National Council on Teacher Retirement
Federal E-News

TUESDAY, SEPTEMBER 18, 2012

Moody's to Apply 5.5% Discount Rate to Governmental Plan - "Backdoor PEPTA?"

Moody's has announced plans to adjust the pension liability and cost information reported by state and local governments and their pension plans, and has requested comments from interested parties. In addition to using a uniform 5.5% discount rate for all plans, Moody's intends to apply a single, 17-year amortization period to annual pension contributions, and replace asset smoothing with the market value of assets as of the actuarial reporting date. The results, according to Moody's own estimates, will be to nearly triple fiscal 2010 reported unfunded actuarial accrued liabilities for the 50 states and the local governments that Moody's rates. Ironically, while Moody's thinks that these uniform standards will improve the comparability of pension information across governments, it has strongly opposed similar standardization efforts for credit rating agencies. NCTR and NASRA are very concerned with the Moody's proposal, and have drafted joint comments strongly objecting to the planned adjustments, which member retirement systems can also sign onto. If Moody's succeeds in their goal of publically restating governmental pensions' unfunded liabilities using a discount rate based on a bond index, why would Congressman Devin Nunes (R-CA) and certain other members of Congress need to continue to push for the adoption of a Federal law requiring the U.S. Treasury to provide virtually the same thing?

On July 2, 2012, Moody's Investor s Service ("Moody's") announced that it was requesting comment from market participants on its plan to implement several adjustments to pension liability, asset, and cost information reported by state and local governments and their pension plans. Initially, Moody's placed a deadline of August 31, 2012, on its comment period, but later extended this until September 30th.

The Moody's Proposal

Saying that "Pension liabilities are widely acknowledged to be understated," Moody's Managing Director Timothy Blake explained that the proposed adjustments would "improve the comparability and transparency of pension information across governments, enhancing our approach to rating state and local government debt." In addition, the adjustments are intended to permit the assessment of the scale of pension liabilities in a way comparable to debt obligations.

Moody's is considering four principal adjustments to as-reported pension information:

1. Multiple-employer cost-sharing plan liabilities will be allocated to specific government employers based on proportionate shares of total plan contributions, similar to the way in which the Governmental Accounting Standards Board (GASB) has required cost-sharing plan liabilities to be allocated.
2. Accrued actuarial liabilities will be adjusted based on a high-grade long-term corporate bond index discount rate (5.5% for 2010 and 2011). Moody's says that it proposes to replace the varying discount rates with this uniform high-grade bond rate because investment return assumptions used by public plans today "are inconsistent with actual return experience over the past decade (when total returns on the S&P 500 index grew at about 4.1% annually);" a high-grade bond index is a reasonable proxy for government's cost of financing portions of its pension liability with additional bonded debt; and high-grade bonds are an available investment that could be used in a low-risk strategy to "match-fund" pension assets and liabilities.
3. Asset smoothing will be replaced with reported market or fair value as of the actuarial reporting date.
4. Annual pension contributions will be adjusted to reflect the foregoing changes as well as a common amortization period of 17 years which reflects Moody's estimate of the average

remaining service life of employees based on a sample of public pension plans. Moody's says that this proposed adjusted contribution "translates our other adjustments into a pro-forma measure of annual fiscal burden that can be compared across plans and issuers, relative to capacity to pay."

These adjustments are necessary in order "to address the fact that government accounting guidelines allow for significant differences in key actuarial and financial assumptions, which can make statistical comparisons across plans very challenging," according to the formal Moody's Request for Comment.

Based on Moody's own analyses, the impact of the adjustments will be to significantly increase reported unfunded actuarial accrued liability and annual pension contributions:

- After adjusting for the discount rate alone, the State sector's unfunded actuarial accrued liabilities (UAAL) would grow 129% to $894 billion from $391 billion, decreasing the funded ratio to 55%. With the additional adjustment of asset valuation, the State sector's UAAL would grow to $1.056 trillion, or 74% of total annual State revenues, from $391 billion, or 28% of revenues, an increase of 170%. This would further decrease the funded ratio to 46%.
- Adjustments to State sector annual pension contributions would result in an increase of 252%, from $36.6 billion to $128.8 billion, or from 2.6% of revenues to 9.1% of revenues.
- For the local government sector, the discount rate adjustment would increase the UAAL by 158%, to $967 billion from $375 billion, and reduce the funded ratio to 59% from 79%. The asset value adjustment would likely result in an additional increase in UAAL to $1.135 trillion and a further reduction in the funded ratio to 52%.
- Adjustments to reported annual contributions for local governments are not made because the necessary data is not uniformly disclosed, according to Moody's.

Moody's says that it will publish its specific adjustments for states and selected local governments "when we have finalized our analytical approach later this year."

NCTR Response

NCTR and NASRA take strong exception to Moody's proposals for several reasons:

1. Moody's proposed adjustments will reduce transparency and consistency in the analysis of pension liabilities by adding yet another set of calculations that will result in increased, widespread confusion and misunderstanding of the meaning and implication of public pension actuarial measures.
2. GASB, the public body charged with setting public pension plan financial rules, has just completed a comprehensive examination of public pension accounting that has taken more than 6 years to complete. GASB considered the issue of the discount rate, and after careful analysis and public comment, it rejected the idea of a uniform rate in favor of a blended rate that more accurately reflects the unique composition of each pension system. Thus, Moody's decision to apply a rate based on long-term corporate bonds not only ignores the fact that this metric has been deemed inappropriate for the public sector, but also the fact that such rates are currently at historic lows.
3. The application of a single, 17-year amortization period fails to account for both the diversity of public pension plan demographic structures and the essentially perpetual nature of their plan sponsors.
4. The use of a point-in-time measure, in lieu of one that recognizes longer-term trends through the use of smoothing, will result in near-term volatility of pension plan funding conditions. For an entity with virtually a perpetual expected life, a smoothed asset value more fairly reflects the true condition of the plan than does a "spot price' as of the plan's fiscal year-end date.

