



**Colorado PERA Comments to the Public Interest Committee
of the American Academy of Actuaries, August 29, 2008**

Colorado PERA welcomes the opportunity to comment on the proposed requirement that public pension systems report the measure of their market value of assets and liabilities based on an arbitrary market driven discount rate, also known as the liquidation defeasance method. Colorado PERA believes that a requirement to use liquidation defeasance valuation would be detrimental to public pension systems, their members, sponsoring governmental employers, and taxpayers. Reasons for this conclusion are briefly highlighted below.

Governments do not operate like businesses. Governments, unlike profit seeking enterprises, are not subject to mergers, acquisitions, spinoffs, buyouts, bankruptcy or liquidation. In the corporate pension fund environment, liquidity is necessary where a short-term approach to assessing the health and viability of private sector pensions is required. Unlike corporations, governments have time horizons that are not only decades longer, but are indeed perpetual. Moreover, governments are ultimately “owned” by citizens/taxpayers. A liquidation defeasance requirement would lead to higher contribution expenses to be borne by taxpayers, leading to a decline in public employee retirement security and to lower returns on taxpayer funds.

Government sponsored pensions are cost-effective. Public pensions are able to take advantage of significant economies of scale in providing life-time annuities to retiring employees. Public pensions can pool the risks and maximize the rewards of investing funds over long periods of time at a low cost.

Moving to a liquidation defeasance based valuation of liabilities method would increase costs. Ascertaining the market value of plan assets is generally a straight forward exercise. However, the liability side of public funds is significantly more complex, necessarily incorporating assumptions concerning uncertain future events decades into the future, well beyond the speculative selection of a discount rate or the time value of money. Public pension funds have a long history of investing members’ assets in diversified portfolios successfully balancing the risk and yield to maximize long-run returns. The unilateral imposition of a liquidation defeasance standard would, in effect, arbitrarily restrict the investible universe, decreasing returns and increasing costs, for no discernable benefit. Proponents of a liquidation defeasance standard suggest that this approach is “risk-free”. In fact, it presents members and taxpayers with an entirely new set of volatile risks related to inflation.

Public pension investment returns would decline and public pensions’ positive impact on state and local economies would disappear. A liquidation defeasance discount rate using the 10-year U.S. Treasury bond would result in a rate for valuation purposes four percentage points lower than the typical eight percent public fund assumed investment rate of return. A four percent difference in the assumed return on the \$2.7 trillion in public pension fund assets approximates \$110 billion per year. Compounding this amounts to nearly \$1.5 trillion over the next decade and

is equivalent to twenty percent of the annual general fund tax revenue for the fifty states. This is truly an unconscionable, significant and unnecessary additional taxpayer expenses.

Forcing public pensions to use liquidation defeasance valuation is arbitrary. The proposed measure of accounting for costs/contributions on an arbitrarily set market-based fixed income discount rate takes away the economic advantages of a public pension system and would unduly alarm and harm public policy decision makers and taxpayers. Further, taxpayers today would have to pay up-front for liabilities that would not be realized for decades, and, more than likely, be accounted for at a higher value than necessary. Calls for public pensions to use liquidation defeasance methodologies are irresponsible, and not based on logic or on the historical investment experience of public plans.

Public pension liabilities are long-term, and the methods used to calculate liabilities should be long-term, too.

Moving to a market-based valuation would cause public pensions to disappear. Over time, if the economic advantages of public pension systems are taken away, they will cease to be the preferred method for providing retirement benefits to public servants. As we have witnessed in the private sector, older employees are that are unable to retire with steady income must continue to work (if their health permits) or retire at a greatly reduced standard of living, perhaps having to rely on public assistance programs for basic needs.

History tells us that public pensions are getting it right. The real issue is whether pre-funded public pension plans efficiently generate the wealth necessary to pay off the contractual claims entered into by the governmental sponsors on behalf of their employees. The 75-year history of public pensions in the United States suggests that the answer to this question is a resounding "yes."