

American Federation of Labor and Congress of Industrial Organizations



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Submitted Electronically to picpubplanswritten@actuary.org

Public Interest Committee
American Academy of Actuaries
1100 17th Street, NW
7th Floor
Washington, DC 20036

Re: Public Pension Plans
Disclosure of Market Value of Assets and Liabilities

Ladies and Gentlemen:

On behalf of the more than 10 million working men and women of the AFL-CIO, more than three million of whom work for state and local governments, we offer our comments on the disclosure of the market value of assets and liabilities for public pension plans.

Throughout its existence, the labor movement has been committed to assuring retirement income security for its members and all Americans. Through collective bargaining, unions secured defined benefit pension plans for their members in both the private and public sector, adding impetus for spreading this benefit to the non-union workforce.

Today, retirement income security is fast becoming a goal beyond the reach of most Americans. Our private sector pension system is fraying, with fewer workers now covered by defined benefit pension plans. Most of our 76 million baby boomers will face retirement with fewer assets than previous generations, if they are able to retire at all, and many will be forced to remain in the workforce to stave off poverty.

While defined benefit pension plan coverage has declined dramatically in the private sector over the last three decades, state and local government workers continue to be protected by these plans.¹ Because defined benefit plans remain the soundest vehicles for building and

¹ In 1975, 88 percent of private sector workers participating in pension plans were covered by defined benefit plans. By 2005, the percentage dropped to 33, a decline of more than 60 percent. For state and local government

safeguarding retirement income security,² any change in how they operate should be carefully considered in order to determine its impact on the continuation of these critically important plans.

In our view, as we explain below, neither disclosing the market value of public pension plan liabilities nor using that valuation as a basis for funding these plans is in the public interest.

Valuing plan liabilities by reference to spot prices in markets for other types of obligations ignores the essential nature of defined benefit pension plans and the purpose of an actuarial valuation of plan finances. These plans are funding vehicles for paying long-term pension promises to workers. Because they are expected to exist well into the future, they are able to, and in fact do, invest in more diversified portfolios and manage investment risk and volatility better than workers can on their own. As a result, defined benefit plans earn higher investment returns than those individuals achieve through defined contribution plans.³ When valuing the liabilities of public sector defined benefit pension plans, it is more appropriate to reflect the actual manner in which these plans are managed and their likely needs to pay promised benefits based on their actual and expected investment performance.

Instead of taking the long-term horizon into account, the market valuation of liabilities focuses on the short term, a snapshot in time, and implicitly assumes the immediate termination of the pension plan. As a result, pension funding is turned on its head. Rather than looking toward a contribution stream extending well into the future, the goal becomes having sufficient plan assets to cover all liabilities each and every reporting period. Presuming the termination of a public pension plan, however, ignores reality.⁴

Another significant concern is the volatility resulting from the use of a market valuation approach. From year to year, the calculated liabilities are likely to fluctuate. But, if the funding of public plans continues to be based on prevailing actuarial methods, these fluctuations have

workers, the comparable percentages were significantly higher—98 in 1975 and 92 in 2005. A. Munnell, K. Haverstick and M. Soto., *Why Have Defined Benefit Plans Survived in the Public Sector?* (Center for Retirement Research Boston College, December 2007)

² Defined benefit plans, as opposed to defined contribution plans, provide a guaranteed, predictable stream of retirement income and typically offer additional protections through early retirement, disability and survivor benefits. These plans also generally prohibit any payments before actual retirement, unlike the overwhelming majority of 401(k) plans, assuring that participants have income during their retirement. B. Almeida, *Retirement Readiness: What Difference Does A Pension Make?* (National Institute on Retirement Security, May 2008) available at http://www.nirsonline.org/index.php?option=com_content&task=view&id=49&Itemid=49.

³ See A. Munnell, M. Soto, et al., *Investment Returns: Defined Benefit vs. 401(k) Plans* (Center for Retirement Research Boston College September 2006). Another factor contributing to the enhanced performance of defined benefit plans is their use of professional managers.

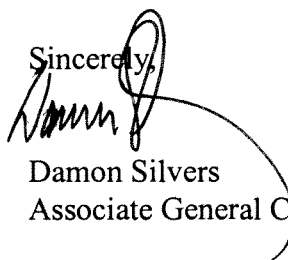
⁴ Public pension plans are sponsored by governmental entities that are less likely than business organizations to become insolvent and rarely liquidate. GASB White Paper, *Why Governmental Accounting and Financial Reporting Is and Should Be Different* (2006) available at <http://www.gasb.org/>.

absolutely no significance and will do nothing but create unrealistic expectations of benefit increases or raise questions about the funded status of the plan and workers' benefit security.⁵

Relying on the market valuation of liabilities to make decisions about public pension plans could lead to results that harm workers and their future retirement security. The unpredictability of plan contributions could lead to a decline in defined benefit plans if public entities, facing pressures to limit contribution demands, replaced defined benefit plans with defined contribution plans and their fixed contribution obligation. Alternatively, if the investment of plan assets was changed to moderate contribution volatility, the benefits provided by public sector plans might have to be decreased. In either case, workers receive lower benefits in retirement.

Advocates of marking pension plan liabilities to short-term market prices for other supposedly comparable liabilities typically base their arguments on two completely false positions. First, that there is no benefit to plan participants and beneficiaries in having a diversified portfolio of assets that takes advantage of the superior ability of pension plans to weather short-term volatility compared to individual workers. Second, that pension plans should be financially managed in the interests of their contributing sponsors rather than their participants—a proposition that is not just wrong but advocates that fiduciaries violate their duties. These two positions have no empirical or legal foundation and if acted upon would profoundly damage workers' retirement security.

Because reporting the market value of liabilities for public pension plans could lead to decreasing the retirement security of public sector workers, it would not be in the public interest and we urge the Committee to conclude that a public statement is not warranted.

Sincerely,

Damon Silvers
Associate General Counsel

⁵ Should market liability measures be used to determine the funding of public pension plans, state and local governments are likely face significant contribution volatility. If plan contributions become unpredictable, public entities could face budget difficulties and the possibility of unmanageable fiscal demands.