other essential government obligations.

Proponents argue, among other things, that calculating MVL would provide a standardized measure of pension liabilities, simplifying comparisons between and among plans. While comparison of plans within and across states may provide worthy data for research, the calculation of the differences between MVL and traditional liabilities will create confusion and may distort the public and political perception of the value and cost of these plans. Actuarial assumptions should not be determined using mandated measures designed to prepare for events that rarely occur in the public

sector. None of the key stakeholders of these plans – participants, sponsors, and taxpayers – would benefit from this change.

Each defined benefit governmental pension plan is a unique entity designed to meet the needs of a specific government employer or groups of employers. These plans provide different levels and types of benefits that ultimately are best compared on how well they deliver the highest level of replacement income for the lowest cost to employees, employers, and taxpayers. MVL does not take into account this essential value. And, in fact, the application of MVL is likely to result in a combination of reduced public pension benefits, higher required contributions, and reduced funding levels over time.

We are also concerned that adoption of MVL accounting methods would lead to lower investment returns by lowering equity holdings relative to fixed income. Over the last 30 years, public pension plans have developed tremendous expertise in equity investing. This expertise has translated to higher returns that have in turn lowered the required contributions of employers and employees to these programs. According to the U.S. Census Bureau, during the period 1982 to 2006, public pension plans generated some \$4 trillion in revenue, of which approximately \$2.6 trillion (65 percent) was from investment earnings. According to estimates by the National Association of State Retirement Administrators, had public pension funds been invested in “risk-free” portfolios, the cumulative investment earnings during this period would have been lowered by approximately \$1 trillion.

We believe that mandating that public pension funds calculate and disclose a market value of liabilities would have negative consequences for public plans, public employees, employers, and, ultimately, taxpayers. Taxpayers will be forced to pay unnecessary additional taxes for current employees and retired workers that under the current framework are provided through investment gains. Public pension systems provide the opportunity to employees and employers to smartly finance retirement security over a lifetime of work and should not be undermined by ill-fitting and inapplicable “one-point-in-time” (termination liability) corporate accounting methods that are designed to prepare for failure. At a time when the national savings rate is dismal and retirement security is in jeopardy for so many Americans, we urge the Academy to reject efforts to standardize MVL accounting for public pension plans and allow public plans to continue with traditional accounting methods that are working well for all public sector stakeholders.

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