



# National Conference on Public Employee Retirement Systems *The Voice for Public Pensions*

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## Statement of the National Conference on Public Employee Retirement Systems to the American Academy of Actuaries August 29, 2008

The National Conference on Public Employee Retirement Systems (NCPERS) is pleased to enter the following statement into the record at the Public Pensions Forum of the American Academy of Actuaries. NCPERS is the largest trade association for public sector pension funds, representing more than 500 public funds throughout the United States. We are a unique network of public trustees, administrators, public officials and investment professionals who collectively oversee nearly \$3 trillion in retirement funds on behalf of six million retirees and 14 million active public servants.

The purpose of this forum is to hear the views of stakeholders in the debate over the disclosure of the market value of assets and liabilities in public pension plans. One of the frequent arguments made in favor of applying "market value liability" (MVL) to public plans is that this measurement will help ensure that plan participants will receive the benefits promised to them. However, there are a number of differences between public plans and ERISA plans that undermine this argument.

While the purported goal of the MVL proponents is to support public plans, the more likely results of applying the MVL approach to those plans would be to (1) increase reported plan liabilities and required contributions; (2) increase the volatility of contributions; (3) confuse decision-makers, taxpayers, and the press; and (4) jeopardize the plan's sustainability. This could lead to the needless abandonment of public pension plans, which, for over a century, have proven to be effective and efficient vehicles for providing retirement income.

### **Enhanced Property Right**

It is generally accepted in every state that at some point in time, rights in a retirement plan become contractual and protected against diminution or repeal by the contract clause of the U S Constitution (Article I, Section 10) or by similar provisions in the various state constitutions. Some states, like Alaska, New York, and Illinois (among others) have specific state constitutional provisions making participation in a public pension plan an enforceable contract.

The question here is whether contributory plan members have greater rights to such protections than non-contributory members. As a general principle, *Corpus Juris Secundum, Constitutional Law, s.405*, a well regarded compendium of American jurisprudence, holds as follows:

*By rendering services and making contributions to the public employees' retirement system, an employee acquires a limited vested right to pension benefits which may not be eliminated or substantially changed by the unilateral action of a governmental employer to the detriment of the member.*

This conclusion is supported by case authority. For example, in *Public Employees' Retirement Board v. Washoe County*, 615 P.2d 972 (Nevada 1980), the Nevada Supreme Court held that the payment of contributions was a specific source of protection against impairment of benefits. Similarly, in *Singer v. City of Topeka*, 607 P.2d 467 (Kan. 1980), that state's high court found that the payment of a portion of the employee's salary over a period of years, whether voluntarily or on mandatory basis, creates vested rights which cannot be taken away or diminished.

Similar conclusions were reached in *Wagoner v. Gainer*, 279 S.E.2d 636 (W.Va. 1981) and *Legislature of the State of California v. Eu*, 816 P.2d 1309 (Cal. 1991).

### **Differences Between Governmental Entities and Businesses**

The Governmental Accounting Standards Board in 2006 released a white paper detailing the manner in which governments are fundamentally different from businesses. According to the report, governmental and business accounting standards are—and should be—different, including the standards related to pensions and other post employment benefits. For such benefits, the governmental accounting approach supports allocating long-term benefit costs to periods of service as a level percent of payroll. This helps to smoothly spread the costs among different generations of taxpayers, promoting intergenerational equity. Level contributions also help governments to better plan and budget their contributions. This is different from business accounting, which places greater emphasis on the measurement of plan liabilities, since these affect the value of the business if and when it is sold, or if the plan is terminated.

Governmental entities, additionally, do not face the threat of dissolution or sale in the same fashion that private plans do, nor are governments expected to meet profit targets and report their earnings, which has demonstrably led to financial shenanigans in recent years, which in many cases has adversely affected retirement programs.

### **Conventional Actuarial Methods and Contribution Rates**

Proponents of the MVL approach claim that conventional actuarial methods calculate contribution rates at levels that are too low to sustain public plans. However, many state and local government pension plans have existed for over 50 years and some have existed for over a century. MVL proponents would likely counter that public plans only appear well funded because conventional approaches use a discount rate to calculate liabilities based on expected (rather than realized) long-term returns, they underestimate the risks of equity investments. However, for the most part, the expected returns used by public plans actually reflect the long-term historical rates of return earned by the plans. Many public plans use discount rates based on expected long-term returns of 8.0 percent. As reported in Callan's *Capital Market Review*, for the 15 years ending March 31, 2008, state and local retirement plans in Callan Associates' Public Database earned annual investment returns averaging 9.1 percent. This period includes the significant domestic equity declines from 2000-2002, as well as declines in the last quarter of 2007 and the first quarter of 2008.

### **Conclusion**

Public pension plans have faced significant strains over the past decade. The downturn of the domestic equity markets from 2000 through 2002 resulted in plan funding ratios falling, on average, from a little over 100 percent to about 86 percent. The need to amortize this sudden increase in unfunded liabilities resulted in increased employer contribution rates during a time of fiscal stress for state and local governments. Moreover, some governments had increased pension benefits in the late 1990s, believing that the high investment returns at the time would continue.

However, the MVL approach would not directly address these issues. A better approach would be to face them directly:

- To the extent there is too much risk in public pension portfolios, pension administrators and trustees should diversify their investment holdings in ways that better manage downside risk. If this results in lower expected returns over the long-term, these lower returns should be reflected in the actuarial assumptions used under conventional actuarial methods.
- To the extent governments have promised benefits based on plan “overfunding” they should realize such promises will be difficult to sustain. All stakeholders should recognize this as well and work to ensure that the benefits promised can be reasonably sustained over the long-term.
- To the extent governments are not making their full actuarially determined contributions to the plan, they should recognize that the shortfall will likely need to be paid in the future with interest. Taxpayers should understand this as well and monitor their governments to ensure that the necessary contributions are made in a timely manner.

All of these can be addressed using actuarial methods and assumptions, as well as appropriate decision-making strategies, that reflect the fundamental dynamics of the plan, i.e., the conventional approaches.