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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Funding Of State And Local Government Pension Plans: A National Problem

Many State and local government pension plans are not funded on a sound actuarial basis because they are not setting aside sufficient funds to provide for estimated future benefits. Billions of dollars in unfunded liabilities have accumulated, and unless remedial steps are taken, these liabilities will increase.

GAO reviewed 72 State and local government pension plans. Of these, 53 did not receive large enough contributions to satisfy the funding standard imposed on private plans by the Employee Retirement Income Security Act of 1974. To meet the standard of the act, which specifically excluded State and local government plans pending further study, many of the plans would have to increase annual contributions by more than 100 percent.

Sound funding of the plans is a national problem which may eventually require congressional action. The Congress should closely monitor actions taken by State and local governments to improve their plan funding to determine whether congressional action may be necessary and, if so, at what point.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

In this report on the funding of State and local government pension plans, we describe the magnitude of unfunded accrued liabilities, actions or lack of actions being taken to fund the plans on a sound actuarial basis, and the fiscal impact of requiring actuarial funding on State and local governments. The report also considers the impact financing the liabilities will have on Federal grant programs. We believe the information presented will help State and local government chief executives, plan officials, and citizens to fulfill their responsibilities regarding public pension plans.

We are sending copies of this report to the Governor of each State; the Director, Office of Management and Budget; and the Executive Director, President's Commission on Pension Policy.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FUNDING OF STATE AND LOCAL GOVERNMENT PENSION PLANS: A NATIONAL PROBLEM

D I G E S T

The Congress is considering establishing Federal standards for State and local government pension plans similar to those imposed on private plans by the Employee Retirement Income Security Act of 1974.

GAO made this review to ascertain the impact that establishing Federal funding standards would have on State and local governments and on the Federal Government, which makes significant contributions to the plans through Federal grants. In analyzing the potential impact, GAO used the criteria set forth in the 1974 act governing private pension plans.

The act generally provides that the minimum standard for pension funding by private employers be an annual contribution for normal (current) costs plus the amount needed to amortize (to pay off) current unfunded liabilities in 40 equal annual installments.

Public pensions are becoming a large financial burden on State and local governments, and that burden will increase in the future. Many jurisdictions do not systematically fund retirement benefits accruing to their employees.

GAO reviewed the funding of 72 pension plans administered by 8 States and 26 local governments within those States. Total annual government contributions to these plans amounted to $2.4 billion. (See p. 6.)

The 72 plans reviewed had accumulated unfunded actuarial liabilities of about $29 billion. Eleven State and 42 local government systems were not receiving

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large enough contributions to satisfy funding standards of the 1974 act. (See pp. 6 and 8.)

Adopting a funding standard similar to that required by the act would require many of these governments to raise their contributions by more than 100 percent, and a few by more than 400 percent. (See p. 8.)

Pension plan funding to the act standard would have a serious initial impact on some jurisdictions. But doing nothing will eventually have an even more serious impact.

For instance, GAO made a 40-year projection of pension contributions for three plans on a pay-as-you-go basis. The projection showed that pay-as-you-go contributions will exceed actuarially determined contributions (contributions based on estimated future needs) for two of the plans in 17 years and for the other plan in 39 years. (See pp. 13 to 16.)

During the years the plans are on a pay-as-you-go basis, their unfunded liabilities will continue to grow. At the end of the amortization period of 40 years required for private plans, their unfunded liabilities will more than triple and yearly pay-as-you-go contributions will increase several fold. (See p. 34.)

Many governments believe they cannot afford actuarial pension funding. Voter resistance to tax increases could be an obstacle. Proposition 13 in California drastically cut back on limited tax sources for pension financing, and similar resistance is expected in other States. (See pp. 8 and 22 to 25.)

A number of State and local governments have begun to tackle pension funding with actions ranging from attempts to identify the problem to adopting and implementing measures to solve it. Other jurisdictions, however, have taken no steps to start funding their plans on a sound actuarial basis. (See pp. 12 and 13, 20 to 22, 24 and 25.)

In Illinois, pension laws require actuarial funding of State pension plans, but these plans are not funded on a full actuarial reserve basis. In Massachusetts, a change in pension laws allows local governments to voluntarily amortize unfunded liabilities, but only a few small and affluent cities and towns have set up pension reserve funds. (See pp. 21 and 22, 24 and 25.)

