

**NASRA White Paper:
Public Pensions
and
Market Value of Liabilities**



**Keith Brainard, Research Director
National Association of State Retirement Administrators
July 21, 2008**

This paper explores the use of market value of liabilities (MVL) in the context of public pension plans, including whether or not public pensions should be required to disclose this figure; the source of efforts to require this disclosure; and the effects this disclosure might have. The paper presents evidence that MVL is based on a corporate finance model that is poorly suited to the unique environment of public sector pensions.

The author gratefully acknowledges the assistance provided by members of the NASRA Actuarial and Accounting Standards Task Force: Tom Cavanaugh, Gary Findlay, Norm Jones, and Pat Robertson.

Introduction

Pension accounting seeks to answer questions like, *what is the value of the plan's liabilities?* and, *what is the cost of funding those liabilities?* Answering these questions is the primary purpose of an actuarial valuation and related public pension accounting standards. Actuaries for public pension plans traditionally have calculated liabilities and the contributions required to fund present and future plan liabilities, on a going-concern basis, using an investment return assumption based on expectations for assets held by the plan. For most public plans, this assumption falls in the range of 7.0 percent to 8.5 percent, with 8.0 percent being the most common and the median figure.

Adherents to a field of study known as financial economics are seeking to require state and local government pensions to, at a minimum, also disclose (and, for some adherents, disclose only) a figure known as the market value of liabilities (MVL). Corporate pension accounting standards require the disclosure of this value.

Defenders of traditional public sector actuarial methods, practices, and assumptions contend that MVL is irrelevant for public plans, that public and corporate pension plans are fundamentally different, and that measuring and accounting for their liabilities should be performed differently.

Most financial economists are critical of conventional public sector actuarial methods and assumptions and believe that public pension liabilities should be calculated and disclosed in the same manner as for corporate pensions.

What is MVL?

MVL reflects a pension plan's settlement cost—the amount the plan would owe if it were terminated and required to settle its liabilities with a so-called risk-free portfolio of bonds. Calculating the MVL involves three elements that currently are not part of the conventional

method for determining public sector pension liabilities: 1) an investment return based on a portfolio of high quality bonds; 2) use of the accrued benefit (plan termination) obligation rather than a going-concern benefit obligation; and 3) marking assets to market, which precludes smoothing of assets.

Opinions vary of what “risk-free” rate should be used to determine the MVL, ranging from the rate on 10-year US Treasury notes to a basket of fixed income securities that is higher than the US Treasury rate.

Calculation of the MVL results in the determination of liabilities accumulated by a plan only up to the measurement date (such as the date of the actuarial valuation), and does not consider the impact of future salary growth. By contrast, conventional public plan valuation methodology does consider future expected economic and demographic activity, including salary growth. This is because, unlike corporate pensions, which can freeze benefits to existing plan participants, public pensions generally are guaranteed by their plan sponsor. Also, public sector entities, unlike corporations, are going concerns that rarely declare bankruptcy and are not subject to merger or acquisition.

A third defining element of MVL is that it requires that assets be measured at their market value, or “marked-to-market,” rather than smoothed, as most public plans currently do to reduce funding level and contribution volatility.

Some arguments for requiring public pensions to calculate and disclose a MVL include that it would:

- provide a standardized measure of pension liabilities, simplifying comparisons between and among plans;
- reduce the temptation of policymakers to increase benefits;
- reduce the possibility that costs will be passed to future generations;
- stabilize public pension funding levels;¹ and

- increase the transparency of public pension risks.

Some arguments against requiring public pensions to calculate and disclose a MVL include that this measure:

- is inconsistent with the nature of the public sector and public pensions, which are going concerns;
- increases funding level and cost volatility;
- could lead to lower investment returns by requiring lower equity holdings in lieu of fixed income;
- could be misleading or confusing regarding plans' funding condition; and
- could require contribution rates higher than necessary.