The NCTR/NASRA comment letter also points out that when Moody's filed comments with the Securities and Exchange Commission (SEC) in February of 2011 in connection with the SEC's Credit Rating Standardization Study, Moody's opposed the imposition of uniform standards on credit rating agencies

such as itself. Arguing that increased transparency was a reasonable substitute for standardization, Moody's stressed that "ratings cannot be reduced to an output from a formulaic methodology or model." Furthermore, Moody's insisted that a single quantitative interpretation of credit factors "would miss a myriad of considerations that arise naturally in the rating process," and that "a single-dimensioned definition likely would underemphasize ratings stability, which many investors value."

NCTR and NASRA believe that these concerns about the application of uniform, standardized credit rating factors also apply to the analysis of public pensions, and that the new GASB standards, with their increased transparency, will permit the public to develop an adequate and consistent understanding of the public pension community's approach to the discount rate appropriate to each plan.

Outlook

Will Moody's change direction in response to these and other comments from public sector organizations, elected officials, and public pension actuaries? And if they do not, will the presence of one more set of liability measurements be that problematic?

As we know, GASB, as the independent standard setter of generally accepted accounting principles for state and local governments, has already taken action in this area. As the Government Finance Officers Association (GFOA) has pointed out in its comments, Moody's "expedited three-month process of soliciting and collecting comments from stakeholders stands in marked contrast to the systematic and transparent approach used by the GASB over a three-year time period, which involved the issuance of no less than three separate due-process documents that preceded the final standard."

Moody's is a private sector organization with no mandate or authority to regulate public pension accounting or actuarial standards, and Moody's has no accountability to GASB or other oversight bodies when it comes to its proposed adjustments. Furthermore, Moody's methodologies for rating state and local government debt already incorporate an analysis of pension obligations, underscoring the fact that seeking public "feedback" is not necessary for them to make such changes. Indeed, a close reading of their request for comments reveals that they are not seeking advice as to whether or not to proceed, but rather to see if their adjustments will be seen as useful in enhancing the comparability of pension obligations among state and local government entities.

Therefore, it would appear that Moody's is committed to making its proposed adjustments. It firmly believes that they "are material, feasible and practical given current disclosures." Finally, on August 17th, when Moody's extended it deadline for comments to September 30th, it also released a "Frequently Asked Questions" document intended to provide responses to questions that have been raised by investors, issuers and other interested parties. In this document, Moody's indicates that it will publish its specific adjustments for states and selected local governments "when we have finalized our analytical approach later this year. " Note that they say "when," not "if."

So what would be the significance of Moody's actions? After all, Moody's goes out of its way to state that its proposal "is not intended to provide an alternate or replacement actuarial valuation of public pension liabilities." Furthermore, Moody's says that "We are not suggesting that [Moody's adjustments] be a guide, standard or requirement for a state or local governments to fund these obligations." Finally, with regard to its proposed adjustments to annual contributions, Moody's states that "We would not intend it to be a prescriptive funding strategy."

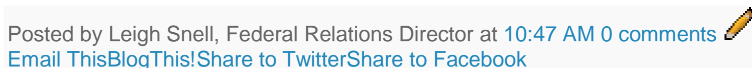
Nevertheless, a new set of public pension liabilities – in addition to the actuarial calculation required to meet new GASB requirements and another to inform policymakers of the plan's funding requirements -- will, at best, be confusing to decision makers and to the public, compounding the selective use that already surrounds these various measurements of liabilities. At worst, the new Moody's numbers, coming from an organization with a high profile and degree of credibility, will be seen as an independent, third-party reliable source of information. And notwithstanding Moody's representations to the contrary, what is the purpose of measuring a financial obligation if not to assist it satisfying it?

In short, many are concerned that the new Moody's numbers will become a generally acceptable benchmark, free from the taint of politics and abstract academic theory. And if this happens, it would seem to satisfy one of the primary goals of the "Public Employee Pension Transparency Act" (PEPTA), which is to have public pension liabilities restated using a bond rate as the discount rate.
Indeed, in many ways, having the Moody's adjustments would be worse than having PEPTA, in that the Moody's process is not dependent upon Federal appropriations to fund the development of a Treasury database, nor the annual filing of such information by pension plans, all of which could take several years to fully implement. Instead, as Moody's has indicated, it intends to have these new, adjusted numbers available by the end of this year.

Therefore, the filing of comments, however convincing they may be, may not be sufficient to alter Moody's intended course of action. Accordingly, it is very important that elected officials involved with the obtaining of credit ratings for municipal bonds make their concerns known to Moody's in as direct a manner as is possible. Given that Moody's has indicated that its proposed changes could have an impact on ratings for local governments "where the adjusted liability is outsized for the rating category and without mitigating factors such as demonstrated flexibility to respond to higher fixed costs," it is particularly important that local officials make their voices heard. NCTR is working with national organizations representing State and local governments to ensure that they are aware of the implications of Moody's actions.

Investment performance and the discount rate have a considerable effect on a pension plan's current and projected cost and funding condition. Applying a single discount rate to measure these plans will result in distortion and confusion, not clarity and transparency, and any comparability among plans will not be meaningful. State and local government officials need to understand this and to convey their concerns to Moody's as soon as is possible. NCTR members are encouraged to help in this educational process, and to this end, comment letters from national organizations and actuarial firms with a deep understanding of public pensions may be very helpful. Links to several of these are found below. NCTR members are also encouraged to file their own comment with Moody's, or join in signing onto the joint NCTR/NASRA letter, a link to which is also provided. Please contact Leigh Snell, NCTR's Director of Federal Relations, at lsnell@nctr.org to add your system to this letter.