Some local government officials believe it is the State governments' responsibility to bear the cost of any reforms they mandate. These officials believe that, if States write pension laws and control and regulate pension plans, they should also pay for reforms. (See pp. 9, 23, and 24.)

FEDERAL REGULATION OF PUBLIC PENSION PLANS

The Supreme Court's decision in National League of Cities v. Usery (426 U.S. 833) (1976) has raised a real but unresolved constitutional question about whether the Federal Government has the authority to impose funding standards on State and local government pension plans under the Commerce Clause of the U.S. Constitution. The practicality of using Federal spending and taxing authority also has not been resolved. (See pp. 30 to 32.)

A 1978 report of the Pension Task Force of the House of Representatives concluded that, although a number of Federal constitutional and statutory provisions significantly affect public pension plans, the effects are not clear. According to the Task Force, the protection such provisions offer to plan participants has been sharply limited by inconsistent interpretation and enforcement. (See p. 30.)

Grant programs involve the Federal Government in State and local government pension plans. GAO estimates that about $1 billion in plan contributions is being reimbursed yearly to State and local governments under Federal grant programs. This amount would increase considerably if the State and local governments were required to adhere to the funding standards of private plans. (See p. 33.)

CONCLUSIONS

Pension reform at the State and local levels is moving slowly, and the prospects for significant improvement in the foreseeable future are not bright.

It is clear that, to protect the pension benefits earned by public employees and to avert fiscal disaster, State and local governments should fund the normal or current cost of their pension plans on an annual basis and amortize the plans' unfunded liabilities. (See p. 35.)

Although sponsoring governments are responsible for sound funding of State and local government plans, the Federal Government has a substantial interest in these pension plans. Many jurisdictions have increasingly relied on Federal grant funds and revenue sharing to help meet pension plan costs. These plans directly affect the continued well-being and security of millions of State and local government employees and their dependents.

It might be in the national interest for the Congress to assure, through legislation, the long-term financial stability of these pension plans through sound funding standards. But the Federal Government's authority to regulate State and local government plans has not been resolved. (See pp. 35 and 36.)

RECOMMENDATION TO THE CONGRESS

The Congress should closely monitor actions taken by State and local governments to improve the funding of their pension plans to determine whether and at what point congressional action may be necessary in the national interest to prevent fiscal disaster and to protect the rights of employees and their dependents. (See p. 36.)

COMMENTS OF STATE AND LOCAL GOVERNMENTS, FEDERAL AGENCIES, AND OTHER INTERESTED PARTIES

The consensus among those who commented on our report was that adequately funding public pension plans is a serious problem; however, there is no clear agreement on what the solution should be. Many believe that any funding standard for public plans should be less demanding than the standard imposed on private plans. The percent-of-payroll approach (see p. 16) to pension funding was the one favored by many officials.

There was general opposition to Federal involvement in establishing a funding standard for State and local government pension plans. Most officials argue that the Federal Government has not dealt adequately with its own pension funding problems, as evidenced by the poorly funded Social Security system and the pension plans for Federal personnel. (See pp. 36 and 37.)

Contents

ABBREVIATIONS

ERISA	Employment Retirement Income Security Act of 1974
GAO	General Accounting Office

CHAPTER 1

INTRODUCTION

State and local government pension plans are excluded from the major provisions of the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1001). This act protects the pension rights of employees participating in private plans. It prescribes standards for plan participation, vesting, funding, fiduciary duties, and disclosure reporting and provides mechanisms to enforce these standards and to ensure that employees receive certain of their pension benefits.

The Congress excluded governmental retirement systems from the major provisions of ERISA pending further study of the need for Federal regulation of governmental plans. The act required certain congressional committees to study governmental pension plans, analyzing (1) the adequacy of existing levels of participation, vesting, and financing arrangements, (2) existing fiduciary standards, and (3) the need for Federal legislation and standards regarding such plans.

In determining whether plans were adequately financed, the committees were to consider (1) the need for minimum funding standards and (2) the taxing power of the government maintaining the plan. The committees were to submit to the Congress their study results and recommendations.