MVL is based on a corporate finance model

MVL stems from modern finance theory, which holds that firms are created and managed to maximize shareholder value. Financial economics, an outgrowth of modern finance theory, is the field on which MVL is based. The Pension Actuary's Guide to Financial Economics (The FE Guide) states, "Financial economics is a subset of microeconomics that is focused on the capital markets. Financial economics is the study of how individuals and institutions acquire, save and invest money. Individuals decide how much to save and how to invest their savings. Institutions raise capital by offering securities to investors and invest that capital in business opportunities."

The FE Guide also contains multiple references to financial economics in the context of corporate finance. For example:

- "[T]he work of a pension actuary involves *pension finance*, which is a subset of corporate finance."
- "The driving force for investing pension assets is corporate finance, not portfolio selection. Thus, whether equities or bonds provide higher expected returns is

irrelevant. In the corporate finance paradigm the right question is not which asset class has a higher return but, rather, where in the corporation's capital structure should risk be taken? Given the current tax structure, where excess returns that arise from equity risk bearing are taxed at a lower rate than returns from fixed income, it is more tax-efficient to take equity risk (beta) outside of the tax-sheltered pension plan."

- "Financial economics takes the view that benefit payments to pension plan participants are a form of corporate debt and that assets held in the pension trust are corporate assets."

Adherents to financial economics maintain that a pension liability should be valued like a bond. This view is based on the "law of one price," which states that securities or bundles of securities must sell at equal prices to preclude arbitrage opportunities.ⁱⁱ "[T]wo cash flows that are identical in amount, tax treatment, credit risk, liquidity, etc. must have identical market values. If this were not the case, there would be an arbitrage opportunity to exchange the higher-priced cash flow for an identical cash flow at a lower price. This is the Law of One Price."ⁱⁱⁱ

In the context of a pension plan, the two cash flows referred to in the law of one price are the liability stream and the assets needed to fund those liabilities. According to FE, failure to match the liability stream with equally risky (or riskless) assets violates the law of one price, because the risk of the investment portfolio does not match the risk of the pension liabilities. Financial economists argue that arbitrage opportunities (i.e., a free lunch for someone) exist when the true value of assets, liabilities, or income are obscured, such as by a) failure to match risk in pension assets and liabilities; or b) smoothing investment gains and losses, which permits the plan to take credit for asset gains before they occur, and to discount the effect of their potential losses.

Another fundamental tenet of financial economics holds that corporations are “pass-through entities,” which means that corporations by themselves do not create value, but rather are conduits through which shareholder value is created. Pension plans also are considered pass-through entities, i.e., conduits through which corporations compensate their employees. The FE Guide states:

Analyses that focus on the pension plan alone (“pension-centric” or “plan-centric”) are unable to reflect the shareholder value perspective. Statements like “a pension plan is a long-term enterprise” or “pension plans can take a long-term view of risk and reward” are not supported. Pension plans cannot be managed on a time horizon that differs from that of the shareholder.^{iv}

Financial economists argue that any liability measure other than MVL reduces the transparency of the pension plan. For example, calculating liabilities and plan costs on the basis of investment returns from a portfolio of equities and other “risky” assets, reduces the risk-adjusted costs of the plan for current shareholders and participants, and shifts those costs to future taxpayers. Jeremy Gold contends that taking credit for equity gains up front creates an illusory free lunch that defined benefit plans appear to provide.^v

Since 1988, financial accounting standards have required corporate pensions to calculate and disclose their MVL. The justification for this is that in the event of the firm’s bankruptcy, acquisition, or freezing of its pension plan, shareholders and other stakeholders must know the plan’s settlement costs. The latest standard on accounting for corporate pension benefits, FASB Statement No. 158, acknowledges the need for a corporation to calculate and disclose a settlement liability:

