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May 4, 2011

The Honorable Ron Kind
United States House of Representatives
Washington, DC 20515

Delivered Electronically

Dear Congressman Kind:

On behalf of the Wisconsin Retirement System (WRS) and its nearly 570,000 members whose retirement security we provide and protect, I am writing to urge your active opposition to HR 567 legislation that imposes one-size-fits-all Federal reporting mandates regarding our pension costs. The Subcommittee on Oversight of the Committee on Ways and Means has scheduled a hearing on the legislation on Thursday, May 5, 2011.

Rather than creating transparency, HR 567, the "Public Employee Pension Transparency Act," would needlessly create turmoil in the municipal bond market and would confuse bondholders, taxpayers and retirees by erroneously claiming our pension trust will soon be exhausted. The legislation reflects a lack of understanding not only regarding the financing of state and local pensions, but also the strong accounting rules and strict legal constraints already in place that require open and transparent governmental financial reporting and processes.

Public plans are established, operated, and overseen in a very transparent manner. Wisconsin's plan is no exception. The terms of public plans typically are set through the legislative process, the plans are overseen by a board of fiduciaries acting in open meetings, and the finances of the plans are regularly disclosed and audited in extensive and detailed publicly available reports prepared in accordance with well-established government accounting standards. Thus, contrary to what the proponents of the legislation suggest, the issue is not a current lack of transparency and disclosure – it is simply an effort to justify a Federal take-over of areas that are the financial and regulatory responsibility of State and local governments.

The WRS has several unique features including risk sharing between members and employers and modest benefit levels, which, when combined with the funding discipline of the State and local units of government across Wisconsin and the professional management of the assets of the System by the State of Wisconsin Investment Board, makes it one of the best funded plans in the country. The funding strength of the WRS is documented in the latest PEW Center on the States report that was released in April 2011. I have attached a brief fact sheet about the WRS that you may find useful.

HR 567 directly conflicts with existing governmental accounting standards and usurps the role of the Governmental Accounting Standards Board, which is currently in the middle of a multi-year review process of its existing rules in this very same area. Furthermore, the academic study on which this legislation is based is highly suspect. Attached is a critique, along with links to supporting data and reports, of the study's faulty assumptions and recommendations that essentially create a problem in order to solve it.

I hope that we have an opportunity to personally discuss this proposed legislation in the near future.

Sincerely,

David A. Stella

David A. Stella, Secretary
Wisconsin Department of Employee Trust Funds
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Attachments

Faulty Analysis is Unhelpful to State and Local Pension Sustainability Efforts

October 2010

NASRA

As state and local governments lead efforts to address the unprecedented fiscal challenges created by stagnant economies, in the face of aging populations and workforces, the accuracy and integrity of information is more vital than ever. Authors of a new paper, *The Crisis in Local Government Pensions in the United States*, would be more constructive, as well as provide more accurate municipal pension information, if their assumptions were based on historical experience and their methodology appropriate for the government sector. Robert Novy-Marx and Joshua Rauh – who also earlier this year authored, *Are State Public Pensions Sustainable?* – again vastly underestimate projected future contributions to public pension plans and expected investment returns to draw dramatic and improbable conclusions regarding the solvency of these plans.[1] Both papers are based on pension fund assets values as of 2009, prior to the recent improvement in financial markets. Further, their method used to determine future pension liabilities of states and localities is not recognized by governmental accounting standards. The authors additionally ignore changes already underway at the state and local levels to restore long-term pension sustainability, and they make recommendations that would only serve to worsen the financial condition of these plans.

Assumptions of Future Behavior Are Not Supported by Past Practice

The reports' findings are premised on two key suppositions: 1) state and local governments will contribute nothing to amortize past pension liabilities, and 2) funds will generate rates of return commensurate with highly conservative, "risk-free" all-bond portfolios, rather than the diversified portfolios actually in use. These two assumptions are inconsistent with plans' actual experience, as most governments have a history of paying their pension contributions. In fact, according to the Public Fund Survey, from FY 01 to FY 09, on average, pension plan sponsors paid 91 percent of their required contributions. Regarding investment returns, the standard assumption is that pension fund portfolios will earn a real (after inflation) return of 4.5 percent annually, based on the mix of assets they typically hold, and more reasonable given the current ratio of stock prices to trend earnings.[2] Further, analysis shows that public pension funds' actual long-term investment returns still exceed this assumption, even after incorporating losses from the 2008 market collapse.[3]

Projections Are Based on Asset Values Near Their Market Low Point

The authors base their financial analysis on pension asset values as of June 30, 2009, at the end of a 12-month period when the S&P 500 had a return of -26.2%, and prior to much of the market increase that took place the following year. Pension fund asset values have been growing since March 2009, and for the year ended June 30, 2010, median public pension fund investment returns were 12.8 percent, well above plans' typical assumed investment return of eight percent. In addition, historical investment experience over 20-, 25- and 30-year time periods, a more appropriate measure of the long-term investment horizon of public funds, also exceed this assumed rate of return.[4]

