July 31, 2009

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: Project 34, Pension Accounting and Financial Reporting

Dear David:

The National Federation of Municipal Analysts (NFMA) is pleased to respond to the Governmental Accounting Standards Board's (GASB) Invitation to Comment (ITC) on Pension Accounting and Financial Reporting. Defined-benefit pensions represent substantial and growing financial obligations for many municipal debt issuers, and the burden of meeting these obligations may have significant implications for the credit strength of state and local governments. NFMA strongly supports efforts to improve the transparency and quality of information available to help credit analysts and investors evaluate how future pension outlays are likely to affect the credit standing of municipal borrowers.

NFMA was chartered in 1983 as a not-for-profit association with the goals of promoting professionalism in municipal credit analysis and furthering the skills of our members. NFMA now comprises approximately 1,000 members who evaluate credit and other risks of municipal securities. Our members represent institutional investors, including mutual funds and insurance companies, bond insurers, broker/dealers, and rating agencies. Credit analysts are present at all stages of the municipal securities market, from the inception, structuring, rating, insurance and primary market offering of each transaction through the sale and purchase of securities in the secondary market.

In this letter, we first provide some general observations about the information we use to assess the credit implications of municipal pensions, and then respond to a number of the specific questions posed in the ITC.

Overview

Evaluating the credit implications of defined-benefit pensions often presents a difficult challenge for municipal credit analysts. Two basic challenges complicate the exercise. First, estimates of pension costs require assumptions about many critical, inherently uncertain variables, including retiree longevity, employee salary growth rates and turnover, and earnings on pension fund assets, among others. Second, these variables may be used in a variety of actuarial models that

can yield quite diverse estimates of pension liabilities and costs. Even with the same key assumptions, different actuarial methodologies can yield strikingly different estimates of pension costs. Given the complexity of pension costs, we do not expect that any single measurement approach will fully capture the credit (and other) implications of pension liabilities. By providing better information about underlying facts and assumptions and permitting a narrower range of actuarial methodologies, financial reporting can improve the greater clarity and consistency of pension cost estimates.

As credit analysts, our primary concern is to understand the ongoing claim on an issuer's resources that pensions represent. By estimating the amount of future resources sponsor governments will need to fulfill their pension commitments and their ability to afford those commitments, given the size and expected growth of the resources they can tap to support them, we try to arrive at a reasonable basis for comparing the relative burden of pension obligations across government debt issuers. Single measurements, such as the unfunded actuarial accrued liability (UAAL), provide useful information, but the assumptions and methodology underlying them must be carefully deconstructed and interpreted before they can be used for comparisons.

Responses to Individual Questions

In responding to the questions presented in the ITC, we have focused on the key themes that we believe are particularly important to credit analysis and on which there is a reasonable basis for consensus among our members. As suggested above, we are more concerned with the availability of clear, comparable information on expected pension liabilities and costs than the attempt to capture a single measure of the liability on the balance sheet or of the annual cost on the statement of operations.

Question 1: The Underlying Process - Credit analysts seek to understand both how pension obligations are incurred and how they are financed and would like to see information about both processes included in the financial statements. The process of incurring pension obligations provides a useful cross reference for assessing the adequacy of the financing plan.

Question 2: Pension Liabilities and Expenses – As stated above, our primary focus is on whether the government employer has (1) produced an estimate of pension costs that is based on reasonable and clearly-stated assumptions and a suitable methodology and (2) adhered to the prescribed funding schedule dictated by that estimate. Our objective is to assess whether the employer has made adequate financial provisions for funding its pension liabilities over time. Financial statements should show whether the employer is making annual required contributions sufficient to meet its funding obligation.

While we recognize that the unfunded accrued benefit obligation meets certain characteristics of a liability of a sole or agent employer, we do not view it as essential that the entire unfunded accrued benefit obligation or the annual cost be recognized in the basic financial statements. Disclosure of this information in the notes to the basic financial statements may, in fact, be the more suitable approach given that the size of the obligation cannot be measured with sufficient reliability in light of the long-term funding approach being taken, the variety of assumptions involved in arriving at the estimate of the liability, and year-to-year volatility in investment performance.

Of the alternatives outlined in the ITC, it appears that Alternative 1 most closely approximates this approach. Alternative 1 treats the unfunded accrued benefit obligation as “an actuarial funding target” or “surrogate measure of the employer’s incurred obligation to employees for pension benefits earned by services to date in excess of the amount of assets that have been set aside in trust for payment” and discloses the obligation and events that affect it in the notes to the financial statements.

Questions 3 and 4: Effects of Future Changes – Where future impacts on pension costs, including projected service credits, salary increases, and cost-of-living adjustments for retirees can be reasonably estimated, we believe that including these future changes in pension cost projections yields a more meaningful assessment of the likely financial impact of employee pensions. To the extent that the sponsor retains discretion over the implementation of these changes, supplementary information as to the effects of these assumptions on projected costs would be useful.