In making [the discount rate] assumption, employers shall look to rates of return on high-quality fixed-income investments currently available whose cash flows match the timing and amount of expected benefit

payments. If settlement of the obligation with third-party insurers is possible ... the interest rates inherent in the amount at which the postretirement benefit obligation could be settled are relevant in determining the assumed discount rates.^{vi}

FASB Statement 158 amended Statement 87, which established the initial requirement that corporations calculate a market value of liabilities. Statement 87 states, “Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled.”^{vii}

By contrast, in its white paper, *Why Governmental Accounting Is—And Should Be—Different*, GASB asserts that the conceptual accounting framework for users of public pension financial statements is fundamentally different from that of corporate pensions:

Reflecting the needs of their stakeholders, including citizens and their elected representatives, governments predominantly focus on accountability in financial reporting. For governments, information necessary to make political and social decisions is as important as information necessary to make economic decisions in shaping accounting and financial reporting objectives. Reflecting the needs of the stakeholders of business enterprises, including equity investors, financial reporting of business enterprises predominantly focuses on financial performance—earnings and its components. For business enterprises, information for making economic decisions is most important in shaping accounting and financial reporting objectives.

The GASB paper also details a series of factors that distinguish public sector from corporate accounting standards, including:

- Organizational purposes
- Sources of revenue
- Potential for longevity
- Relationship with stakeholders
- Role of the budget

GASB also specifies why MVL-type accounting measures may not apply to the public sector:

[I]t is not appropriate for government employers to immediately recognize ... fair value changes or changes in accrued actuarial liabilities resulting from a change in benefit plan terms. These short-term fluctuations could produce a measurement of the period's employee benefit costs, which are included in cost of services that may be less decision-useful for governmental financial report users. Financial reporting by business enterprises is more likely to recognize such changes in fair value because of the importance of the current value of equity.^{viii}

What could cause public pensions to be required to disclose their MVL?

Actuarial standards are set and maintained by the Actuarial Standards Board. Professional actuaries must follow ASB standards in order to maintain their professional credentials.

Public sector accounting standards in the US are set and maintained by the Governmental Accounting Standards Board. Public sector entities, including public retirement systems and their plan sponsors, must follow GASB rules or risk lower bond ratings or being shut out of tax-exempt debt markets.

The ASB in March 2008 issued a request for comments on Actuarial Standards of Practice Number 27, *Selection of Economic Assumptions for Measuring Pension Obligations*, as part of a review of that standard. The ASB comment period ends August 1, 2008. The ASB's request for comments specifically cites "the emergence of financial economics as an alternative to the traditional actuarial model" as one reason for considering changes to ASOP 27.

Likewise, the Governmental Accounting Standards Board in May 2008 announced its intention to re-examine Statements 25 and 27, which govern the accounting and reporting of public pension liabilities. GASB's technical

plan for this project specifically mentions financial economics as a factor in considering possible revisions to Statements 25 and 27:

Prominent in recent discussions of pension accounting issues in accounting and actuarial arenas has been a view of pensions reflecting the discipline of financial economics. Actuaries and financial analysts of that school of thought have expressed a distinctive analysis of pension benefits, the relationships among key parties having an interest in pension benefits, and the effects of accounting and financial reporting standards on decision making and the investment of plan assets. This view also has stimulated spirited response within the U.S. from some public pension actuaries that favor the traditional actuarial funding model.^{ix}

GASB projects a 2013 completion date for this project.

Effects of MVL on public pension contribution rates and funding levels

If applied to public pensions, the MVL would result in the appearance of lower funding levels for most plans and increase funding level and required cost volatility.

Current actuarial methods determine an actuarially required contribution (ARC), which represents the amount needed in the current year to fund the plan's normal cost and to amortize its unfunded liability over a period not to exceed 30 years. In addition to increasing volatility of required contributions, replacing the current method of determining the ARC with one based on MVL would also result in significantly higher contributions due to the use of a lower investment return assumption. If the plan's investment returns exceed the risk-free rate used to calculate the MVL, the ARC would prospectively decline. This would mean that the current generation of taxpayers have been overcharged, resulting in a loss of intergenerational equity.