The Method Used to Value Future Liabilities Is Inconsistent With Accounting Standards

Another factor driving the authors' findings is the method used to value future pension liabilities, which is not compliant with public sector accounting standards. In fact, the Governmental Accounting Standards Board, which has been reviewing these standards over the past three years, recently affirmed its support for the use of a long-term expected rate of return, rather than the use of current interest rates. In its Preliminary Views, published last June, GASB specifically "considered but rejected" an interest rate-based method for valuing future liabilities (the approach used in the Norvy-Marx-Rauh paper), stating instead that, "The rate used should be a reasonable estimate of the rate at which plan net assets are expected to grow, over a term commensurate with the accounting measurements for which the rate is used, as a result of investment earnings."

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[1] Based on original analysis prepared by Paul Zorn and Mita Drazilov at Gabriel, Roeder, Smith & Company, Paul Angelo at The Segal Company, and Keith Brainard at NASRA.

[2] "More Scare Stories About State Pensions at the NYT," Dean Baker, Center for Economic and Policy Research, June 20, 2010.

[3] "NASRA Issue Brief: Public Pension Plan Investment Return Assumptions," National Association of State Retirement Administrators, March 2010.

[4] "Investment Return Assumption for Public Funds: The Historical Record," Callan Investments Institute Research, June 2010.

Analysis Does Not Account for Recent State/Local Pension Changes

More state and local governments have enacted significant modifications to their retirement plans in 2010 than in any other year in recent history.[5] Since 2006, nearly two-thirds of the states have made changes to benefit levels, contribution rate structures, or both[6] and many more local governments also have made adjustments. Ignoring these alterations results in a gross mischaracterization of the current situation and disregards the measured approach that can be and has been taken to *realistically* and responsibly close pension funding gaps.

The Authors' Recommendations Do More Harm Than Good

In response to their dire projections, the authors have suggested that state and local governments should no longer offer pensions to new hires, recommending instead that such employees be covered with Social Security and a 401(k) plan, and that states and cities should issue debt – possibly at a federally subsidized rate – to pay off the added cost of closing pension plans. These recommendations ignore the significant cost and disruption that would be imposed by such changes:

- Mandatory Social Security Adds Billions in Expenses. Conservative estimates of the added expense of mandating newly hired public workers into Social Security are over **$44 billion in the first five years alone,**[7] which would worsen the financial condition of the sponsoring governments and their pension systems.
- Putting New Hires Into a 401(k) Increases Costs. Recent studies have shown that closing pensions to new hires can have several serious, unintended consequences, including increasing administrative costs associated with running two plans, forgoing or undermining economic efficiencies of traditional pension plans, accelerating pension costs for employees in the closed plan, worsening retirement insecurity, and potentially damaging employer recruitment and retention efforts. [8] Moreover, although 401(k)-type plans are a useful means of supplementing pension benefits, they are inherently not as effective or efficient as a primary source of retirement income. By pooling mortality and investment risks, traditional pensions reduce participants' risk of outliving retirement assets and can provide the same benefit at nearly half the cost of a defined contribution plan.[9] Unlike a traditional pension plan, a 401(k) does not include provisions for disability and death benefits, which are especially important for employees in hazardous occupations such as firefighters and police officers, who face higher risks in the line of duty. Without a pension, these benefits would have to be provided through commercial insurance, likely at significantly higher costs to the employer.
- Issuing Debt and/or Asking for Federal Involvement Adds Risk. Proposing that state and local governments should issue debt to fund their pension benefits adds risk to the funding equation. Such debt would become a liability for the sponsoring government. If the markets fall after the funds are invested, the government now has two sets of liabilities: the outstanding debt and the pension liability. Even with a federal subsidy – which is unlikely given current federal government budget constraints and which raises additional challenges – this is a risky approach.[10, 11]

In the wake of the Great Recession, states and cities are examining and adjusting pension benefit levels and financing structures to restore reserves and long-term sustainability. Hyperbole and distortion, as presented in the referenced academic papers, are not helpful to these efforts or to the long-term fiscal health of state and local governments and their retirement systems.

Contact:

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5 "Pensions and Retirement Plan Enactments in 2010 State Legislatures," Ronald K. Snell, National Conference of State Legislatures, October 10, 2010.

6 "Pensions and Retirement Plan Enactments in 2010 State Legislatures," Ron Snell, National Conference of State Legislatures, May 17, 2010.

7 "The Cost Impact of Mandating Social Security for State and Local Governments," Cathie Eitelberg, Alexander Sussman, F.S.A., and Leslie Thompson, Revised 2005.

