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Estimating State and Local Government Pension and Retiree Health Care Liabilities

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Background

- Recently, high attention has been given to unfunded liabilities of states and local governments
- Questions are being raised about how these liabilities have been calculated

Magnitude of Public Sector Retiree Liability

- States (Pew Study 2007: *Promises with a Price*) (amounts below in billions)
  - Pension:

Pension:	Liabilities:	$2,353
	Assets:	1,992
	Unfunded Liability:	$ 361
OPEB:	Liabilities:	$ 381
	Assets:	11
	Unfunded Liability:	$ 370

- All state and local governments
  - Pension – Estimated to be $700 billion to $1 trillion
  - OPEB – Estimated to be $1.5 trillion
- Totals are based upon individual results that use dissimilar cost methods and use actuarial assumptions that have varying degrees of aggressiveness or conservatism

General Measurement Issues

- Measurement of liability depends upon:
  - Actuarial cost method
  - Actuarial assumptions
- Guidance from Actuarial Standards of Practice (ASOPs)
  - ASOP No. 4: *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*
  - ASOP No. 6: *Measuring Retiree Group Obligations*
  - ASOP No. 27: *Selection of Economic Assumptions for Measuring Pension Obligations*
  - ASOP No. 35: *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*

Comments Regarding Guidance in ASOPs

- Standards permit a very broad range of actuarial methods and assumptions
- Cost methods
  - Some methods do not re-compute actuarial accrued liability at each valuation date, but only "roll-forward" unfunded amounts from prior dates
  - One method (aggregate method) does not compute any actuarial accrued liability
- Assumptions
  - ASOP No. 27 only requires that economic assumptions (such as investment return rate) be selected from a best-estimate range
- ASOPs are not concerned with comparability among different retirement programs, but only concerned with compliance to generally accepted actuarial principles

Private Sector Measurement

- Three primary standards issued by the Financial Accounting Standards Board (FASB)
  - FAS 87 *Employers' Accounting for Pensions*
  - FAS 106 *Employers' Accounting for Postretirement Benefits Other Than Pensions*
  - FAS 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*
- Requires use of one actuarial cost method: Projected Unit Credit Method
- Requires discount rate based on current long-term bond rates (market value liability)
- FAS standards eliminate most issues regarding comparability

Public Sector Measurement

- Two primary standards issued by the Governmental Accounting Standards Board (GASB)
  - GASB 27 *Accounting for Pensions by State and Local Governmental Employers*
  - GASB 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*
- Standards generally incorporate principles of ASOPs
- Broad choices are permitted for actuarial cost methods and assumptions
- Discount rate
  - For funded plans, use the assumed rate of return for the fund's asset allocation (average public plan uses an 8% discount rate)
  - For unfunded plans (primarily retiree medical plans funded pay-as-you-go) use the assumed rate of return on the employer's unrestricted assets

Public Sector Measurement *(continued)*

- Actuarial assumptions are usually selected by the retirement system board with advice from the actuary
  - Some actuarial assumptions are stated in statutes
  - General tendency has been not to lower investment return rate since it would have adverse effects on funded ratios and contribution rates
- Results from various systems may not be comparable due to a wide range of flexibility in methods and assumptions

Comments Regarding Private vs. Public Measurement Differences

- Some observers have called for public plans to disclose liability at market similar to FASB requirements
  - Ennis paper *Moral Hazard in Public Pensions*
  - Gold and Latter paper being presented on this panel
- GASB 2006 white paper: *Why Governmental Accounting and Financial Reporting Is – And Should Be – Different*
  - Private business: “Voluntary exchange between any willing buyer and seller”
  - Governments: “Involuntary payment of taxes”
  - Governmental accounting should focus on resources and allocation of costs to generations of taxpayers
  - GASB 27 and 45 are based upon research with users of governmental financial statements

Potential Changes

- Mark to market
  - Private sector model – may not be consistent with principles of public sector finance
  - Not yet clear that this information would be useful to users of financial statements
  - Significant increase in disclosed unfunded liabilities
  - Huge paradigm shift for public sector
- Modifications to current practice which could make information more useful
  - Restrict cost method selection to those that re-compute liability at each valuation (Entry Age Normal and Projected Unit Credit)
  - Require actuarial certification of assumptions as the actuary’s best estimate