Richard Ennis estimated in 2007 that applying the MVL to public pensions would reduce their overall funding level by 15 percent. This estimate was based on a risk-free rate of 5.50 percent, plan termination assumptions, and valuing assets at market value.^x The median discount rate used by corporate plans in 2007 was 6.20 percent.^{xi}

Basing a plan's funding level on its MVL would increase funding level volatility by eliminating actuarial smoothing in lieu of calculating liabilities based on their market value. As shown in Figure 1, corporate pension plans experienced greater funding level volatility, declining in the aggregate from 125 percent in 2000 to 83 percent in 2002, then rising above 108 percent in 2007.^{xii}

By comparison, aggregate funding levels for public pensions peaked in 2001 (later than those of corporate plans due largely to longer asset smoothing periods) at 101 percent and declined to 84.5 percent in 2006 before beginning to rise again in 2007.^{xiii}

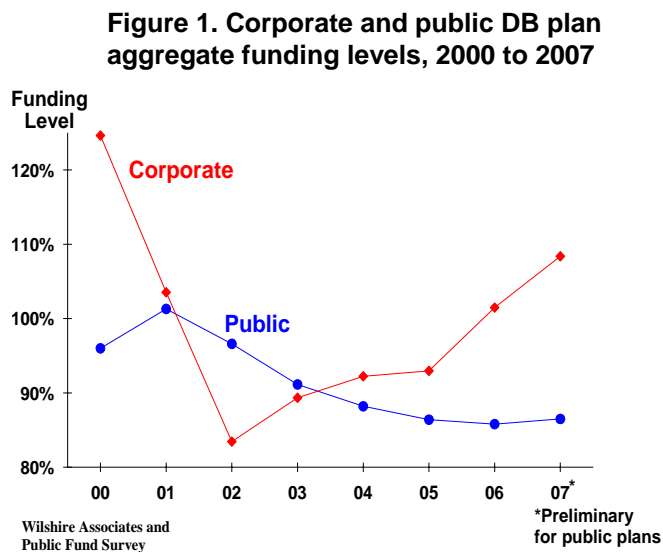


Figure 2 compares the volatility in contributions between public and corporate pension funds since 1988. The use of MVL by corporate plans to calculate required contributions results in

significantly higher volatility for corporate pension plans compared to public plans.

Requiring public pensions to calculate contributions based on their MVL rather than using conventional actuarial methods and assumptions is likely to increase cost volatility in the face of interest rate changes and market volatility. Tying a plan's liabilities to interest rates causes the plan's liabilities to rise and fall with changes in interest rates. Yet for public pensions, which invest and operate on multi-decade horizons, a change in the interest rate does not mean the plan's liabilities have changed, or that the cost of funding those liabilities has necessarily changed. Yet this is exactly what occurs with corporate plan liability measures.