- Moody's Request for Comment
- Moody's FAQ
- Moody's Letter to SEC on Credit Rating Standardization
- NCTR/NASRA Joint Comment Letter
- GFOA Comment Letter
- Cavanaugh Macdonald Comment Letter
- Gabriel Roeder Smith Comment Letter



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FRIDAY, AUGUST 24, 2012

NCTR Commends Senator Harkin for Efforts to Provide Retirement Security for All

NCTR has advised Senator Tom Harkin (D-IA) that it stands ready to work with him to find a solution to the retirement security needs of all Americans. Harkin, the Chairman of the Senate Health, Education, Labor and Pensions (HELP) Committee, issued a report in late July documenting a national retirement crisis and proposing a new type of retirement plan as well as several proposed improvements to Social Security. The Senator says he intends for his report to be "the starting place in an evolving discussion about retirement security." Meredith

Williams, NCTR's Executive Director, wrote to Harkin that NCTR also strongly believes that all Americans should have access to a pension plan that will provide adequate and reliable retirement security, and commended the Senator for providing an excellent foundation for this vitally-important conversation.

Senator Harkin's new report, "The Retirement Crisis and a Plan to Solve It," was released on July 27, 2012, and is based on a series of hearings in the Senate HELP Committee that highlighted the state of retirement security and attempted to provide a better understanding of how the system can be improved. (Diane Oakley, the Director of the National Institute on Retirement Security (NIRS) testified at once such hearing.)

The report begins by documenting the nature and degree of the problem. As Senator Harkin puts it, the retirement crisis is real and it will have significant repercussions. "As older Americans transition out of the workforce, either voluntarily or involuntarily, many will find that they cannot afford basic living expenses," the Senator warns. "They will be forced to make the difficult choice between putting food on the table and buying their medication," according to Harkin's findings. In short, "the retirement crisis will put an enormous strain on our families, our communities, and our social safety net," he concludes.

Senator Harkin believes that his hearings have provided a clear picture of the kinds of changes needed to ensure the retirement system can work for everyone. These changes can be reduced to what he terms as four basic principles:

1. The retirement system should be universal and automatic.

2. The retirement system should give people certainty that they will have a predictable stream of retirement income that they cannot outlive.

3. Retirement is a shared responsibility among individuals, employers, and the government; it is unfair for any one player to shoulder the burden alone.

4. Retirement assets should be pooled and professionally managed.

Based on these principles, Senator Harkin has suggested one possible solution with two components.

<u>USA Retirement Funds</u>

The first component is what he calls Universal, Secure, and Adaptable ("USA") Retirement Funds, a new, privately-run, hybrid pension plan that incorporates many of the benefits of traditional defined benefit pensions. Each USA Retirement Fund would be overseen by a board of trustees consisting of qualified employee, retiree, and employer representatives, and its assets would be pooled and professionally managed.

The USA Funds would be based on automatic payroll deductions. Employers that do not offer a workplace retirement plan with automatic enrollment and a minimum level of employer contributions would be required to automatically withhold a portion of their employees' pay and remit such amounts to a USA Retirement Fund. Employees would be automatically enrolled at a specified contribution level, but they could increase their contributions, decrease their contributions, or opt out of automatic enrollment at any time; employers would receive a credit to help off-set any payroll withholding administrative costs. Harkin stresses that employers that already have pension plans or DC Plans with automatic enrollment and a match "would not have to change anything."

USA Retirement Fund participants would earn a benefit paid out over the course of their retirement, with survivor benefits, based on contributions and investment performance over time. These benefits would also be completely portable. They could be reduced (or increased) if market conditions so warranted. Since Harkin believes that it is

“nearly impossible” for low-wage workers to save enough for retirement, these employees would be eligible for refundable retirement savings credits that would be contributed directly to these new USA Retirement Funds.

USA Retirement Funds are intended to eliminate virtually all risk to employers by spreading them across large groups of employees and retirees. Employers’ only responsibility would be to automatically enroll employees, ensure that employee contributions are processed, and make modest contributions. Harkin underscores that employers would not “guarantee” the USA Retirement Funds or have any residual responsibility to provide additional funding or make up shortfalls.

Finally, Senator Harkin offers reassurances that these new Retirement Funds are not intended to supplant DC plans, but rather to supplement them. His report makes it clear that employers could offer both a USA Retirement Fund and a DC plan for their employees.

Social Security Reform

The second component of Harkin’s proposal deals with Social Security. The Senator proposes modifying the Social Security benefit by increasing the amount of earnings covered by the first income level of the existing formula. Currently, this formula replaces 90% of a person’s first $767 of average indexed monthly income. The Senator would, over a 10 year period, increase the $767 by 15%. “Although the increase is modest,” Harkin’s report states, “it will have an especially profound effect for those in the middle and at the bottom of the income distribution for whom Social Security has become an ever greater share of their retirement income.”

Senator Harkin also would change the way the Social Security Administration calculates the COLA by tying the annual adjustment to the Consumer Price Index for the Elderly (CPI-E). Currently, the CPI for all Urban Wage Earners (CPI-W) is used, but it is based on a basket of goods that Harkin believes does not adequately track the purchases of seniors. “Making this change ensures that Social Security benefits keep pace with the rising costs of essential items for seniors, including health care,” Harkin argues.

Finally, Senator Harkin would address the solvency of the trust fund by phasing out over 10 years the cap on wages subject to the payroll tax; this cap is currently $110,100. Furthermore, he would create a new replacement factor of 5% for income over the current wage cap “to ensure that people receive a benefit for every dollar they pay into the system,” he explains.

NCTR Letter of Support

Senator Harkin notes that his proposals “are intended to be a starting place” in the national debate he envisions. In his letter to Senator Harkin, Meredith Williams notes that Harkin’s framework that the Senator believes is necessary to ensure that the retirement system for the private sector can work for everyone echoes the design features that NCTR supports for the public sector. “While we may take a different approach on some aspects of a specific plan to provide for retirement security, your basic concept for rebuilding pensions is compatible with the policy positions of NCTR,” Williams assured the Senator.

Senator Harkin concludes that the retirement crisis is simply too big to ignore, and that “it is time for us to roll up our sleeves and get to work.” “We agree,” writes Williams, “and your report provides a solid basis for an evolving national discussion on how best to address this crisis.” Furthermore, the NCTR letter stresses that governmental plans’ record of success in offering protection from financial risk and providing a guaranteed stream of income for life “is worth careful study.”