In March 1978, in accordance with the ERISA mandate, the Pension Task Force of the House of Representatives issued a report to the Congress. That report points out a compelling need for revised and expanded Federal standards for public pension plans. It predicted serious consequences unless immediate steps were taken to remedy deficiencies in the public pension systems.

This report provides added information for the Congress to consider. It discusses the potential financial impact on selected State and local governments and describes actions certain jurisdictions have taken toward pension reform, obstacles to reform, and the extent of Federal authority to regulate State and local government pension plans. It also discusses the potential consequences if pension funding reform action is not taken.

STATE AND LOCAL GOVERNMENT PENSION PLANS

In recent years, as government services have proliferated, the labor-intensive nature of services has resulted in State and local government employment growing more rapidly than employment in the Federal Government and the private sector. According to a 1978 study by the Committee for Economic Development:

> "* * * the preponderance of government administration (about 80 percent of nondefense purchases of goods and services) takes place at the state and local levels. That heavy weight of administrative responsibility is reflected in employment figures: The federal civilian workforce was 2.7 million in 1977; whereas the state-local workforce was more than 12 million, or more than four times as great."

Membership in State and local government pension plans has grown even more rapidly than employment. In 1972, 98 percent of full-time State and local government employees belonged to pension plans. 1/ Thus, most of the 12 million employees expect to draw pensions in future years.

In 1975, there were 6,630 State and local government retirement systems covering about 12.7 million active and retired employees. Pension fund investments amounted to over $108 billion in 1975 and were growing by 13 percent a year. Benefit payments were $7.3 billion and were increasing at an annual rate of 15 percent. State and local governments contributed about $10 billion to these plans in 1975, and their employees paid in another $5 billion.

State and local government pension plans are created through the legislative process; State or local laws establish the plan and prescribe the terms. An independent board of trustees usually is responsible for administering the plan. Often State law mandates pension plans for local governments and prescribes the details, including the funding method. State law also may specify sources of financing and limit the contributions of local governments to their pension funds.

1/David J. Ott, Attiat F. Ott, et al., "State-Local Finances in the Last Half of the 1970s," American Enterprise Institute for Public Policy Research, Washington, D.C., April 1975, p. 58.

PROPOSALS TO REGULATE STATE AND LOCAL GOVERNMENT PENSION PLANS

Since 1975, bills have been introduced in the Congress to reform State and local government pension plans. These bills have been primarily intended to protect benefit rights of plan participants. The first, House Bill 9155, the "Public Service Employee Retirement Income Security Act of 1975," was introduced in July 1975. It had requirements similar to those imposed on private pension plans by title I of ERISA, including funding requirements that were the same as those placed on private employers. 1/ The provisions included:

--Reporting and disclosure requirements.

--Participation and vesting standards.

--Funding standards.

--Fiduciary requirements.

--Administration and enforcement requirements.

A similar bill was introduced in September 1978: House Bill 14138, the "Public Employee Retirement Income Security Act of 1978." This bill was not as comprehensive as the earlier bill and did not include funding standards. Federal regulation of public pensions continues to be a matter of congressional concern, and similar bills will be introduced in the 96th Congress.

UNFUNDED ACCRUED LIABILITIES OF PUBLIC PENSION PLANS

The unfunded accrued liability of a pension plan is a much misunderstood actuarial term that is essential to a discussion of financing pensions. The accrued liability

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1/Under ERISA, private employers are required to fund on an annual basis the normal or current cost of a pension plan. In addition, these employers are required to fund on an equal annual installment basis the unfunded accrued liability of a plan. The installments, which include principal and interest, are to be made over a 30- or 40-year amortization period, depending on the type of plan and the date it was established.

is the excess of the present value 1/ of all benefits for the present members, active and retired (and their beneficiaries), and administrative expenses over the present value of all future normal cost 2/ contributions assigned by the actuarial method in use. The unfunded accrued liability is the excess of the accrued liability over the value of the pension plan assets. The Pension Task Force estimated the unfunded accrued liabilities of all State and local government pension plans to be from $150 billion to $175 billion in 1975, and these liabilities have grown since then.