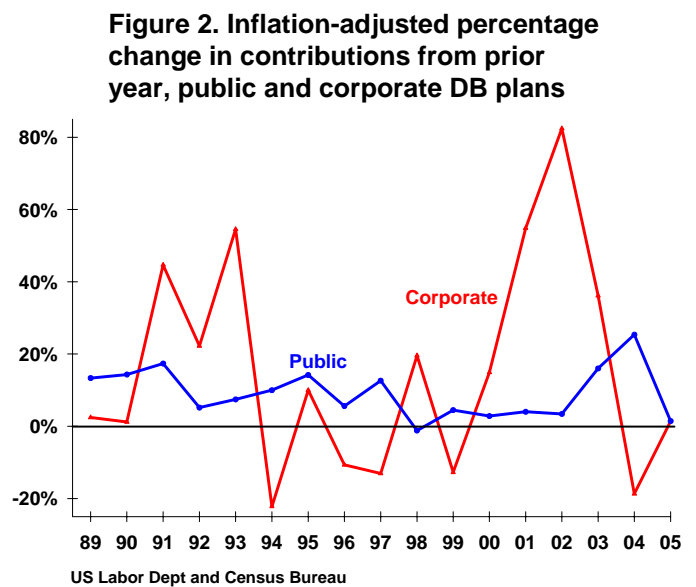


Figure 2 illustrates that public pension contributions were fairly steady during the period measured, changing from the prior year by more than 15 percent in just three of the 17 years and by less than six percent in seven of the years. By contrast, corporate pension contributions changed by 15 percent or more in nine of the 17 years, including three years of increases of greater than 50 percent. In only three of the 17 years did corporate contributions change by less than 10 percent.

Without a reduction in benefit levels, determining public pension contribution rates on MVL generally would result in higher required contributions due to the use of a lower investment return assumption. The amount of the increase would vary by plan, just as the change in funding level would depend upon the plan's individual circumstances.

Effects of MVL on asset allocation

According to The Pension Actuary's Guide to Financial Economics, "Many pension actuaries have heard that financial economics says that all DB plans should be invested entirely in bonds. Financial economics does often, but not always, reach this conclusion."^{xiv}

In "The Case Against Stock in Public Pension Funds," Bader and Gold imply that equities should not be part of public pension portfolios, because equities allow current taxpayers and plan participants to take credit for future, risky investments while passing the risk to future taxpayers. "Governments under-price employees' pensions by anticipating risk premiums, and they share "excess" risk premiums earned with employees, further loading risks onto taxpayers for which they stand to earn no rewards. ... Intergenerational risk-sharing is thwarted by each taxpayer generation's inclination to take winnings off the table and let the losses ride."^{xv}

The Pension Protection Act of 2006 continued a trend of incorporating financial economics principles into corporate accounting standards, by shortening the permissible asset smoothing period for corporate pension plans to two years from four, effective in 2008. This change is expected to create an incentive for corporate plans to reduce holdings of more volatile assets, such as equities, and increase allocations to less volatile assets, such as fixed income.

A study of the 100 largest corporate DB plans in 2007 provides evidence that a shift from equities to fixed income may be underway.

Compared to 2006, Milliman reports that corporate pension fund allocations to fixed income increased from 30 percent to 33 percent while allocations to equities declined from 60 percent to 55 percent.^{xvi}

A July 2008 research report issued by Russell Investments predicts that the PPA will encourage corporate pension plans to reduce market risk and accept greater contribution rate volatility; that corporate pension asset allocations will move to 60 percent to 80 percent fixed income, with the remainder in alternative assets such as real estate, hedge funds, and derivatives; and that corporations will terminate their pension plans "if the opportunity presents itself."^{xvii}

Over the past few decades, equities and other assets riskier than high quality bonds have fueled public pension investment earnings. During the period 1982 to 2006, public pension plans generated some \$4 trillion in revenue, of which approximately \$2.6 trillion (65 percent) was from investment earnings.^{xviii} During this period, public pension funds increased in size from \$262 billion to \$3 trillion^{xix}, while distributing \$1.7 trillion in benefits. The average annual median investment return among large public pension funds during this period was 11.7 percent.^{xx} These returns enabled the investment earnings that funded a large portion of both the benefits and public plans' current 86 percent aggregate funding level.^{xxi}

Had public pension funds been invested in "risk-free" portfolios based on a rate equal to the 10-year Treasury bill plus 150 basis points, their cumulative investment earnings during this period are estimated to have been lower by approximately \$1 trillion.^{xxii} It is likely that these foregone earnings would have resulted in a combination of reduced public pension benefits, higher required contributions, and reduced funding levels.

Opposition to MVL

While corporate plans have been required to disclose their MVL since 1988, MVL is largely a new concept for the public pension community. Efforts to require public pensions to disclose their MVL have been met chiefly with skepticism and disapproval by most members of the public pension community and its consulting actuaries.

