

Comments to the Public Interest Committee
American Academy of Actuaries

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AFSCME believes that the application of (corporate) financial economics to governmental pension plans is unnecessary. Although financial economics may be applicable to corporate accounting and investment banking, it is not suited to governmental pension plans, and would simply add an additional level of complexity to an already complex subject. There is no need to add another "disclosure" number, especially one that can easily be misunderstood or intentionally misconstrued against public plans

Government pension plans are fundamentally different from corporation plans, and the actuarial methods applied to government plans must recognize these differences. Unlike corporate plans, government plans are expected to continue indefinitely, and cannot be terminated by the decision(s) of one or a few senior executives.

Public pension plans are *not* pass-through entities. They are as permanent as the governments that sponsor them. Even those comparatively few places that have closed their DB plans to newly hired employees continue to administer their DB plans, and will do so for the next 50 or more years.

There is no market (no "invisible hand") for public plan liabilities. These liabilities are not bought, sold or assigned. They are not sold to annuity providers, and, importantly, they are not guaranteed by the PBGC. There are no arbitrage opportunities for outside investors.

Generally speaking, corporate entities operate to serve (stock)owners, creditors and employees. Most measures of corporate effectiveness involve valuations, either of net worth, operating margins, or both. Governments are measured to difference standards.

Governments have comparatively few “entry level” positions, and equally few “executive” positions. It is not uncommon for a public employee to enter government service at a midlevel position, and retire from essentially the same or a similar position after 20-30 years of service. Although government plans serve as retention tools, they are to a greater extent a reward for long service in positions with limited upward mobility.

It is also important to note here that the vast majority of public plans are contributory, oftentimes with employee contributions exceeding 5% of gross pay. Furthermore, virtually all of these plans are a “condition of employment.” Participation is mandatory, making the employee contributions also mandatory. A significant portion of plan assets consist of employee contributions, which are owned by the individual employees. However, an employee who withdraws his or her contributions at termination (even if termination is for retirement) often forfeits his or her entire vested pension benefit. Mark-to-market distorts the liabilities because it fails to address these issues.

Finally, the application of financial economics to governmental plans could increase the volatility of pension obligations because of minor but frequent changes in the underlying discount rate. From a public policy perspective, the stability of a long term rate (projected returns on actual investments) is superior to one that may result in wide swings in estimated liabilities for reasons only loosely related to changes in the accrued benefit obligations of the plan.