The significance of the unfunded accrued liability bears some discussion. Almost all public and private pension plans have unfunded accrued liabilities and will continue to have such liabilities for many years. The central issue is whether a commitment exists to accumulate assets equal to the accrued liability in an attempt to eliminate this liability.

An unfunded accrued liability may arise initially when a pension plan is established and pension rights are given to members for service before the plan was established. An unfunded accrued liability may arise after a plan is established if it is amended to increase benefits. If no credit were given for prior service, if enough were paid into the pension fund each year to cover the normal cost as determined by the plan actuary, and if the actuarial experience coincided with the assumptions, the pension plan would have no unfunded accrued liability.

The amount of unfunded accrued liability depends partly on the method used by the actuary. Some actuarial methods do not compute an unfunded accrued liability. If contributions are made equal to the normal cost plus interest on the unfunded accrued liability and the actuarial assumptions are realized, the unfunded accrued liability will remain unchanged. The major problem posed to State and local governments by a Federal funding standard would be: how much more

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1/"Present value" is a concept that recognizes the time value of money. It is used to determine the amount of money which, if invested today at a given interest rate, would be sufficient to provide periodic benefits in the future.

2/"Normal cost" is the annual cost assigned, under the actuarial cost method in use, to years following a particular valuation date.

would they have to pay each year during the amortization period to finance the unfunded accrued liability? 1/

METHODS OF MEETING PENSION COSTS

The first step in establishing or evaluating a pension plan is to commission an actuarial valuation. In estimating future pension costs, the actuary makes assumptions about future experience, such as yield from investments, retirement rates, death rates, disability rates, termination rates, and rates of salary increase. Later valuations may compare the actuarial assumptions with actual experience under the plan. Differences between actual and expected experience give rise to "actuarial gains and losses."

The plans we reviewed generally used a form of actuarial funding known as entry age normal, in which contributions consisted of normal cost plus a payment--either as a uniform dollar amount each year or a uniform percentage of payroll--to amortize an unfunded accrued liability. Under this funding method the actuary calculates a level cost based on each employee's entry age and projected retirement age. There are several other acceptable actuarial methods, but the entry age normal method fits in well with the budgetary ideal of level pension contributions, whether expressed as a level amount per year or a level percentage of payroll.

In the parlance of pension funding, "pay-as-you-go" means recognizing pension costs only when benefits are paid to retired employees or other beneficiaries. Public pension plans on a pay-as-you-go basis typically meet the employer's pension costs through appropriations from general tax revenues and from taxes earmarked for pensions. Pay-as-you-go, or nonfunding, is the opposite of actuarial funding.

1/The Secretary of Pennsylvania's State Employees' Retirement System believes that some distinction should be made between unfunded liabilities which arise as a result of deliberate plan changes and those which arise from faulty or outdated actuarial assumptions. The latter type is much more insidious than the former in that, even if a point in time liability is calculated and a theoretically correct funding schedule adhered to, the liability may continue to increase with each valuation because of unfavorable experience. (See app. XXIII.)

SCOPE OF REVIEW

Our review covered the funding of 72 pension plans administered by 8 States and 26 local governments within those States. The plans examined cover about 1.4 million active members and pay pensions to about 425,000 retirees or beneficiaries. The 72 retirement systems had assets valued at $18.3 billion and unfunded liabilities of about $29 billion. (See app. I for a complete list of governments and plans covered.) The governments contributed $2.4 billion to the plans during the financial year selected for review. Based on nationwide data collected by the Pension Task Force, the plans we examined covered about

--14 percent of active and retired employees,

--17 percent of plan assets,

--17 percent of estimated unfunded liabilities ($175 billion), and

--24 percent of the total contributions made by State and local governments.

The States selected--California, Delaware, Florida, Illinois, Massachusetts, Oklahoma, Pennsylvania, and Wisconsin--included different parts of the Nation and different approaches to pension funding. In each State we reviewed the pension plans of selected local governments with large, medium, and small populations. Generally, we examined at least one plan administered by the State government and all of the plans under the selected local governments.

Our review was directed toward including a broad spectrum of pension activity at the State and local government levels within the context of our objective of determining the potential financial impact of pension funding reform. The selection of pension plans was judgmental and, thus, does not purport to be representative of all existing plans.