A 2007 NASRA resolution (accessible in the appendix) cites public pensions' "presumed infinite life," their "guarantee of public pension benefits under State constitutional, statutory, contractual, and/or case laws," and "the observable past and reasonable future return expectations for capital markets and common public fund portfolio construction" as factors that should be reflected in calculating and disclosing public pension liabilities.

Likewise, a 2008 resolution approved by the executive committee of the National Council on Teacher Retirement contends that MVL is an inappropriate measure for public retirement systems, stating in part:

NCTR believes that financial reporting models applicable to terminable private sector corporations and their pension plans that require the report of short-term liabilities (often referred to as "market value liabilities") are inappropriate for governments and are inconsistent with the nature and purpose of public retirement systems.

Dimitry Mindlin questions the value of MVL, particularly for public plans:

[MVL] must be clearly labeled as what it really is: *the cost of termination* - a figure of questionable utility for a majority of plans published several months after the moment this figure might have been meaningful. ... When the actuarial valuation report (released sometime in June if we are very lucky) reveals the cost of termination *as of January 1*, it will be up to the proponents of "marked-to-market" pension accounting to educate the plan's decision makers why the cost of imaginary

plan termination is vital and no other measurement is needed.^{xxiii}

Mindlin also questions the applicability of the Law of One Price to pensions, especially public pensions:

[The law of one price] logic does not work because the following two important conditions are not satisfied. First, the law of one price requires *both* financial instruments to be tradable, and pension benefits are not tradable ... Second, the two payments must be perfectly, and not hypothetically, matched. Matching bonds may exist for some pension payment and may not exist for some others - even "long-term U.S. Treasury bonds" are not long enough. Furthermore, while public pension payments are risk-free in a sense that they will certainly be paid, they are not risk-free in a sense that their timing and magnitude are far from certain. In particular, since *public pension plans are on-going*, their benefits may depend on the wage inflation in a particular region and/or occupation (at least, to some extent), but U.S. Treasury bonds are not diverse enough to provide a perfect hedge for this type of risk for all plans.^{xxiv}

Another objection to requiring MVL disclosure pertains to the purpose for valuing a plan's liabilities. As noted in The FE Guide, financial economics is focused on pricing liabilities: "One particular interest for the financial economist is how markets determine current values or prices of items that involve future cash flows. ... [T]he crux of the challenge financial economics poses to traditional actuarial practice [is why] do actuaries place different values on future cash flows than capital markets?"

The reason actuaries value future cash flows on the basis of expected investment returns is to determine how to fund the plan, not to price the plan's liabilities in case the plan is terminated. Unlike corporations and their pension plans, which are considered by financial economists to be mere "pass-through" entities, the public sector and its pension plans are not simple market institutions whose value and price must match all times. This is a key difference

between corporate and public pension plans and illustrates the pitfall of applying a corporate finance model to the public sector.

Another concern about MVL is the volatility in costs, which take the form of required contributions. Cost volatility has been a major factor in corporations' decisions to freeze their pension plans. Requiring public plans to determine contributions on the basis of their MVL would almost certainly increase the volatility of public pensions' required contributions, potentially leading to their disuse among some plan sponsors.

David Kausch also suggests that required MVL disclosure by public plans could result in their abandonment:

[Actuaries] ... must take care when explaining a change in methodology such as reporting a market value of liabilities where no market value has been reported before. Consider the case of public-sector pension plans where disclosing market value of liabilities is not currently required and is rarely done. If the change in measurement appears to cause unfunded liabilities to increase at a time when the political environment calls for tax cuts, some feel that the change would be misused to justify a switch from defined benefit plans to defined contribution plans.^{xxv}

The components that make up MVL appear to be inconsistent with the public pension operating environment, which is that of a going concern whose benefits are guaranteed. This environment enables public pensions to design and employ investment strategies based on long investment horizons that can sustain and even capitalize on market volatility. Public pension liabilities and the costs needed to fund them do not necessarily rise and fall with changing interest rates, and requiring public pensions to pretend otherwise, through accounting and actuarial disclosures, will mislead and cause confusion.

