NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS



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Letter of Comment No. 256 File Reference: 34-E Date Received: 10/14/11

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Director of Research and Technical Activities Project No. 34-E Governmental Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856-5116

Dear Sir or Madam:

The National Coordinating Committee for Multiemployer Plans (NCCMP) is pleased to provide these comments regarding the GASB exposure drafts related to pension accounting and financial reporting.

The NCCMP is the only national organization devoted exclusively to protecting the interests of the approximately twenty-six million workers, retirees, and their families who rely on multiemployer plans for pension, health and other benefits. The NCCMP's purpose is to assure an environment in which multiemployer plans can continue their vital role in providing benefits to working men and women. The NCCMP is a nonprofit, non-partisan organization, with members, plans, and plan sponsors in every major segment of the multiemployer plan universe, including in the airline, building and construction, entertainment, health care, hospitality, longshore, manufacturing, mining, retail food, service and trucking industries.

While the NCCMP does not represent the interests of government sponsored pension plans, we believe that it is in the interest of our members that all pension plans in all sectors of our society be properly regulated and fairly measured. Defined benefit pension plans are vital to the retirement security of millions of Americans, and challenges to plans in one sector make it more difficult for plans in other sectors to receive the support they need and deserve. For these reasons, we are submitting these comments on the GASB exposure drafts related to pension accounting and financial reporting.

The primary purpose of the NCCMP comments it to express support for the joint position submitted by the National Conference on Public Employee Retirement Systems (NCPERS), the National Council on Teacher Retirement (NCTR), and the National Association of State Retirement Administrators (NASRA). These joint comments raise several primary concerns regarding the accounting proposals with which the NCCMP is in full agreement. These primary concerns are as follows:

• The ability of many public retirement systems to rely on employee contributions to fund a varying portion of their pension obligations indicates that these obligations do not meet the definition of a liability established by GASB Statement 4.

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• The Annual Required Contribution (ARC) is a superior measure of the long-term funding requirements of the plan compared to the new Pension Expense (PE) figure. The ARC is more stable from year-to-year, and better reflects the long-term nature of the pension obligations.

- The majority of states have relied on the existing pension measures to adopt changes to either their contribution or benefit structures in response to the global economic crisis of 2008. These states are on the proper track towards returning their pension systems to financial strength, and this was accomplished with the existing reporting structure, demonstrating that a radical overhaul is unnecessary.
- In a cost-sharing multiemployer system, the allocation of assets and liabilities to individual employers is arbitrary and misleading. The Financial Accounting Standards Board recently went through this process with private multiemployer plans, and while they initially proposed such an allocation, ultimately the Board understood that is was an inappropriate measure.

The joint NCPERS / NCTR / NASRA comments also discuss the proposed blended discount rate, suggesting that the new standard should specify the use of taxable municipal bonds. The position of the NCCMP is different, in that we believe that any use of a market sensitive discount rate to measure the pension liabilities of public sector plans is entirely inappropriate.

The best way to understand this issue is to consider the fundamental issue that the readers of pension plan financial statement are trying to answer. The readers want to know if the assets held by the plan can reasonably be expected to be sufficient to pay the benefits promised by the plan, and if not, the estimated amount of the shortfall. If we keep this fundamental question in mind, it is easy to see why the use of a market sensitive discount rate is not appropriate for measuring public sector pension liabilities.

Most public pension plans invest their assets in a balanced portfolio that consists of both equity securities and fixed-income bond securities. The majority of these plans assume that their asset portfolios will return 8% per year, with very few plans assuming a rate that is more than 50 basis points above or below this average. Various studies have shown that historically this is a conservative estimate of the long-term returns these portfolios can achieve, even when you include the dramatic asset losses that recently occurred in 2008. While some economists are forecasting that the coming decades will not replicate the asset returns of the past decades, if you blend these pessimistic projections with the historical data, it is difficult to claim that the 8% assumption is an unrealistic or unreasonable expectation.

Consider a pension plan that has \$100 million of liabilities when measured at 8%, and \$90 million of assets. Under the current measurement structure, a reader of the financial statements would conclude that the plan is 90% funded, and currently has a shortfall of \$10 million. Actuarial calculations have many uncertainties regarding areas such as retirement ages, termination patterns, disability experience, mortality rates and assets returns. As such, there is no guarantee that \$100 million is the precise amount of money that is needed today to cover the benefit payments of the plan. But, based on all of the available information, it is the best possible estimate of this figure, and the reader's understanding is correct.

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However, if the liability calculation were to use a discount rate below 8%, either in whole or in part, the funding shortfall of the plan becomes exaggerated. In today's artificially low interest rate environment, the liabilities of this plan could easily increase to \$110 million if a market sensitive discount rate is applied. Now the reader of the plan's financial statement believes that the plan needs \$20 million more in additional assets to reasonably be expected to cover its obligations, which is double the best estimate figure. Further, if the plan actually had \$110 million of assets, the most likely scenario is that this would ultimately be more money than is actually needed to support the promised benefits. In this way, the use of market sensitive discount rates causes confusion and misunderstanding among readers, and exaggerates the financial challenges faced by plans.

It is inevitable that people will compare public pension plans to private pension plans, but this comparison is entirely misguided. Specifically, the fact that single-employer private pension plans are measured using market sensitive discount rates has no bearing at all on public sector plans. The reason for this disparity comes from the plan termination experience of these private sector plans. Since the passage of ERISA, roughly 4,000 single-employer private sector plans have terminated and received financial assistance from the Pension Benefit Guaranty Corporation. This represents an average pace of nearly one plan every 3 days. In this environment, it is easy to understand the appeal of a market discount rate liability calculation. The one time when a market sensitive discount rate does make sense is when the plan sponsor is unable or unwilling to bear any investment risk, which is exactly what happens when a plan terminates. While there are strong arguments as to why private sector single-employer plans should not use market sensitive discount rates, the termination experience of these plans provides at least some practical justification for their use.

The situation is very different in public sector plans. Most are explicitly supported by tax revenues, and therefore face essentially zero risk of default. A typical pension plan has a weighted average benefit payment horizon of around 30 years, and the likelihood that the state, city, or other entity that sponsors a public sector plan will continue to support the plan over this horizon is nearly a certainty. Using a method of measuring liabilities with market sensitive discount rates that is appropriate in a plan termination setting is completely illogical for public sector plans. These plans have minimal risk of terminating, and therefore should be measured under the assumption that the asset allocation policy currently in place will remain in place in the future. As discussed above, any deviation from this approach will result in mistaken conclusions by the readers of the financial statements and the dangerous exaggeration of the financial challenges faced by public sector pension plans.

In conclusion, the financial statements of public sector pension plans should answer the question of how much money the plan needs to hold to reasonably expect to be able to pay its promised benefits. These plans invest their assets for the long-term, and the answer to this question should reflect this long-term approach. Using a bond discount rate for the portion of the liability that is not covered by the plan assets might make sense if the plan sponsor intended to issue debt to cover the shortfall, or if it intended to purchase annuities from an insurance company. But the reality is that in most cases the shortfall will be covered by future contributions that will be invested in the same manner as the current assets of the plan, and so the entire liability calculation should be consistent with this reality.

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Thank you for the opportunity to submit these comments, and please do not hesitate to contact us if you would like any additional information.

Best regards.

Josh Shapiro

Deputy Director