State plans

Seventeen of the plans in our review covered State employees, elected officials, judges, and teachers. Annual employer contributions for these plans ranged from $436 million for the State teachers' plan in California to $82,000 for the judiciary plan in Delaware. As a percentage of payroll, employer contributions ranged from 32.4 percent for the Delaware State Police plan to 6.7 percent for the Illinois State employees' plan.

Local government plans

Fifty-five of the plans in our review covered local government police, firefighters, and nonuniformed employees. Annual employer contributions for these plans ranged from $89.8 million for the new pension plan 1/ for the firefighters and police officers of the city of Los Angeles, California, to $24,000 for the firemen's relief and pension fund of Wagoner, Oklahoma. As a percentage of payroll, employer contributions ranged from 420.9 percent for the old plan 1/ for the firefighters and police officers of Los Angeles to 3.4 percent for the plan for municipal employees of Enid, Oklahoma.

Generally, for the 34 government entities in our review, we used the actuarial studies and financial data for the most recently completed fiscal year. The studies and data were for fiscal years ended in 1977 for 28 of the entities, in 1976 for 5 entities, and 1978 for 1 entity. In the few places where actuarial studies for the pension plan were not available, our actuaries estimated the unfunded accrued liabilities. For most plans we obtained the three most recent actuarial studies, made a cursory evaluation, and found that they were generally prepared in accordance with recognized actuarial procedures. However, these procedures do not necessarily comply with those required of private plans under ERISA.

1/The Los Angeles Fire and Police Pension System consists of an old and a new plan. The old plan resulted from a city charter change on January 29, 1923. The new plan was established on January 29, 1967, as a result of a voter-approved charter change. Membership in the new plan is mandatory for firefighters and police hired after the plan was established. Most old plan members joined the new plan for its increased benefits. As of June 30, 1977, the old plan had only 257 active members, and the new plan, 9,972.

CHAPTER 2

SOUND FUNDING OF STATE AND LOCAL GOVERNMENT

PENSION PLANS CAN BE A FISCAL PROBLEM

State and local officials are generally aware of the need for sound actuarial funding of pension systems, but they view with apprehension the financial impact of imposing ERISA-type funding standards on public pensions. An ERISA-type minimum funding standard for public pensions would require an annual contribution to cover the normal (current) costs plus the amount needed to amortize the existing unfunded liabilities over a specified future period. For private pension plans, ERISA requires the amortization in 40 equal annual installments for existing plans and in 30 equal annual installments for new plans.

FINANCIAL IMPACT OF FUNDING UNDER ERISA-TYPE STANDARDS

State and local government officials expressed concern that meeting ERISA-type funding standards would be too expensive in relation to their governments' revenues. In jurisdictions where the added costs of pensions under an ERISA-type standard would be most burdensome, officials did not believe that taxes could be raised to pay for them. Some predicted that the money would have to come from a cutback of personnel and services or an increase in employee contributions for pensions.

Of the 72 State and local pension plans we reviewed, 19 met the ERISA minimum funding standard for private pension plans. The other 53 plans were not receiving large enough contributions to satisfy the ERISA funding standard. The 53 pension plans--11 State and 42 local government systems--accounted for $1.8 billion of the $2.4 billion total annual government contributions to the plans for the year we reviewed. Adopting an ERISA-type funding standard would have required $1.4 billion in additional moneys from these governments. Many of them would have to raise their contributions to some of their plans by more than 100 percent, and a few would have to raise contributions by more than 400 percent.

Appendix II shows, for all the jurisdictions we visited, the potential effects of applying the minimum funding standard under ERISA. The table gives the added immediate pension expenditure in dollars and as a percentage of (1) tax revenues and (2) current contributions.

The costs under ERISA, in addition to existing pension costs, would require the equivalent of from 0.3 to 49 percent more of the tax revenues of the affected jurisdictions. 1/ For example, to meet the ERISA funding standard, the Enid, Oklahoma, pension plans would require an amount equal to 65 percent of the city's tax revenues, compared with the 16 percent now going for pension costs. 2/ In Pittsburgh, Pennsylvania, pension costs under ERISA would require about 33 percent of tax revenues, compared with the 13 percent now going for retirement systems. According to a Pittsburgh official, funding of the city's pension plans up to the ERISA standard could lead to bankruptcy. In Reading, Pennsylvania, pension funding under ERISA would take an amount equal to about 40 percent of taxes, compared with 15 percent currently. A Reading city official believed that the citizens would resist any tax increase for pension funding. Clearly, added pension costs to meet an ERISA-type amortization standard would be a devastating drain on the incomes of some jurisdictions.