Conclusion

In addition to being the subject of vigorous debate, the question of how public pensions measure their liabilities and what liabilities they should disclose also is under consideration by the Actuarial Standards Board and the Governmental Accounting Standards Board.

Proponents of financial economics are highly critical of traditional actuarial methods and seek to replace these methods with the use of a risk-free rate of investment return, termination liability, and elimination of asset smoothing. Financial economists believe these changes will increase the transparency of the risks public pension plans are taking and result in an appropriate reduction in those risks.

Those who support current public pension actuarial methods and practices believe they are working well for relevant stakeholders and that requiring public pension funds to calculate and disclose a market value of liabilities would have one or more negative consequences on public pensions. These negative effects could include increased funding level and contribution rate volatility, funding levels that are misleading and confusing; contribution rates greater than what are needed; and lower investment returns as a result of shifting from equities to fixed income. Defenders of current public pension actuarial methods believe these consequences could encourage public sector plan sponsors to abandon their traditional pension plans in lieu of defined contribution plans, as has occurred outside the public sector.

Endnotes

- ⁱ Gabriel, Roeder, Smith, “Valuing Public Pension Plans: Comparing Financial Economics with Conventional Approaches” *GRS Insight* April 2008
- ⁱⁱ Bodie, Kane, Marcus, “Investments” Richard D. Irwin, Inc. 1993
- ⁱⁱⁱ “Pension Actuary’s Guide to Financial Economics,” Joint AAA/SOA Task Force on Financial Economics and the Actuarial Model
- ^{iv} *ibid*
- ^v Jeremy Gold, “What’s Next? DB Plans for the long run,” *The Actuary*, October 2003
- ^{vi} Statement of Financial Accounting Standards Number 158, *Employers’ Accounting for Defined Benefit Pensions and Other Post-Employment Benefits*, Financial Accounting Standards Board, Sept. 2006
- ^{vii} Statement of Financial Accounting Standards Number 87, *Employers’ Accounting for Pensions*, Financial Accounting Standards Board, December 1985
- ^{viii} GASB, “Why Governmental Accounting Is—And Should Be—Different “
- ^{ix} “Postemployment Benefit Accounting and Financial Reporting Excerpt Second-Third 2008 Technical Plan,” Governmental Accounting Standards Board
- ^x Richard Ennis, “What Ails Public Pensions?” EnnisKnupp, 2007
- ^{xi} Wilshire Associates, *2008 Report on Corporate Pension Funding Levels*
- ^{xii} *ibid*.
- ^{xiii} Public Fund Survey, National Association of State Retirement Administrators and National Council on Teacher Retirement
- ^{xiv} “Pension Actuary’s Guide to Financial Economics”
- ^{xv} Lawrence N. Bader and Jeremy Gold, “The Case Against Stock in Public Pension Funds,” Pension Research Council Working Paper 2004-20
- ^{xvi} Milliman 2008 Pension Funding Study
- ^{xvii} FundFire, “DB of the Future: Less Risky, Better Funded,” July 17, 2008
- ^{xviii} US Department of Commerce Census Bureau
- ^{xix} Federal Reserve of the US, Flow of Funds Accounts of the US, 4th Quarter, 2006
- ^{xx} Callan Associates report of investment returns for public pensions with assets greater than \$1 billion
- ^{xxi} Public Fund Survey
- ^{xxii} Author’s calculation
- ^{xxiii} Dimitry Mindlin, “The Good, The Bad, and The Ugly of Pension Accounting” CDI Advisors
- ^{xxiv} *ibid*
- ^{xxv} David T. Kausch, “The Case for Stocks in Pension Funds,” *Contingencies*, Jan/Feb 2008

