Metrics and Measurements for State Pension Plans

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Many New & Distinctive Public Pension Measurements

- **Books**—computing an annual position regarding pensions for financial statements (GASB)
- **Bonds**—calculating how pension obligations affect a government’s creditworthiness (Ratings Agencies)
- **Budgets**—determining the appropriate annual contribution to the retirement system for sound funding (Funding Policies)
Government accounting standards used to require the calculation of an ARC within certain parameters and disclosure of actual contributions in comparison. Most governments based funding policies on the ARC as defined under GASB. Credit rating agencies also incorporated this into their analysis.
What’s Changed?
The Divorce of Public Pension Accounting from Funding (GASB 68)

- New focus:
  - Accounting position of the pension plan
  - change in this position from year to year
- Placement of these on the face of the financials of each employer
- Annual employer contribution calculations and history moved to financial notes
Credit Rating Agency Pension Adjustments

- Proprietary methods for measuring public pensions
  - Only one part of credit ratings process and vary between credit ratings agencies
  - Stress-test the degree to which pension obligations may affect a government’s ability to repay bonded debt
  - Adjustments of assumptions from conventional metrics
  - Some ratings agencies publish adjusted pension numbers outside of credit ratings context - should not be confused with the funding condition of the plan
Pension Funding Metrics

- Governments typically maintain a funding policy for their pension plans, which has not materially changed after GASB 68.
- Actuarial valuations continue to be conducted and include the calculation of an employer’s actuarially determined contribution (ADC).
- Governments must disclose in the financial notes their actuarial assumptions and a 10-year history of actual contributions in comparison to the ADC.
Distinguishing the new and separate pension numbers.
# Separate Pension Numbers for Books, Bonds, and Budgets

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<tr>
<th>Purpose</th>
<th>Books</th>
<th>Bonds</th>
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<td>Standardized financial reporting of pensions for accounting</td>
<td>Stress testing the degree to which pension obligations may affect a government’s ability to repay bonded debt</td>
<td>Determining an annual pension contribution to properly fund benefits</td>
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<tr>
<th>Primary audience</th>
<th>Books</th>
<th>Bonds</th>
<th>Budgets</th>
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<td>Users of government financial statements</td>
<td>Ratings analysts</td>
<td>State/local policymakers</td>
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<tr>
<th>Source of calculation</th>
<th>Books</th>
<th>Bonds</th>
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<td>Accounting standards set by the Governmental Accounting Standards Board (GASB)</td>
<td>Practices established by individual credit rating agencies</td>
<td>State/local statutory, administrative and procedural rules</td>
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<th>Methodology</th>
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<td>Pensions are accounted for through the computation of a Net Pension Liability, i.e., the difference between the market value of pension fund assets and benefit obligations as of a specific date</td>
<td>Varies by rating agency, as pensions are just one of many metrics used to determine a bond rating</td>
<td>Most governments make actuarially determined contributions, calculated within established parameters as a level percentage of payroll to fully fund benefits earned each year and to amortize unfunded liabilities</td>
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<td>The Net Pension Liability is a new figure that will be placed on basic government financial statements and is expected to create unprecedented volatility and, in some cases, could dwarf other items on the financial statement</td>
<td>Some ratings agencies have announced that in their credit analytics, they will adjust pension data using uniform, generally more conservative assumptions regarding amortization periods and investment returns</td>
<td>New GASB standards will no longer include parameters for calculating an annual required contribution. Although this does not necessitate a change to existing funding policies or statutes, governments are urged to follow recommended guidelines established by the Pension Funding Task Force</td>
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Guidelines adopted by organizations representing the nation’s governors, state legislatures and other state and local officials

Urge state and local policymakers to adopt sound funding policies that include:

- Actuarially determined contributions
- Funding discipline
- Intergenerational equity
- Contributions that are stable as a percentage of payroll (projections in real vs. nominal dollars)
1. State and local governments provide significant oversight for their retirement systems and require open reporting and processes. These systems are established under state statutes, local ordinances, or both; subject to fiduciary, investment and administrative laws, as well as to open records and sunshine statutes; overseen by elected governmental bodies, state and local regulators, elected office holders, the public, and independent boards of trustees.

2. The Governmental Accounting Standards Board (GASB) is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments. GASB standards must be followed to receive a clean audit. GASB was established by state and local government organizations in conjunction with the Financial Accounting Foundation, in recognition of the fact that governments are fundamentally different from for-profit business enterprises, including their unique time horizons, oversight, revenue streams, constitutional or contractual protections, stakeholders and accountability for resources.

3. GASB has recently completed a multi-year process of reviewing and revising its accounting standards on public pension reporting. GASB Statement 68, which will be implemented into state and local government financial statements this year, includes many changes. Notably, state and local governments will now be required to report their net pension liability on their balance sheets.