MANY PLANS ARE NOT ACTUARIALLY FUNDED

About 56 percent (40 plans) of the 72 pension plans in our review were not actuarially funded--for 24 percent (17 plans) pay-as-you-go funding was used, and for 32 percent (23 plans) employers were not contributing enough to amortize or contain the growth of unfunded liabilities.

Even though most plans reviewed were partially funded, the failure to actuarially fund pension plans not only causes unfunded liabilities to grow, but also creates other fiscal problems for the sponsoring governments. An example of such a problem was the June 1978 revision of the rating of Wilmington, Delaware, general obligation bonds from

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1/Many local fire and police pensions are partially paid from earmarked State taxes on insurance premiums, so they do not depend entirely on local taxes.

2/Enid officials informed us that any additional cost related to funding its police and fire pension plans would have to be borne by the State. These plans are authorized by State statute and are controlled and regulated by the State. The city's contribution to these plans is limited by the State to 10 percent of gross salaries. At the time of our review, the city was contributing 6.05 percent of gross salaries to the police pension plan and 4 percent to the fire plan.

A-1 to A by Moody's Investors Service. Moody's lowered the rating because the city's tax base had grown little over the previous decade, the city had an excessive debt in relation to full valuation, and the city failed to establish full funding of its pension system. The city's pension system is on a pay-as-you-go basis and, as of July 1, 1976, had unfunded liabilities of $59.4 million.

A comprehensive, systematic method of funding pensions based on actuarial valuations has three main advantages: (1) the jurisdiction avoids unanticipated future financial strain to fund pension costs, (2) the jurisdiction treats accruing pension costs as payroll costs to be met currently, thus fostering equity among generations and providing a basis for keeping benefits at an affordable level, and (3) the contributions build up assets for investment.

The investment earnings of a pension plan help to meet pension obligations and thus may eliminate the need to continue or increase future taxes or increase employee contributions. For example, in 1976 the Wisconsin Retirement Fund earned $70 million from its investments compared to $47 million it paid out in benefits. It should be recognized, however, that excess of income over benefits in all cases is not necessarily an indication of financial strength since a weakly funded new plan might exhibit this condition.

The Pension Task Force estimated that about 42 percent of the defined benefit plans 1/ in the public sector are funded in ways not related to their accrued pension liabilities: they use the pay-as-you-go method (17 percent) or some other nonactuarial method (25 percent) (for example, matching of employee contributions or earmarked tax revenues).

The effect on the unfunded liability of pay-as-you-go funding is illustrated by the following examples:

--In Massachusetts, between 1974 and 1976, the unfunded liability for the State employees' retirement system grew by $200 million--from $1.4 billion to $1.6 billion.

1/Eighty-two percent of the covered employees of State and local governments are members of defined benefit plans. Defined benefit plans provide definitely determinable benefits to participants based on such factors as years of employment and compensation received.

--In Boston, between 1974 and 1976, the unfunded liability for the city's retirement system grew by $39 million--from $1.113 billion to $1.152 billion.

--In Delaware, between 1971 and 1976, the unfunded liability for the State police pension plan more than doubled--from $38 million to $80 million.

The California State Teachers' Retirement System is a plan for which employer contributions set by statute are not enough to amortize the unfunded accrued liability. The law requires the employer's contribution to match employees' contributions, but because the combined amount is not enough to cover even the normal costs, the plan's unfunded liability continues to escalate. It was calculated at $7.6 billion in 1975 and had grown to $8.6 billion by 1977.

Chicago's yearly contribution to the Municipal Employees' Pension Fund is limited by statute to a multiple of the employees' contributions. The city levies a tax to pay its share. Between 1970 and 1976, the yearly multiples went from 1.20 to 1.56, but the unfunded liability for this plan almost doubled, from $261.1 million to $506.1 million.