Harkin says that over the coming months, he plans to bring together business and labor leaders, policy experts, advocates, and his fellow lawmakers to implement necessary reforms. “Please count us in,” Williams tells the Senator. “NCTR stands ready to roll up our sleeves and work with you over the coming months on this most important undertaking.”

Outlook

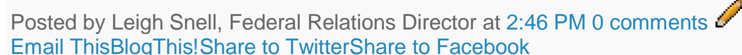
Senator Harkin's report has been generally well-received to date. For example, Karen Friedman, policy director for the Pension Rights Center in Washington, is quoted in a press release as saying that "Senator Harkin's bold report identifies the causes of the retirement crisis and proposes imaginative and realistic solutions to address the crisis." Pensions and Investments (P&I) conducted a poll and found that of 612 respondents, 73% supported Harkin's concept of a new private retirement system offering universal coverage through automatic payroll deductions with professional money management. Even Andrew Biggs, an economist with the American Enterprise Institute, is quoted as saying that he is "glad it is out there," although, as he correctly points out, the devil is always in the details.

However, others were more cautious. A spokesman for the American Benefits Council (ABC), representing private sector employers and other organizations who sponsor directly or provide services to retirement, health and compensation plans covering more than 100 million Americans, is quoted in P&I as stating "We stand ready to work with Sen. Harkin and other lawmakers to improve retirement coverage and adequacy." But the spokesman went on to also note that ABC's first priority "is making the existing employer-sponsored system more flexible and administrable for companies competing in a challenging global economy."

Senator Harkin does not yet have specific legislative language ready to introduce in Congress. Nor have detailed estimates of the economic impact to employers, employees or the Federal government been developed. Given that the devil is, indeed, always in the details, the future of Harkin's specific proposal is therefore still unclear. Nevertheless, as Ms. Friedman pointed out to P&I, the proposal should create new business for financial institutions and money managers, and should therefore garner their support.

When announcing his report, Senator Harkin is quoted as saying that "I am under no illusions that we're going to get anything done this year, but I want to be ready to go in with this next year." When he does, NCTR will be there.

- Harkin Report: "The Retirement Crisis and a Plan to Solve It"
- NCTR's Executive Director Meredith Williams' Letter to Harkin
- Harkin Video on Retirement Security from NCTR2011 Conference



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WEDNESDAY, AUGUST 1, 2012

New Study Finds Many Teachers Lack Confidence in their Retirement Outlook; Rising Health Care Costs Possible Culprit

Based on a 2012 nationwide survey of over 1000 state and local government employees, including public educators, police and firefighters, the Center for State and Local Government Excellence and the TIAA-CREF Institute have found that only 16 percent of teachers are very confident they are saving the right amount for retirement. Overall, just 19 percent of full-time public sector workers are very confident in their retirement income prospects, according to the survey results.

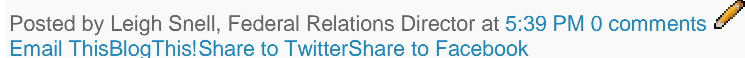
The results of the Survey are analyzed in a new report entitled "2012 Retirement Confidence Survey of the State and Local Government Workforce," published July 26, 2012.

Other findings include:

- 49 percent of teachers believe that they will need to replace 70 percent or more of their pre-retirement income each year in retirement so that they can live comfortably.
- Among K–12 teachers, the average preferred retirement age is 59 years and the average expected retirement age is 63 years.
- 57 percent of public sector workers expect to work longer than they would like.
- Overall, 72 percent of public sector workers expect to work after retiring; for full-time K–12 teachers, 77 percent anticipate doing so.
- Only 22 percent of public sector workers are very confident that they will have enough money to take care of medical expenses during retirement.
- Only one third of public sector workers are confident that Medicare can be counted on to provide benefits equal to the value of those provided today.

The Center believes that the survey results indicate that "the rising cost of health care is a factor in the tepid expression of overall retirement confidence."

- 2012 Retirement Confidence Survey of the State and Local Government Workforce



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THURSDAY, JUNE 28, 2012

New PEW Report Relies on FY 2010 Data, Presents Flawed Picture of Current State of Public Pensions

New PEW Report Relies on FY 2010 Data, Presents Flawed Picture of Current State of Public Pensions

On June 18, 2012, the Pew Center on the States released an update to their report, "The Widening Gap," which addresses state liabilities and costs for pensions and retiree health care benefits. The report asserts that States "continue to lose ground in their efforts to cover the long-term costs of their employees' pensions and retiree health care," and that in fiscal year 2010, states were $1.38 trillion short of having saved enough to pay their "retirement bills," a nine percent increase from the year before, according to Pew.

However, the Pew report's analysis uses old data that fails to reflect recent market gains. As Keith Brainard, NASRA's Director of Research, points out, by relying on FY 2010 data, "the dates the Pew study is using to measure the condition of many public pension plans are near the low point of the recent investment market decline." Nearly one-half of plans in the NCTR/NASRA Public Fund Survey have an actuarial valuation date that pre-dates their fiscal year-end date, usually by one year, Keith notes.

Also, in order to arrive at the $1.38 trillion figure, Pew once again combines pensions with retiree healthcare. As NCTR and NASRA have noted in the past, retiree healthcare cost containment options, financing structures and benefit protections are entirely different from those of pensions. Pew's decision to couple retiree healthcare with pension liabilities distracts from the issues States face with these very different benefits.

Finally, as Pew itself notes, its report does not reflect the many actions that States have taken in 2010 and 2011 to address plan sustainability, including benefit cuts. The condition of some states "may have improved because of those reforms," Pew concedes.