4. The new GASB requirements do not affect actuarial funded ratios or pension contribution requirements; they only change where and how pension costs are accounted for in financial statements to provide additional and more prominent information.

5. The placement of net pension liabilities on an employer’s balance sheet could create the erroneous impression that this is an obligation that is due immediately. This is not the case. Pensions are funded and paid out over very long periods – contributions are made over employees’ careers and distributions are provided in monthly installments in their retirement.

6. A new term, pension expense, refers to the change in the net pension liability from one year to the next, and should not be confused with what governments actually budget and expend on pension contributions. The new GASB net pension liability figure will be volatile, because it is based, in part, on the market value of pension assets, which fluctuate with investment markets. Under GASB 68, pension expense is a measure of this volatility, not an employer’s pension contribution.

7. Information about annual pension contributions has not gone away. Actuarially determined pension contributions, as well as the assumptions that underlie them, are required to be included in financial notes, along with a government’s 10-year pension contribution history. The financial condition of the retirement system, including funded status and necessary contributions, must be certified by qualified actuaries that adhere to Actuarial Standards of Practice maintained by the Actuarial Standards Board, which identifies what U.S. actuaries should consider, document, and disclose.

8. Adjusted pension data being published by some credit ratings agencies does not change a government’s pension liabilities, it is merely part of their credit analytics. Some credit ratings agencies are now modifying pension data using their own methodologies to standardize results and they are publishing this adjusted data. Credit ratings agencies have long been factoring pension liabilities into their credit ratings and bond ratings for only a small number of governments are expected to change due to pension obligations.

9. State and local policymakers are urged to review the effectiveness of existing funding policies and practices. National organizations representing the nation’s governors, state legislatures, state and local officials, and public finance professionals have released Pension Funding: A Guide for Elected Officials, which recommends the calculation and payment of actuarially determined pension contributions within accepted guidelines so that pension promises can be paid, employer costs can be managed, and the pension funding policy is clear to all stakeholders.

10. Since the Great Recession, all 50 states and numerous localities have been taking steps to strengthen their pension funding: none has requested nor required federal intervention. Federal legislation has been proposed to eliminate the tax-exempt status of municipal bonds if state and local governments do not comply with federally-imposed, conflicting and costly reporting mandates. It is inappropriate for the federal government to propose unfunded mandates and penalties in an area that is the fiscal responsibility of sovereign States and localities.
1. Public pensions have significant state/local regulation
   - established under state statutes, local ordinances, or both
   - subject to fiduciary, investment and administrative laws, as well as to open records and sunshine statutes
   - overseen by elected governmental bodies, state/local regulators, and independent boards of trustees
   - Additionally, subject to federal tax laws
2. GASB is the official source of generally accepted accounting principles (GAAP) for state and local governments
   - Must be followed to receive a clean audit
   - Established by state and local government organizations in coordination with the Financial Accounting Foundation (who oversees both GASB and FASB)
   - Recognition that governments are fundamentally different from for-profit business enterprises
     - unique time horizons, oversight, revenue streams, protections, stakeholders and accountability for resources
3. GASB has recently completed a multi-year process of reviewing and revising public pension accounting standards
   - Many changes went into effect this year, reflecting what disclosure standards were deemed appropriate for state and local governments

4. The new GASB requirements do not affect actuarial funded ratios or pension contribution requirements
   - Only change where and how pension costs are accounted for in financial statements
5. Net pension liabilities are long-term projections that are not due immediately (40 to 60 years)
   - Contributions are made over employees’ careers
   - Distributions provided in monthly installments over their retirement

6. “Pension expense” is a new (and possibly confusing) term
   - Change in the net pension liability from one year to the next
   - Should not be confused with what governments actually budget and expend on pension contributions
7. The ARC has not gone away, it has been renamed and moved
   - Now called “actuarially determined contribution”
   - Disclosed in financial notes, along with assumptions and a government’s 10-year pension contribution history

8. Adjusted pension data published by credit rating agencies does not change a government’s pension liabilities
   - Only one part of credit analytics
   - Bond ratings for only a small number of governments are expected to change due to pension obligations
9. While funding policies have not materially changed, state/local policymakers are urged to review their effectiveness
   - Calculation and payment of an actuarially determined contribution within acceptable parameters

10. Since Great Recession, all 50 states have taken steps to strengthen pension funding; none have requested nor required federal intervention
   - Federal mandates have been proposed that conflict with GASB and threaten state/local tax-exempt bonds
   - Inappropriate to impose federal penalties in areas that are the fiscal responsibility of sovereign states and localities