COMMENT 9: JULY 31, 2008

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Sent via Electronic Mail: comments@actuary.org

ASB Comments
American Academy of Actuaries
1100 17th St., N.W., 7th Floor
Washington, DC 20036

Dear Actuarial Standards Board:

We are writing in response to the ASB's request for comments regarding Actuarial Standards of Practice No. 27. Together, we represent 72 retirement systems sponsored by state and local governments in the U.S. and its territories. These systems administer pension and other benefits for some 15.1 million working and retired public employees, and hold in trust approximately $2.0 trillion in defined benefit plan assets.

We appreciate the ASB's interest in the adequacy of actuarial standards, particularly as they pertain to the calculation and disclosure of public pension liabilities. The outcome of the ASB's deliberations regarding ASOP No. 27 is of great interest to us and could have significant consequences for the plans we administer.

The background to the ASB's request for comments on ASOP 27 states in part, "In the decade since ASOP No. 27 was first adopted, pension actuarial practice has evolved and the pension actuarial landscape has been affected by such factors as deteriorations in the funded status and increases in the costs of many plans, an altered regulatory environment, changing expectations regarding actuarial assumptions, and the emergence of financial economics as an alternative to the traditional actuarial model."

In certain important respects, the experience of the public pension community differs from this assessment. For example, based on the latest available data, aggregate public pension funding levels today are approximately the same (around 86 percent) as they were in 1996.

Also, in the aggregate, public pension costs are lower than they were one decade ago. Measured as a percentage of employee pay, in 2006 public pensions cost employers (taxpayers) 9.74 percent, slightly less than their 9.95 percent cost in 1996. As a percentage of all state and local government spending, public pensions in 2006 cost less than they did in 1996: 2.6 percent of total expenditures compared to 3.0 percent. This figure generally has declined steadily in recent years.

Notably, recent analyses of state and local government pensions' funding condition by the U.S. Government Accountability Office stated, "The funded status of state and local government pension funds is reasonably sound …" and "most state and local government pension plans have enough invested resources set aside to pay for the benefits they are scheduled to pay over the next several decades …" GAO also stated that these plans would need slightly higher contributions—less than one-half of one percent—"to achieve healthy funding on an ongoing basis."

With regard to an altered regulatory environment, regulation of state and local government pensions occurs almost exclusively among state and local governments, and revisions to their regulatory arrangements varies widely from one state to another. We believe that the absence of a single, one-size-fits-all regulatory structure is a major factor contributing to the ongoing success that public pensions continue to enjoy. Public pension regulation and administration embodies the spirit of states as "laboratories of democracy," in which individual states can experiment and innovate, allowing others to learn from their experience.

With respect to changing expectations regarding actuarial assumptions, we believe the existing ASOP 27 standard, which permits actuaries to select a range of economic assumptions and to identify a single point within that range, continues to serve as an effective model. We believe this standard provides actuaries with the flexibility needed to respond to changing economic circumstances and expectations.

As to the reference to the emergence of financial economics as an alternative to the traditional actuarial model, we believe that financial economics is based on a corporate finance model that does not have practical application to public sector pension plans. In particular, we believe the financial economics principle of a market value of liabilities is ill-suited to public sector pension plans.

By requiring calculation of liabilities on the basis of a risk-free investment portfolio, accrued benefit obligation, and mark-to-market accounting, MVL represents a termination liability. This contradicts the nature of public pension plans and their sponsors as going-concerns. Termination of public pension plans is extremely rare, and their benefits generally are guaranteed by state constitutional and statutory provisions or case law.

Disclosure of pension liabilities must provide information that is meaningful and useful to stakeholders. For public pensions, those stakeholders include public employers and policymakers, public employees, creditors and potential creditors of governments, and taxpayers. Changes in the nature or amount of information currently disclosed under existing governmental accounting and financial reporting standards should enhance the overall value of such disclosures to these users.

We believe that MVL not only fails to offer such an improvement, but could actually provide a distorted view of plan funding that would confuse and mislead rather than inform and enlighten stakeholders.

We note that the requirement that corporate pensions calculate and disclose their MVL has resulted in significantly greater volatility in their funding levels and required contributions, and that many corporate pension plans have been frozen or terminated in the years since this requirement was established. Although other factors may have played a role in the decline in corporate pension coverage, we believe that the MVL requirement also was a factor. As

professionals responsible for administering pension benefits for employees of state and local government, we have a responsibility to guard against factors that could produce a similar result among public plans.
This is not to say that changes to current actuarial standards should not be considered. Governments and their operating environment are not static; the manner in which the need for public accountability is satisfied must therefore be capable of reflecting such an ever-changing landscape. This evolution in standards, however, should continue to respect the unique nature of government and the differing needs of the users of governmental financial reports as compared to other business enterprises, such as corporations, and their stakeholders.

MVL disclosure fails in this regard. We believe the application of the MVL approach to governmental plans would be harmful for the following reasons:

- It could lead to the disclosure of plan costs and liabilities that do not accurately represent the dynamics and unique operating environment of governmental plans and are therefore unnecessarily high;
- It could lead to the application of investment approaches that would unnecessarily limit the asset allocation and investments returns that can be earned by plans; and
- It would create confusion among decisions-makers, taxpayers, and the media about the funded levels of public pension plans, potentially leading to their disuse or abandonment.

Governmental accounting and financial reporting standards should continue to reflect the important and fundamental differences, particularly in long-term sustainability and benefit protections, between State and local governments and private sector employers and the pension plans they sponsor. We reiterate our belief that financial reporting models applicable to terminable private sector corporations and their pension plans that require the reporting of MVL are inappropriate for governments and are inconsistent with the nature and purpose of public retirement systems. We urge the ASB to reject standards for public pension plans that are based on financial economics, particularly standards that require calculation or disclosure of an MVL.

Thank you for your consideration.

Sincerely,

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