No funding provision for costs of improved benefits

Unfunded liabilities can climb if pension benefits are raised and made retroactive. The cost-of-living adjustment of pensions is a benefit change that has become particularly important and costly because of inflation. The experiences of the cities of Los Angeles, California, and St. Petersburg, Florida, illustrate the fiscal effects of some cost-of-living benefits.

An amendment to the Los Angeles city charter, effective July 1, 1971, removed the previous 2-percent ceiling on annual cost-of-living allowances under the pension system for firefighters and police officers. Since then, this plan has provided an automatic annual increase of pensions to match the previous year's change in the Consumer Price Index. This liberalization caused a substantial increase in the unfunded liability. During the 3-year period from 1975 to 1977, the unfunded liability increased by about $700 million--from about $1.2 billion to about $1.9 billion. Of this amount over 70 percent (about $500 million) resulted from cost-of-living increases.

The St. Petersburg City Council, in July 1977, approved annual cost-of-living increases up to 2 percent for members of the General Employees' Retirement System. All current retirees received this benefit retroactive to their time of retirement. This retroactive application was the primary cause of an increase in the pension plan's unfunded liability from $1.2 million to $5.1 million between July 1976 and October 1977. However, contributions to this plan meet the ERISA standards. The city manager advised us that funding for the cost-of-living increases was developed in coordination with actuarial recommendations. He does not believe that the cost-of-living increases will become a detrimental cost burden. (See app. XIII.)

NEED FOR SYSTEMATIC FUNDING OF PENSIONS

Funding of public pension benefits has aroused widespread interest and controversy in recent years. Much has been written on the subject. Many persons concerned with the issue agree that sound funding of public pensions is needed, but they disagree as to what constitutes sound funding.

Most public pension plans have unfunded liabilities, so the debate has turned on whether and how to fund these liabilities. Some persons believe that no money need be set aside before pension benefits are due (pay-as-you-go), and others, such as the administrators for the California Legislators Retirement System, have recommended full funding. This plan, established in 1947, had an unfunded liability in 1976 of about $29 million. In that year the liability was eliminated by an appropriation by the California Legislature.

The consensus, however, is that some kind of actuarial funding is needed to either contain or diminish the growth of the unfunded liability, or to amortize it. The Illinois Public Employees Pension Laws Commission recommended, as a minimum, paying the normal cost plus interest on the unfunded liability. This approach also was recommended for local governments by the Pennsylvania Secretary for Community Affairs as a way to keep liabilities from growing.

The Massachusetts League of Cities and Towns, in May 1978, opposed funding unfunded liabilities over any set period. Recognizing that pay-as-you-go financing of public pensions in Massachusetts is weak because it depends on local property taxes, the League wants to build up a fund by paying the greater of annual benefit payments or normal cost. The yearly amount would be determined every 3 years to control pension payments. In contrast, the Massachusetts Retirement

Law Commission--a State body--recommended annual payment of normal cost plus an amount to amortize the unfunded liability over 40 years.

The California Taxpayers' Association believes that all retirement plans should amortize liabilities in 30 years, on the grounds that failure to fund benefits leads to the granting of too-generous pensions and shifts the costs to future generations.

Defenders of the pay-as-you-go method contend that the employer governments will not go out of existence and that the unlimited taxing power of the States can guarantee payment of obligations. Critics of the method fear that pensioners could lose their pension benefits if the employer government were to run into financial difficulties.

Systematic funding helps avert fiscal disaster

The many local retirement systems that are not actuarially funded threaten cities with severe future financial difficulties, which in turn could affect State governments. The actuarially unsound condition of these pension plans has earned them the label "financial time bombs." A systematic funding plan for amortizing the unfunded liability over a specified period could help avert fiscal disaster for a number of State and local governments.

To illustrate the need for systematic long-term funding, we selected three pension plans now on a pay-as-you-go basis and projected their pension costs for 41 years, both under the pay-as-you-go method and under actuarial funding as prescribed by ERISA. The plans selected were the State-Boston Retirement System in Boston, the Policemen's Relief and Pension Fund in Pittsburgh, and the Delaware State Police Pension Plan.