Question 5: Discount Rates – We support the current practice of using an assumed long-term rate of return on the assets set aside to fund benefit payments as the best method for converting projected future benefit payments into their present value over the alternatives suggested including a risk-free rate of return, the government’s borrowing rate, or an average return on high quality municipal bonds. While we recognize that no one approach to arriving at a discount rate will yield a perfect result, our view is that the alternatives suggested would each result in a significantly lower discount rate requirement, creating undue stress on state and local governments by producing overly conservative estimates of the obligation and larger ARC expenses. Again, our focus is not so much on the discount rate itself but on the assumptions utilized in arriving at the rate and on understanding how the rate is incorporated into actuarial models to estimate pension liabilities and costs. We believe these objectives are best achieved through explanations provided in the notes to the financial statements.

Questions 6 and 7: Actuarial Cost Methods – Different actuarial methods yield very different portrayals of the funded status of pension plans and can make meaningful comparisons between issuers difficult or virtually impossible. While we recognize that each actuarial method may have advantages, we favor consistency over flexibility and support the narrowing of options among actuarial cost methods. We would prefer to see the adoption of a single method, entry age, which is already used by 75 percent of US public sector pension systems. If the case is made for additional flexibility, projected unit credit would be acceptable as well, though we note that this method tends to result in more back-loading of contributions and the accumulation of assets.

Question 8 and 9: Amortization Methods - Generally, the NFMA favors the use of a closed amortization period of 30 years or less for prior service costs. In addition to the benefits of this approach described in the ITC, limiting the amortization period to a closed method with a 30 year maximum term is consistent with the NFMA’s preference to enhance the comparability of the relative burden of pension obligations across government debt issuers and the consistency of pension cost estimates to the fullest extent possible.

Questions 10 and 11: Valuation of Pension Plan Assets – Annual changes in the fair value of pension plan assets are generally recognized over a three to five year period in order to minimize

the effect of year-to-year volatility on calculations of the ARC. The NFMA favors the current approach over introducing annual fair value changes, as the current methodology tends to provide for the smoothing of investment returns and therefore better mitigates the impact of large annual fluctuations in funding requirements for the ARC. In our view, this approach is to the benefit of state and local government issuers who otherwise might not be able to adjust budgeting practices quickly enough to keep pace with rapidly changing funding requirements resulting from market fluctuations that ultimately may have limited long-term significance. While the establishment of a specific valuation period could enhance consistency and comparability between plans, we recognize that state and local governments may have specific rationales for the valuation period chosen and that any requirements to convert to a mandatory valuation period could be to the detriment of both policy objectives and to the overall provision of pension-related information on a timely basis. Our preference, therefore, is for the selected valuation period of pension plan assets to be fully described in the notes to the financial statements. We also note that comparability, as it relates to the valuation period, is to an extent already achieved given that the majority of government debt issuers are already utilizing the previously mentioned three to five year smoothing cycle.

Question 12: Cost-Sharing Plans – This question solicits opinions regarding the adequacy of existing accounting and financial reporting requirements for governments participating in cost-sharing multiple employer pension plans. We encourage state and local debt issuers that participate in such plans to disclose where to access a copy of the plan financial report for further information; our view is that the information contained in these reports generally provides an adequate level of detail for interested parties to make an informed opinion regarding the funding progress of the plan and the adequacy of employer contributions. Given that the majority of employers that participate in cost-sharing plans tend to be relatively small in size, we feel that imposing any further disclosure requirements on these entities could potentially have the unintended consequence of delaying their provision of financial information to the markets on a timely basis, therefore hindering (instead of advancing) current disclosure initiatives.

Questions 13, 14, and 15: Presentation of Liabilities of the Plan and Changes in the Unfunded Accrued Benefit Obligation – In response to these questions, we reiterate our general observation that we are more concerned with the availability of clear, comparable information on expected pension liabilities and costs than with the attempt to capture a single measure of the liability on the balance sheet or of the annual cost on the statement of operations. A statement of changes in the unfunded accrued benefit obligation as currently required under notes to RSI is a useful component to overall reporting requirements and an adequate vehicle for describing this consideration. Additionally, we would welcome amendments to current requirements that provide for even more detailed notes about the effects of such changes, the reasons for the changes, and the portion of the overall change attributable to each reason.

Conclusion

The NFMA recognizes the ITC process as an effective tool by which interested participants can offer feedback that can be used as GASB formulates future accounting and financial reporting requirements. We thank you for the opportunity to provide our thoughts on the topic of pension accounting and would be happy to elaborate further on our views in follow-up communication as needed. Public pension liabilities are an important consideration to municipal credit analysis and

we look forward to working with GASB in the future towards the objective of identifying best practices for reporting requirements in this area.

Sincerely,

Lisa S. Good
Executive Director, NFMA