Letter of Comment No. 245
File Reference: 34-E
Date Received: 10/14/11

October 14, 2011

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

Comments on Exposure Draft of Governmental Accounting Standards Board Statement No. 27

Dear Mr. Bean:

These comments will focus on the liability that employers should recognize under the new statement as the net pension liability. I believe that the Exposure Draft incorporates a too narrow view of the responsibility for funding public retirement programs and that this view, while accurate for the majority of public plans, will cause other plans to report exaggerated amounts as net pension liability.

The Exposure Draft continues to express the Board's view that employee contributions provide a portion of the service cost and employer contributions provide the remainder of the service cost and all past service costs. That view is certainly true for the majority of plans that use fixed rates for employee contributions or that peg employee contributions to a percentage of the total service cost. There are public plans, however, that split the total contribution rate or amount between the employer and employees according to specified percentages. For example, some systems share costs equally between employers and employees, in which case employees pay ½ of the service cost and ½ of the past service cost.

The Board steadfastly insists in paragraph 142 that employee contributions are to be allocated entirely to service cost unless they exceed the total service cost, a condition that the Board feels is unlikely to occur. In this paragraph, the Board says that it would be unreasonable for employers to tax their employees to pay for their deficits. Although the Board does not explain why this type of tax is unreasonable, I surmise that the Board envisions a permanent employer (such as a state or city) with impermanent employees. Perhaps the Board feels it unreasonable to require employees to pay for a deficit that was incurred before they were hired. In the case of statewide systems, however, some employers join every year and some of the participating employers, such as charter schools, rather commonly go out of business. Twelve states allow employers to withdraw from their statewide systems, provided they pay a withdrawal liability. And of course, some employees participate for long careers as active members. So why does the Board feel it unreasonable for employees to share in the responsibility for funding deficits? And why does the Board limit its accounting guidance to arrangements that it finds reasonable?

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There are systems that require contributions from employees to fund their deficits, and often they do so as a result of state law. One of my clients that has used (until this year) a 50%/50% split of employee/employer contributions has experienced the following series of employee contribution rates:

Fiscal Year	Employee Contribution Rate
2001	2.17%
2002	2.00%
2003	2.00%
2004	5.20%
2005	5.20%
2006	6.90%
2007	8.60%
2008	9.10%
2009	8.95%
2010	9.00%
2011	9.60%
2012	10.50%

The reason for the increasing pattern is that total contributions have increased over this period due to investment losses, plan amendments, and changes in assumptions. The increase in total service cost during this period has been slight, from 11% to 13%. If employee contributions are really attributable only to service cost, how are we to explain the above pattern?

The 2010 state legislature changed the contribution split formula for this client from 50%/50% to 53%/47%, with the employees contributing the 53%. The change is effective in the current fiscal year, and was enacted to plug the state's budget deficit. The increased employee contribution requirement is precisely the kind of tax on employees that the Board seems to feel will not be levied. As a result of this increase, employee contribution rates have increased to 11.13% instead of 10.50% and we now project (based on July 1, 2010, valuation data) four years in the next ten when employee contributions will exceed total service cost. While the Board has said that this situation is unlikely to occur, we have to know how to account for it when it does.

Most state economists predict future budget deficits, and so the legislature may again increase the employees' share of total contributions to cover these shortfalls. The Board says that these changes should not be recognized until they occur, and that rule seems reasonable. If the state does continue to shift contribution responsibilities to employees, we will have many years when employee contributions exceed total service cost.

The amount to be recorded as net pension liability under the new statement for this client, using 2010 valuation numbers, is $16.8 billion. This amount represents the excess of the liability that the entry age normal cost method assigns to past service over the market value of the assets as were not smoothing its asset values, this amount would equal the present value of all past

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service contributions to be made in the future by both employer and employee contributions. Since participating employees would contribute 53% of these past service contributions, why should the employers record 100% of the liability on their books? In dollar terms, this question represents the difference between showing employer liabilities of $16.8 billion and $7.9 billion.

Thank you for considering these comments.

Sincerely,

Charles E. Chittenden

Charles E. Chittenden
Fellow, Society of Actuaries