NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS

October 8, 2014

Mr. Timothy Blake, MP – Public Finance
Moody's Investor Service
7 World Trade Center
250 Greenwich Street
New York, NY 10007

Dear Mr. Blake:

On behalf of the National Association of State Retirement Administrators, I am writing to express deep concern about the recent Moody's report, "US State and Local Government Pensions Lose Ground Despite Meeting Return Targets." The report is based on Moody's recalculation of pension data for the purpose of rating bonds. The report is not, as the title and description of the report imply, a depiction of the actual financial condition of state and local pension plans. The report's failure to clarify the limited context of Moody's calculations results in a picture of the state of public pensions that is unrealistic, misleading and confusing.

In September 2012, in response to Moody's request for comments regarding its proposed publishing of its adjusted state and local government pension plan data, NASRA stated, "We believe that Moody's proposed adjustments will actually reduce transparency and consistency in the analysis of pension liabilities."

When Moody's representatives later met with staff from NASRA and other organizations in Washington, DC, in January 2013, Moody's claimed that adjusted pension data would be factored into a broader and more detailed analytical framework used by Moody's to assess risk. However, as NASRA noted then, and in follow-up communications, "the public release of adjusted pension data without the public release of the broader and more detailed framework would give the impression that the adjusted data are meaningful and understandable on their own."

With Moody's latest report, concerns regarding the potential mischaracterization and misuse of these manipulated pension numbers have been more than realized. Moody's fails to clarify that these are adjusted numbers, and makes little effort to explain that declining interest rates are the primary cause of the drastic change in liabilities. Yet the report implies, wrongly, that such changes will affect funding.

By Moody's own admission in prior pronouncements, the adjusted pension liabilities calculated by Moody's do not represent a funding requirement. Yet the report makes no effort to clarify that vital fact. Instead, readers are left to infer that the "quadrupling" of unfunded liabilities represents an amount that must be made up with additional contributions.

The report also misrepresents or misstates salient facts regarding state and local government pension funds. For example:

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- Inflation has reduced the value, in real dollar terms, of public pension liabilities relative to 10 years ago. Yet the report does not use inflation-adjusted dollars or qualify that inflation has diminished the value of dollar amounts from a decade ago by more than 20 percent.

- The report insinuates that public pension funds fell short in their investment goals during the three-year period ended in 2013, as "[T]hese returns … lagged the S&P 500 CAGR for this period, which was 18.6%." However, public plans, like other diversified investors, do not use a single asset class, such as the S&P (the highest performing asset class for that period) as a benchmark for the entire portfolio.

- The report accuses public pension funds of seeking high returns and increasing investment risk by increasing allocations of alternative investments. The report does not include the fact that these allocations are also part of an effort to diversify and lower risk. Indeed, the report makes no effort to measure the actual risk being taken by public pension funds and makes no reference to the risk/reward tradeoff. The report also ignores that private equities, the primary type of alternative investment, has been the highest performing asset class for most public pension funds during the last decade.

- Moody's misstates the aggregate value of state and local pension assets, as $5.29 trillion (the actual amount, according to the Federal Reserve, as of 6/30/14, is $3.7 trillion).

- Although the report makes passing references to pension reforms approved in recent years, in fact, since 2009, nearly every state has made material changes to its benefits structure, employee contributions, or both. As a result of these and other factors, on a GAAP basis, annual public pension liability growth has fallen below five percent for five consecutive years. As the investment losses of 2008-09 are fully recognized in actuarial calculations, and as the substantial investment gains since 2009 are actuarially recognized, public pension funding levels will improve sharply, and unfunded pension liabilities will fall.

In sum, the report falls far short of the assurances made that Moody's publication of adjusted pension data would be presented in the context of the analytical framework used by the agency to assess risk. In fact, the report perpetuates the very type of confusion that stakeholders urged Moody's to avoid. I hope that future Moody's reports on the state of public pensions will more clearly qualify the presentation of information and have a better command of relevant facts.

Sincerely,

Keith Brainard

Keith Brainard
Research Director