PensionDialog was quick to point out these flaws. In a June 20th post, Ady Dewey stresses that the Pew report is nothing more than a snapshot in time, "a single frame out of a feature film that runs for decades." Is it any wonder that, using data from the bottom of the market decline, public pension funding levels were lower, she asks? "It's also no surprise that states had difficulty making their full pension contributions as revenues declined sharply in 2009 and 2010," she notes.

PensionDialog suggests that another snapshot should be considered: according to the Federal Reserve, in the first quarter of 2012, public pension plan assets rose to $3.1 trillion, which is up from $2.8 trillion in the fourth quarter of 2011, taking assets above $3 trillion for the first time since 2008. Ms. Dewey suggests that a report can be helpful as long as it is recognized for what it reflects: a static moment in time. "When it comes to public pensions, a series of multiple snapshots, taken with a long-range lens, is going to provide a more accurate perspective of their condition and sustainability," she concludes.

The National Institute on Retirement Security (NIRS) picked up on the PensionDialog "snapshot" analogy a few days later. In a "Commentary" posted by Diane Oakley, NIRS' Executive Director, on June 22nd, she observes that "Flipping through old photo album provides a view of where we have traveled, but it certainly doesn't tell us where we are today." "The same can be said of the recent Pew Center on the States 'new' report on public pension plans," she asserts.

Ms. Oakley also notes the use of 2009 data and the failure to reflect the changes that have been made in 41 states since then. In contrast to the Pew study, she references a May, 2012, Boston College Center for Retirement Research (CRR) report that finds, using moderate economic assumptions, that aggregate pension funding is projected to cross over the 80 percent level in 2015, without taking into account the pension reforms passed by the 41 states. "Fine tuning may still be needed, but we are making progress," Ms. Oakley points out. "This is not reflected in the limited snapshot provided by the Pew study," she concludes.

The Pew report also garnered some attention from the media. However, not all coverage was negative with regard to public pensions. For example, an article by Mark Miller with Reuters notes the Pew report findings, but argues that while pensions are consuming a larger share of some state and local budgets -- and many plans also took major hits in the 2008 crash, with returns since then hurt by low interest rates -- there are five things to keep in mind about public sector pensions "before we continue swinging the axe." According to Miller, these are:

1. Pensions aren't simply a gift from taxpayers.
2. Many workers don't get Social Security.
3. Pension underfunding isn't as bad as you think.
4. Pensions are more efficient than 401(k)s.
5. The retirement crisis is real.

The Pew report also assesses each state's management of its pension and retiree health care obligations as of fiscal year 2010 based on funding levels and contribution policies. States were rated as "solid performer," "needs improvement," or "serious concerns." Pew rated 11 states as "solid performers" in managing their pension obligations in fiscal year 2010; 8 needed improvement; and the 32 remaining states, all of which were less than 80 percent funded according to Pew, were judged to be in the "serious concerns" group.

- Pew's "The Widening Gap Update"
- PensionDialog: "Capturing a Snapshot in Time"
- NIRS Commentary: "The Pew Pension Report: A Snapshot Leads to a Flawed Rating System"

- CRR Report: "The Funding of State and Local Pensions: 2011-2015"

- "Five Things to Consider Before Cutting Pension Benefits"

DELAY CLAIMING SOCIAL SECURITY BENEFITS -- A SMART IDEA?

Is waiting to claim your Social Security benefit in order to obtain a higher monthly benefit at an older age -- using your savings in the interim to pay current expenses – a good strategy? According to a new Issue brief from the Center for Retirement Research (CRR) at Boston College, the answer is essentially yes. Effectively "buying an annuity" from Social Security -- the savings used is the "price" and the increase in monthly benefits is the annuity it "buys" -- is especially attractive in today's low interest rate environment, according to the brief, which finds that this Social Security option "presents an effective, and often overlooked, drawdown strategy that households should seriously consider."

Indeed, CRR says that it is "the best deal in town."

Why? CRR gives several reasons:

1. When interest rates are low, as they are now, living on interest income is "essentially impossible," particularly when these rates are less than the rate of inflation;

2. Basing an income on a portfolio of stocks and bonds is also not very practical since bond interest rates are low and "any increase would reduce the value of the bonds retirees hold;" and

3. Commercial annuities funded by bonds "also provide much less income than they would in 'nor-mal' times."

By contrast, the additional income available by delaying claiming Social Security is not affected by current interest rates, CRR notes. Furthermore, the "annuity rates" for using savings to delay claiming Social Security benefits are much higher than drawdown rates from stock and bond portfolios, and uniformly higher than current rates on commercial inflation-protected annuities.

Thus, CRR claims, the ability to "buy an annuity" from Social Security at these rates "provides a critical safety net against the risk of retiring when interest rates are low." It should also be noted, however, that a key limitation on the use of Social Security as a source of retirement income is the inability to delay claiming past age 70.

- CRR Issuebrief: "Should you buy an annuity fromSocial Security?"

PUBLIC EMPLOYEES: IN THE NEWS AND UNDER THE GUN

As public employees continue to be the focus of political maneuverings in many State capitols as well as in Washington, DC, a new updated report from the Center on Budget and Policy Priorities (CBPP) and a blog post by its author, Elizabeth McNichol – who spoke at the 2011 NCTR Annual Convention – remind readers of "Five Important Facts about Public Employees."

1. Elementary and secondary education comprises — by far — the largest share of state and local government employees.

2. The public workforce has grown only modestly as a share of the population over the last three decades.

3. Public-sector workers earn less in wages than their private-sector counterparts.

4. Counting both wages and benefits, public-sector workers on average still earn less than their private-sector counterparts, though the gap is smaller.

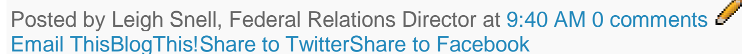
5. Labor costs make up a significant share of state and local spending.

The CBPP is a well-respected Washington think-tank founded in 1981 to analyze federal budget priorities, with particular emphasis on the impact of various budget choices on low-income Americans. It has been referred to by *Congressional Quarterly Today* as being "socially liberal, fiscally conservative, and academically rigorous."