8 "Look Before You Leap: The Unintended Consequences of Pension Freezes," Ilana Boivie and Beth Almeida , National Institute on Retirement Security, October 2008.

9 "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans," Beth Almeida, William B. Fornia, FSA, National Institute on Retirement Security, August 2008.

10 "Evaluating the Use of Pension Obligation Bonds," *Government Finance Officers Association Advisory* (1997 and 2005).

11 "Issue Brief: Pension Obligation Bonds: Financial Crisis Exposes Risks,"Alicia H. Munnell, Thad Calabrese, Ashby Monk, and Jean-Pierre Aubry; Center for State and Local Government Excellence, January 2010.

Welcome to the Department of Employee Trust Funds

The Department of Employee Trust Funds (ETF) is a non-cabinet state agency that administers various fringe benefit programs for state and local governments in Wisconsin. ETF is 100% funded from the segregated Public Employee Trust Fund (Trust) and no general purpose funding is used in its operation. ETF is overseen by an independent board and its trust funds are held on behalf of ETF benefit program participants.

Wisconsin Retirement System

The Wisconsin Retirement System (WRS) is ETF's largest program, providing retirement benefits for more than 565,000 current and former state and local government employees. As of December 31, 2010, WRS assets were valued at $79.1 billion, making it the ninth largest public pension system in the United States and the 30th largest in the world. The system is 99.8% funded on an actuarial basis and is often referred to as a national leader among public sector pension plans due to its benefit and financial structure, among other things.

Other ETF administered programs include health insurance, life insurance, long-term and short-term disability, employee reimbursement accounts, commuter benefits, long-term care insurance, deferred compensation and the accumulated sick leave conversion credits.

Economic Impact

About 90% of WRS retirees live in Wisconsin and as a result much of their spending is done with businesses within Wisconsin. This spending reverberates throughout the local and state economies, as one person's spending becomes another person's income, creating a multiplier effect. The result being nearly $4.5 billion added annually to Wisconsin's economy from WRS pension payments, according to a national study.

Who is Covered in the WRS

- Teachers (including Milwaukee)
- Local government employees, except city of Milwaukee and Milwaukee County
- State government employees (including the UW System)

Important Figures

1,469: Number of WRS participating employers (1,410 local and 59 state).

73%: Percentage of WRS active employees who work for local governments.

More than 66%: Amount of WRS benefits paid by investment returns.

$3.7 billion: Total annual annuities paid to annuitants for an average annual annuity amount of $24,488.

Over 150,000: Annuitant population, which is expected to double to over 300,000 in the next 10 to 15 years, with "baby boom" generation retirements.

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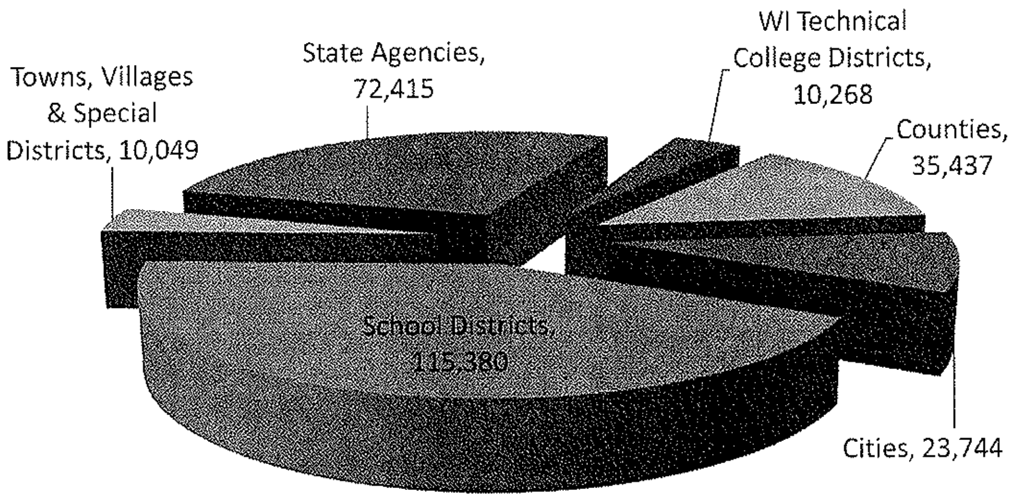
WISCONSIN DEPARTMENT OF EMPLOYEE TRUST FUNDS

WRS Participation

Participants By Employer Type

The following graph shows a breakdown of WRS participation by employer type. School districts represent the highest number of participants with 115,380, followed by 72,415 state agency participants, 35,437 county participants, 23,744 city participants, 10,268 Wisconsin technical college district participants and 10,049 town, village and special district participants.



WRS Participants

The following graph shows the number of WRS participants from 2005 to 2009. Participant numbers of all groups increased yearly, with the exception of an active participant decrease between 2005 and 2006.