REPOSTED October 2, 2012

Cypen & Cypen NEWSLETTER for NOVEMBER 17, 2011

ACTUARY BLASTS COLLINS REPORT

We recently did a brief review of "Report Card: Florida Municipal Pension Plans" from Leroy Collins Institute (see C&C Newsletter for November 10, 2011, Item 2). Foster & Foster, actuary for public plans in the State of Florida, felt compelled to issue a public response to the report because it was so off the mark. The report begins by stating that it focuses on two critical measurements of municipal pension funds' sustainability -- funding levels and costs. The report then assigns letter grades to funds based upon funding levels and cost per active plan member. Unfortunately, the Institute does not understand how funding levels are calculated or what makes a plan sustainable. Furthermore, it is borderline irresponsible to label a pension as passing or failing based upon those two measurements. *Contrary to what the Institute may imply, sustainability of a pension plan has very little to do with the funding level or absolute cost.* Sustainability of a pension plan has far more to do with the sponsor's ability to continue making the annual payment each year. If the sponsor is flush with cash, funding level or cost per member does not matter. Likewise, a plan could have a funded ratio of 100% and a relatively small annual payment, but if the sponsor's tax revenues will not support the payment, the plan's sustainability may be in question. The report erroneously describes how an actuary determines funded ratio. Funded ratio is calculated by dividing the Actuarial Value of Assets (which the report has also misrepresented) by the Actuarial Accrued Liability. Actuarial Accrued Liability is not the present value of projected future payments. It is a description of liability that is developed in accordance with one of a few acceptable actuarial cost methods. Depending upon which actuarial cost method is employed, different answers are developed. *For example, a plan given an "F" grade could be given an "A" grade if a different method was used.* Not every public plan uses the same cost method. Assigning letter grades to a subjective, non-uniform measure is dangerous, and reflects a material misunderstanding of the actuarial information. The report also attempts to refute the "mortgage analogy," but does so erroneously. The portion of the sponsor's contribution each year is made systematically to improve the funded ratio, and many pension boards have made the decision to increase the size of payments so that funding levels increase at a faster rate than what is statutorily required. Further, funded ratio is dependent upon actuarial cost method used, and is not a fair reflection of the percentage of earned benefits covered by current assets. In fact, it is possible that the plan with the 75% funded ratio could cover 100% of liabilities that have been accrued to date based upon current levels of compensation and service. And, yes, a plan that has a 75% funded ratio could easily be 100% funded on a plan termination basis. Besides being largely dependent upon the actuarial cost method chosen, much like a mortgage, it is also dependent upon age of the plan. Some of Florida's municipal pension plans have not been around as long as others, and, thus, it is unfair to compare the plans to one another. In addition, many municipalities have deliberately lowered their funded ratios in order to serve an alternative purpose.

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(For example, some cities have implemented Early Retirement Incentive programs to provide increased pensions to employees in return for immediate retirements. Although the tactic lowers funded ratios and increases pension costs per member, it saves the cities millions of dollars in annual cash outlays and prevents citywide layoffs.) The report makes the bold, unsupported statement that full market recovery should not be expected fundamentally to improve condition of the lower-rated plans. In truth, if the actuarial assumptions are met prospectively, those plans will see dramatic declines in funding requirements ten years from now. Foster & Foster consults in other states, and says the Florida public pension system is far better than anywhere else. First, plans are administered by an independent Board of Trustees. Second, sponsors are required to contribute at least the minimum required contribution set by the actuary, as approved by the Board, developed in accordance with the Actuarial Standards of Practice and reviewed by actuaries at the Florida Division of Retirement. Last, the system itself is very sustainable, and has adequate checks and balances. Costs of these plans has risen over the last decade due to the poor investment performance, not because of any mismanagement. Last year's Senate Bill 1128 requires the Florida Division of Retirement develop a more comprehensive evaluation of public plans. Plans will be evaluated based upon a laundry list of different criteria, as opposed to just two. Meanwhile, we should shift our focus away from the subjective actuarial criteria for purposes of evaluating plans, and focus rather on benefits and associated costs of providing lifetime benefits for public servants. If costs have risen to unsustainable levels when compared to the overall operating budget [which, in our judgment, is extremely rare], then all parties should work together to find ways to bring costs in line. Until then, the plans will take care of themselves. Very well said.