The CBPP report, "Some Basic Facts on State and Local Government Workers," was updated on June 15, 2012. It contains key statistics about state and local employees which are always good to have at hand.

Ms. McNichol is a Senior Fellow at the CBPP. She is also the co-author, along with Iris Lav, of a paper entitled "A Common-Sense Strategy for Fixing State Pension Problems in Tough Economic Times," issued by the CBPP in May of 2011, which argued that it would be "extremely difficult, as well as unnecessary, for states to immediately begin fully funding their pension shortfalls. State economies and budgets continue to struggle because of shrunken revenues and rising needs. The long-term pension shortfalls are not the cause of the current state fiscal problems, and addressing them need not overwhelm state and local budgets now or reduce states' ability to recruit and retain a high-quality workforce."

- "Five Important Facts about Public Employees"
- "Some Basic Facts on State andLocal Government Workers"



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WEDNESDAY, JUNE 6, 2012

Public Pension Trustees and Bankruptcy

By now, you probably know that a U.S. District Court bankruptcy judge in Hawaii has ruled that the pension fund of the Commonwealth of the Northern Mariana Islands (CNMI), a U.S. territory, cannot file for bankruptcy under Chapter 11 of the Bankruptcy Code. However, you might not know that the judge had some pretty good things to say about the actions of the plan's trustees.

On May 29th, Bankruptcy Judge Robert J. Faris tentatively found that the Northern Mariana Islands Retirement Fund is a "governmental unit" and not a "person." Only a "person" may be a debtor in a Chapter 11 case, and since the term "person" does not include a governmental unit, Judge Faris said he was "inclined" to rule that the CNMI pension plan is therefore not eligible for relief under Chapter 11. He went on to say that "Congress did not intend that the Bankruptcy Code could solve all problems, least of all the financial problems of governmental units." He noted that the dismissal of this case "will leave the Fund and its beneficiaries at the mercy of the commonwealth government, but Congress intended that the elected branches of the local government, rather than a federal court, should address such problems."

However, Judge Faris also said that the trustees of the CNMI plan "should be praised, not criticized, for commencing this case." As he explained:

> *"The trustees find themselves in an intolerable position. The Fund for which they are responsible is caught between an irresistible force — obligations to retirees which it cannot pay — and an immovable object — the government, which has persistently failed*

to pay its debt to the Fund. The trustees' attempt to find a solution to this dilemma is creative and praiseworthy even though I am inclined to rule that it cannot succeed.”

On June 1st, Judge Faris formally dismissed the Chapter 11 petition. But he also once again expressed his serious concerns with the situation, saying that “The way the Fund is being treated is shameful! The way the beneficiaries are being treated is shameful!” according to press reports on the teleconference regarding the motions to dismiss.

Where do things go from here if this ruling stands? Reportedly, one option may be to dissolve the CNMI pension fund and give the CNMI Department of Finance the responsibility to pay benefits. However, as the pension plan’s administrator, Richard S. Villagomez, has been quoted as saying, "Having the fund's assets under the control of the entity that owes it the most money and is responsible for remitting contributions is analogous to the 'fox guarding the henhouse.’"

A recent post on National Public Radio’s blog, “Planet Money,” questions whether this option could “foreshadow what may happen to other struggling pension funds here in the continental U.S.”

Could it?

• Northern Mariana Island Pension Fund Chapter 11 Filing

• NPR “Planet Money” Blog Post

• Saipan Tribune Coverage of Dismissal Teleconference

• CNMI Retiree Blog Notes on Dismissal Hearing

Posted by Leigh Snell, Federal Relations Director at 10:48 AM 0 comments

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THURSDAY, MAY 31, 2012

More Biggs Bombast

Andrew Biggs, the economist and self-proclaimed expert on all things related to pensions, has been a busy boy in the merry, merry month of May. From his perch at the American Enterprise Institute (AEI) -- a Washington conservative think tank that is also home to Newt Gingrich, John Bolton, and Lynne Cheney -- Biggs has a long history of bashing public employees and their pension plans.

Teachers have a special place in his heart. He believes that education is a “less rigorous course of study” than other majors; that teachers “enter college with below-average SAT scores but receive much higher GPAs than other students;” and that a degree in education “simply does not reflect the same underlying skills and knowledge” as a degree in other areas. Indeed, he says that “When we compare salaries based on objective measures of cognitive ability — such as SAT, GRE, or IQ scores,” teachers are not only paid too much, but they earn more than they would likely receive in the private sector given their skill sets.

Now Biggs is focusing on what he refers to as the “pension industrial complex.”

No, I am not making this up.

First, in a May 3rd op-ed on the website “Real Clear Markets” entitled “Public Pension Stimulus Nonsense,” Biggs takes on the National Institute on Retirement Security (NIRS) and the pension administrators who belong to it. He labels as “nonsense” the NIRS “Pensionomics” research that shows how each dollar of pension benefits produces $2.37 in economic output, creating millions of new jobs and billions in additional labor income. According to Biggs, the NIRS research is “faulty” and, worse yet,

pension administrators across the country are publishing their own localized versions of "the NIRS fallacy." Instead, Biggs asserts that "the net economic impact of pension benefits is roughly zero."

(He might want to point out similar "faulty' reasoning to his friends at the U.S. Chamber of Commerce, who recently noted, in their White Paper entitled "Private Retirement Benefits in the 21st Century: A Path Forward," that defined benefit plans are "an integral part of the national economy," paying out over $167 billion in retirement benefits in 2009.)

Biggs concludes his May 3rd piece by explaining to his readers that pension administrators should be "apolitical public servants," but that instead they are fighting "tooth and nail to preserve the existing pension systems, advancing dubious arguments along the way." I presume that the last several years of major legislation in over 80% of the states making substantial reforms to pension systems -- in many cases accomplished at the behest of or in cooperation with pension plans and their administrators -- is to be ignored.