Appendix



NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS

RESOLUTION 2007-03 - Public Employee Retirement System Accounting Standards & Actuarial Methodologies

WHEREAS, public sector defined benefit plans have proven to be an effective and efficient means to i) deliver stable income replacement in retirement; ii) attract and retain high quality employees to deliver vital public services; iii) provide ancillary casualty benefits related to disability and death before retirement; iv) manage fund assets to provide an optimum balance of growth potential and risk in investments, v) lower expenses through economies of scale, and vi) provide a source of long-term patient capital; and

WHEREAS, critics of public sector defined benefit plans have cited the potential conflict between the long-term nature of pension liabilities and the shorter time horizon of political decision-making, often making the case by distorting the true financial condition of public pensions in general, mistakenly extrapolating a handful of public pension problems onto the entire public pension community, and advancing arguments that reflect an incomplete understanding of public pension issues; and

WHEREAS, solutions are available to address these concerns (without necessitating measures with negative consequences for all stakeholders) through the adoption of explicit and transparent financial disciplines in benefit, funding and investment policies; and

WHEREAS, this disciplined model must account for the specific nature and needs of governmental jurisdictions and their stakeholders, requiring distinctive reporting, disclosure and accounting models, a perspective well articulated in a 2006 Government Accounting Standards Board white paper, *Why Governmental Accounting and Financial Reporting Is-And Should Be-Different*; and

WHEREAS, government sponsors of retirement systems have infinite time horizons with fundamentally different revenue streams and sustainability than other sectors of the economy; and

WHEREAS, the full faith and credit of the sponsoring government, as well as strong moral, contractual, and in some cases constitutional guarantees in practice virtually rule out any incidence of plan termination in the public sector; and

WHEREAS, these benefit protections and long-term sustainability stand in stark contrast to other sectors of the U.S. workforce where future benefit levels and accruals are not guaranteed and plan sponsors may easily terminate their pension plans, or else go out of business, be acquired, or file for bankruptcy; and

WHEREAS, sound actuarial methodologies and accounting standards have evolved over the years with the objective of providing information regarding the financial position and condition of public pension plans and the governments that sponsor these plans; and

WHEREAS, the utility of such information is directly proportionate to the extent to which it reflects a realistic outcome under ranges of varying circumstances; and

WHEREAS, modeling applicable to terminable plans is completely inappropriate in the public sector, where the perpetual existence of the plan sponsor and the commitment to plan sponsorship enables government-sponsored pension plans to promise and fund benefits and manage and invest assets with a long term focus; and

WHEREAS, support for reporting termination liabilities of public retirement plans may appeal to those not conversant with the mechanics, governance and funding structure of State and local government pension systems, as well as those who stand to benefit financially from additional fees that will be generated as a result of the work involved; and

WHEREAS, the cost of such calculations and the risk of misinterpretation far outweighs any value they may have to those who are attempting to grasp the impact of the financial condition and financial position of the retirement system on the plan sponsor;

NOW, THEREFORE, BE IT RESOLVED, that the National Association of State Retirement Administrators believes the reported liability of a public pension fund must reflect:

- i. the presumed infinite life of public employee retirement plans and governmental plan sponsors,
- ii. the guarantee of public pension benefits under State constitutional, statutory, contractual and/or case laws, and
- iii. the observable past and reasonable future return expectations for capital markets and common public fund portfolio construction; and

BE IT FURTHER RESOLVED, that the National Association of State Retirement Administrators believes the government financial reporting model should not be altered simply to appeal to the misguided perception of the need for public sector/private sector symmetry; and

BE IT FINALLY RESOLVED, that the organization(s) responsible for setting public sector accounting standards should be independent; representative of state and local governments; and focused on the accounting needs of the public sector and its stakeholders.

Adopted on October 15, 2007