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Key Ideas of Article

- The bill's provisions call for using a discount rate rate based on U.S. Treasury bills (page 3). The discount rate is an actuarial assumption that can be thought of as our long term average investment earnings.

- This change in how we ***measure*** benefits will lead to an increase in Unfunded Liabilities (page 3). A change in how we measure the payout does not necessarily (mean there is a) change in dollars paid out.

Battle Lines Form over Public Plan Disclosure

Brendan Hoffman/Getty Images

Reacting: Rep. Devin Nunes' bill is in response to 'very alarming warnings.'

Battle lines form over public plan disclosure

By **Doug Halonen**
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See also

- **Trouble on the horizon**

Business and taxpayer groups and representatives of local governments and unions are squaring off over what is expected be a major legislative brawl next year concerning a bill that could force public pension plans to disclose their finances to the U.S. Department of Treasury.

"The first step to recovery is admitting you have a problem, and from our perspective that means truth in budgeting," said Leslie Paige, a spokeswoman for Citizens Against Government Waste, a Washington-based advocacy group that targets government mismanagement and inefficiency. "We think state and local government pensions are in even worse shape than they appear to be, and part of the reason for that is that underlying assumptions on how well they're going to do in the market are based on inflated returns on investments."

“There's an anti-defined benefit ideology driving some of this,” countered Keith Brainard, Georgetown, Texas-based research director of the National Association of State Retirement Administrators. “Some of these critics want to terminate public pension plans and replace them with 401(k) plans.”

The legislation, which has the backing of key House Republicans, also would bar the federal government from bailing out public plans and would deny a federal tax exemption for bonds issued by governmental entities that don't comply with the new disclosure requirements.

Promote reforms

Proponents contend the enhanced disclosures — which would require use of new actuarial assumptions that could dramatically expand the size of liabilities for many public plans — are needed to promote reforms of financially troubled public pension funds.

“The demand for transparency isn't coming from Congress; it is coming as a result of very alarming warnings by well-respected analysts across this country,” Rep. Devin Nunes, R-Calif., who introduced the bill in the House on Dec. 2, said in an e-mailed response to questions. “If we ignore these warnings, we will have learned nothing from the subprime mortgage crisis.”

Representatives of state and local governments and unions counter that the bill, the Public Employee Pension Transparency Act, amounts to an all-out assault by the federal government on state and local government autonomy.

“It's a terrible proposal, and we're obviously going to oppose it,” said Mark McCullough, a spokesman for the Service Employees International Union, Washington.

Opponents also contend the measure could raise the burden on taxpayers by lowering the discount rates public plans use to calculate their liabilities.

“Inaccurate and inflammatory descriptions of the state of public pensions and unnecessary calls for federal intervention are unwarranted and only serve to confuse the public and unduly alarm state and local government retirees,” said a Dec. 8 statement issued by a coalition of local government groups, including the National Association of Counties, the National League of Cities and NASRA.

But representatives of taxpayer groups say the legislation's reporting reforms are needed to ensure the public has a more accurate understanding of the size of obligations that could eventually fall into their laps.

“Our members are concerned that ... they'll be asked to pay for it (underfunding), both through higher corporate taxes and higher individual taxes,” said Aliya Wong, executive director of retirement policy for the U.S. Chamber of Commerce, Washington.

The reforms also could put public plans on a more equal footing with corporate plans, Ms. Wong said. “While many private employers have had to cut their benefit packages, the government has not,” she added.

One of the bill's key provisions would require public plans to use a discount rate based on Treasury bond rates that are now in the 3% to 4.5% range. While corporate plans use a discount rate based on a blend of high-quality corporate bond rates determined by Treasury, now around 5.5% to 6%, many public plans use a discount rate of 8%. A lower discount rate results in larger liabilities, meaning that a plan's government employers would have to contribute more into the plans in the short term.

Using the lower Treasury-based rates called would present a distorted picture of the liabilities by tying them to current interest rates, NASRA's Mr. Brainard said. “It results in an exaggeration of liabilities by several times,” he said. “It would cause extreme volatility in funding levels and costs.”

Mr. Brainard said the combined total unfunded liability of state and local public plans using an 8% discount rate, based on the long-term expected return on investment for public plans, is about $750 billion to $1 trillion.

Joshua Rauh is an assistant professor of finance at the Kellogg School of Management, Northwestern University, Evanston, Ill. Using Treasury rates for the discount, Mr. Rauh calculated the combined total unfunded liability of state pension plans at $3 trillion and the total unfunded liability of municipal plans at $574 billion.

Mr. Rauh said in an interview that discounting the liabilities at 8% assumes incorrectly that an 8% return can be assumed without risk. “You only get a return of 8% if you take risks, and (these are) risks for which taxpayers bear the downside,” he said.

As to the bill's attempt to bar a federal bailout of public pension funds, critics say the plans are not seeking or anticipating such assistance.

“This is a pure scare tactic,” said the SEIU's Mr. McCullough.

“There is no federal backstop for public pensions, nor are public pensions asking for such a backstop,” added Lisa Lindsley, director of capital strategies for the American Federation of State, County and Municipal Employees, Washington.

“People who are feeding this rumor have another agenda,” Ms. Lindsley continued. “They would like to see government services drastically reduced at all levels of government.”

Hard to resist

Mr. Rauh, however, said a bailout could be hard to resist, even if barred by legislation, because the federal government, “in all likelihood” would consider the states too big to allow them to fail.

In article by Mr. Rauh and Robert Novy-Marx, an assistant professor of finance at the University of Chicago Booth School of Business, the professors encourage states to close defined benefit plans to new workers, shifting those new employees to defined contribution plans, with the federal government rewarding the move by giving cooperating states a tax subsidy on the issuance of bonds for DB plan funding.

“What this (tax subsidy) would be doing is spending a small amount of money now to avoid a massive bailout in the future,” said Mr. Rauh, who provided advice on the drafting of the Nunes legislation.

Allen R. Gillespie, chairman of the $24 billion South Carolina Retirement System Investment Commission, Columbia, said he agreed with the legislation's suggestion that the 8% discount rate that South Carolina and many other public plans are using is probably unrealistically high.

Nonetheless, Mr. Gillespie said the Nunes legislation goes too far on other fronts, particularly in what Mr. Gillespie sees as its promotion of a shift of public plans from a DB to a DC model — and in its attempt to tie the discount rate to Treasury returns.

“Going all the way to Treasuries would go too far — and going all the way to DC fails to recognize the social benefits of mortality risk sharing” offered by defined benefit plans, Mr. Gillespie said. “What we should be looking at is going to some sort of hybrid that uses features of DB and DC plans.”

While nothing is expected to happen on the bill now, Andrew House, a spokesman for Mr. Nunes, said the legislation will be reintroduced early next year after the new Congress begins. Mr. Nunes is a member of the House Ways and Means Committee.

Mr. House said he believes the bill will have no problem winning approval in the House, and some lobbyists agree with his assessment. But the prospects for the bill's passage in the Senate, where Democrats have retained their majority, are considered far less likely.

Whatever its outcome, the measure will have an impact.

“Even if it doesn't pass, it starts the conversation and raises awareness,” said the Chamber of Commerce's Ms. Wong.

Contact Doug Halonen at ***dhalonen@pionline.com***

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