But Biggs has not gone unchallenged. NIRS quickly responded with a post entitled "Perfect Sense" on their website that reiterates that using U.S. Census Bureau data and an economic analysis modeling software widely used by industry and governments analysts, their "Pensionomics 2012" demonstrates that public and private sector pension benefit expenditures supported more than $1 trillion in total economic output in 2009. Moreover, these defined benefit pension expenditures supported some 6.5 million American jobs that paid nearly $315 billion in income to other Americans.

NIRS executive director, Diane Oakley, argues that "What doesn't make sense is the nation's broken retirement infrastructure." She underscores that when older Americans are unable to support themselves, it is inevitable that they will need financial assistance from families or turn to public assistance to meet their basic needs. "It makes perfect sense that the lack of pensions and retirement insecurity are the issues we should be attacking," she concludes.

Dean Baker, an economist and the co-founder of the Center for Economic and Policy Research (CEPR), also responded to Biggs' piece on the CEPR blog, noting that NIRS' claim that the economy gets $2.37 of additional output for each dollar of pension spending due to the multiplier effect of spending is not unreasonable. Baker points out that the Congressional Budget Office's estimates of multipliers for the category that includes pensions has a top range of $2.10 per dollar of spending, suggesting that "NIRS was in the ballpark." Baker said that Biggs' criticism fails to take into account that during a recession, the lack of demand is the real culprit facing the economy, and anything that creates demand – including pension spending -- would in fact increase growth and jobs.

Finally, Monique Morrissey, an economist with the Economic Policy Institute (EPI), joined in the criticism of Biggs. In a post on the EPI blog entitled "Andrew Biggs is at it again," Ms. Morrissey notes that Biggs' real goal is to increase savings in private accounts. However, when promoting President George W. Bush's plan to partially privatize Social Security, Morrissey points out that Biggs did not take into account the cost in the form of reduced guaranteed benefits, which is similar to the "sin" which he accuses NIRS of committing.

Despite these critiques, Biggs was at it again later in the month, this time in AEI's online magazine, "The American," with an article entitled "Public-Sector Pensions: The Transition Costs Myth" on May 21st. In this piece, Biggs begins by stating that public-sector employees and "the pension industrial complex" – which he describes as plan managers, pension actuaries, and investment advisors -- do not like DC plans and are using "deceptive and self-serving arguments despite having an obligation to provide the public with solid facts." In effect, we are all liars.

This time around, Biggs is complaining about the "novel" argument that "DB pensions' massive unfunded liabilities create 'transition costs' that make shifting to DC plans unfeasibly expensive." In other words, according to Biggs, "the more broke DB plans become, the more we have to stick with them."

Biggs refers to a new report by University of Arkansas economist Bob Costrell for the Laura and John

Arnold Foundation that argues that these transition costs are largely a myth. Costrell says that the assertions by plans and others that the Governmental Accounting Standards Board (GASB) rules allow an open plan to amortize unfunded liabilities over a period of 30 years, but require a closed plan to amortize its unfunded liabilities more quickly – thus creating a temporary period of higher pension amortization costs, termed the "transition cost" – are simply not true.

On the contrary, Costrell says that if a government wishes to follow their current amortization schedule even as they shift to a DC plan, there is "nothing whatsoever preventing them from doing so," and that some states that have moved to DC pensions have done exactly that. In short, GASB rules don't govern funding, just accounting and disclosure. Thus, Biggs claims that having new employees participate in a new DC pension makes no difference to what the old DB plan owes.

As usual, Biggs also takes some time in this op-ed to argue the desirability of DC plans over DB plans, underscoring that an "essential difference between traditional defined-benefit (DB) pensions and newer 401(k)-style defined-contribution (DC) plans is that DC plans can't generate unfunded liabilities." Under a DB plan, Biggs explains, the employer promises employees a fixed retirement benefit regardless of how the plan's investments fare. "In a DC plan, by contrast, employers promise employees a fixed contribution, say, 5 percent of salary." As Biggs stresses, "Once that contribution is made, the employer's obligation is fulfilled." In other words, that's that, and let the chips fall where they may.

Once again, Biggs – and the Arnold Foundation report it references -- did not go unanswered. NIRS issued a "Members' Alert" on May 18th that referred to their "Look Before You Leap" research and said that Costrell's paper fails to appropriately address the full context of this NIRS research, as well as the subsequent NIRS research on the effectiveness of sound actuarial practices in assuring well-funded DB plans.

According to NIRS, to suggest, as Costrell and Biggs do, that government officials simply ignore appropriate actuarial analysis of benefit and design changes "can result in ill-informed policy decisions that increase costs and undermine the efficient delivery of public services." Making sure that the appropriate amortization is attached to pension reform options "provides clarity not confusion," says NIRS' Diane Oakley. "Moreover, the pension reform decisions must also address other important factors, such as economies of scale, transition costs, and the eventual investment returns," she reminds her members.

Keith Brainard, the Director of Research for the National Association of Retirement Administrators (NASRA) also prepared a memorandum to NASRA members offering his perspectives on the Arnold report and the Biggs assertions related to it. In this memo, Mr. Brainard explains that even though policymakers may determine the period and basis with which to amortize unfunded pension liabilities, without regard to GASB standards, there are nevertheless "sensible reasons… to consider pension reforms in terms that comply with the sound actuarial principles on which these GASB standards are based." He also notes that constitutional and statutory provisions in many states require policymakers to apply amortization periods that are consistent with the actuarial principles contained in the current GASB standards.

Keith concludes by stating that the impact of a change in amortization policy is only one of many factors policymakers must consider when evaluating pension reform. "Although GASB standards do not directly tie the hands of governmental plan sponsors," Keith acknowledges, "the principles on which these standards are based are primary considerations and should, with cost and other analyses, be calculated for policy makers to determine the full impact of retirement plan changes."

Finally, Gary Findlay, the Executive Director of the Missouri State Employees' Retirement System (MOSERS), responded to Biggs' article with a post on "PensionDialog." In it, Mr. Findlay argues that the so-called "myth" to which Biggs refers is not whether transition costs exist, but how governments must finance them. "I agree that governments can mortgage added costs in any number of ways," Gary states, "What seems to be completely lost is the fact that closing a defined benefit pension plan and setting up a 401(k)-style plan doesn't change the unfunded liability, and often increases other costs," he warns.

Gary also comments on Biggs' statement that DC plans can't generate unfunded liabilities. He points out that participants in such plans have nowhere near the amount that will be needed to provide anything close to a subsistence level of retirement income, and that the difference between what participants accumulate and what they need to survive is an unfunded liability that is going to fall on someone. Employers, Gary notes, will ultimately be on the hook for the financing of entitlement programs needed to fill the gap. "By any reasonable assessment, that is an unfunded liability," he concludes.

Biggs responds, and then Gary responds to the response. Needless to say, neither ends up agreeing with the other. Biggs does offer up a few of what I refer to as "Huh?" moments. For example, he thinks it inappropriate to talk about DC plans generating "unfunded liabilities," saying it is not "a plausible use of the term," and would prefer instead to talk about "savings shortfalls." Call it what you will, the consequences are still going to ultimately fall on the employer, aren't they?

But why quibble over terminology? After all, Biggs argues that "a lot of talk about a retirement savings crisis is far overblown."

Most recently, Biggs has appeared in a May 28th article in "Pensions and Investments" entitled "Cash Balance Plans Gain Favor As Option Among Public Pension Funds." Biggs acknowledges the advantages of cash balance plans, but is still pushing for a DC approach. "The idea that it is more expensive because of transition costs (is) really just a BS excuse to not reform your pension," he once again asserts.

Biggs also says that a big issue is that DC plans can't match "the generosity in contributions to DB plans." "DB plans are scary generous," he warns. A technical, economic term, I suppose.

Responses are in the works.

All in all, a busy month for our Mr. Biggs. However, it is encouraging to see the rapid responses to his diatribes. Also, the fact that they are beginning to come from a number of sources other than just the "pension industrial complex" is also encouraging. Finally, to the extent that opponents of DB plans are reaching out for new reasons to support their "conversion" arguments could suggest that perhaps some of their older ones are not gaining much traction? One can only hope.

• Andrew Biggs, American Enterprise Institute: "Public Pension Stimulus Nonsense," May 3, 2012

- Response by NIRS
- Response by Dean Baker, Center for Economic and Policy Research
- Response by Monique Morrissey, Economic Policy institute

• Laura and John Arnold Foundation: "GASB Won't Let Me - A False Objection to Public Pension Reform"
by Professor Robert Costrell, May 2012

- Response by Keith Brainard, NASRA
- Response by NIRS

• Andrew Biggs, American Enterprise institute: "Public-Sector Pensions: The Transition Costs Myth," May 21, 2012

- Response by Gary Findlay, MOSERS, in PensionDialog.com

• Pensions and Investments: "Cash Balance Plans Gain Favor As Option Among Public Pension Funds," May 28, 2012

Posted by Leigh Snell, Federal Relations Director at 4:55 PM 1 comments
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MONDAY, MAY 7, 2012

A Mixed Bag: New Issue Brief on Public Plan Funding

What's wrong with this picture? The stock market is up; state and local government revenues are on the rise; and governmental pension plans have made record numbers of changes, raising employee contributions for all workers and/or reducing benefits for new workers. However, the funded status of public pension plans has once again slipped.

The latest issue brief from the Center for State and Local Government Excellence, entitled ***The Funding of State and Local Pensions: 2011–2015***, takes a look at 126 state and local pension plans and attempts to answer this question.

The result is somewhat of a mixed bag. As the Center's President and CEO, Beth Kellar, puts it, "Readers can find reason to feel encouraged or worried as they read the analysis from the research team at the Center for Retirement Research (CRR) at Boston College." Indeed.

On the positive side, CRR finds that during 2011, the funded status of public plans slipped only slightly -- from 76 percent to 75 percent. This result reflects only a modest gain in the value of actuarial assets, reflecting the smoothing of gains and losses over several years. However, even when that is factored in, 36 percent of the plans in the brief's sample have a funded ratio of over 80 percent.

There was also an unexpected reduction in liability identified, dropping to 3.4 percent from 4.6 percent in 2010, and about 6 percent in earlier years.

Going forward, CRR projects that the funded ratio will remain steady next year and then gradually improve as the weak stock market experienced in 2009 is fully phased out of the calculation and replaced by years of positive market performance.

But…..

The issue brief also notes that the 75 percent funded ration in 2011 is based on liabilities discounted by the expected long-term yield on plan assets (roughly 8 percent), and revalues liabilities using the riskless rate, "as advocated by most economists *for reporting purposes*," showing an aggregate funded ratio in 2011 of only 50 percent. Unfortunately, the brief does not directly acknowledge the vigorous debate surrounding this topic or the arguments against discounting liabilities by a risk-free interest rate.

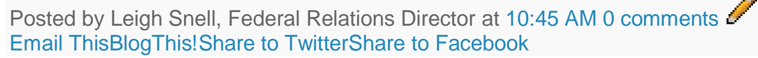
Furthermore, the issue brief finds that the Annual Required Contribution (ARC) rose to 15.7 percent of payrolls in 2011. And the percent of ARC paid dipped to 79 percent.

Next, the issue brief projects funding for 2012–2015 and shows that, under the most likely of three stock market scenarios, the aggregate funded ratio will remain steady next year, and then gradually rise by 2015, but only to 82 percent – far short of the 103 percent average in 2000, or even the 88 percent level in 2007.

Finally, CRR points out that the reason that the growth in liabilities has slowed is that states and localities have laid off some workers, frozen salaries, and reduced or suspended COLAs. "Because many of these changes are one-shot, liability growth is likely to pick up somewhat in coming years," CRR concludes.

The issue brief contains an appendix showing the ratio of assets to liabilities for 136 state and local plans for 2001–2010, along with projections for 2011.

• The Funding of State and Local Pensions: 2011–2015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