The projections for all three plans show that annual costs for pay-as-you-go funding are less than those for actuarial funding until they eventually become equal (crossover point) and pay-as-you-go costs begin to exceed the costs of actuarial funding. Under actuarial funding, after 40 years the initial unfunded liability will have been completely amortized, so the annual contribution will drop to the amount needed to cover normal costs. Under pay-as-you-go funding, on the other hand, after 40 years the unfunded liability will have grown to enormous proportions, and the annual payout will continue to increase.

State-Boston Retirement System

This retirement system covers employees of the city of Boston and Suffolk County, Massachusetts. In addition, it pays the retirement allowance of retired Boston teachers, which is then reimbursed by the State Teachers Retirement Board. A January 1, 1976, actuarial valuation for this pay-as-you-go system calculated an unfunded liability of $1,152,200,000.

Shown below are the results of our comparative projection of pension costs on a pay-as-you-go basis and on an actuarial basis, assuming amortization of the January 1, 1976, unfunded liability over 40 years on a level dollar basis. For this plan, the yearly pay-as-you-go contribution will exceed the actuarial contribution by the 17th year of the amortization period.

	Contribution basis	
	Pay-as-you-go	Actuarial
	(000 omitted)	
January 1, 1976, unfunded liability	$1,152,000	$1,152,000
Contribution:		
First year of 40-year amortization period	64,788	128,592
At 17th year (crossover point)	168,894	166,529
At 41st year	490,098	215,827
Unfunded liability:		
At 17th year (crossover point)	2,260,460	988,651
At 41st year	3,543,910	0

As shown above, we estimate that after 40 years under the pay-as-you-go basis, the unfunded liability will more than triple--from $1,152,000,000 to $3,543,910,000. At that point, it would require a $497,215,000 yearly payment to start amortizing over 40 years the unfunded liability and pay the normal cost. This amount is about four times the amount needed to start amortizing the January 1, 1976, unfunded liability.

Pittsburgh Policemen's Relief and Pension Fund

This plan covers all employees of the Bureau of Police in Pittsburgh. A June 30, 1977, actuarial valuation for this pay-as-you-go plan calculated an unfunded liability of $133,290,000.

Our comparative projection of pension costs for this plan on a pay-as-you-go basis and on an actuarial basis (assuming a 40-year amortization period) shows that the pay-as-you-go yearly contributions will exceed the actuarial contributions in the 39th year of the amortization period.

	Contribution basis	
	Pay-as-you-go	Actuarial
	(000 omitted)	
June 30, 1977, unfunded liability	$133,290	$133,290
Contribution:		
First year of 40-year amortization period	3,920	13,005
At 39th year (crossover point)	24,442	24,181
At 41st year	25,659	16,414
Unfunded liability:		
At 39th year (crossover point)	769,286	8,357
At 41st year	805,712	0

As shown above, we estimate that, after 40 years under the pay-as-you-go basis, the unfunded liability will increase by more than six times--from $133,290,000 to $805,712,000. To start amortizing the unfunded liability at that time over a 40-year period and to pay the normal cost would require a yearly payment of $69,963,000, an amount about five times that needed to start amortizing the June 30, 1977, unfunded liability.

Delaware State Police Pension Plan

This plan covers all uniformed members of the Delaware State Police. A September 30, 1976, actuarial valuation calculated an unfunded liability of $80,435,500 for this pay-as-you-go plan.

Our projection of pension costs for this plan shows that pay-as-you-go yearly contributions will exceed actuarial contributions by the 17th year, assuming a 40-year amortization period.

	Contribution basis	
	Pay-as-you-go	Actuarial
	(000 omitted)	
September 30, 1976, unfunded liability	$ 80,435	$80,435
Contribution:		
First year of 40-year amortization period	2,402	8,744
At 17th year (crossover point)	12,954	12,763
At 41st year	39,795	23,922
Unfunded liability:		
At 17th year (crossover point)	181,297	65,772
At 41st year	286,122	0

On the pay-as-you-go basis, the unfunded liability is projected to increase after 40 years by about 3-1/2 times--from $80,435,000 to $286,122,000. Amortization of the increased liability over a 40-year period and the payment of normal cost would require a yearly payment of $42,938,000, an amount almost five times greater than the amount required to start amortizing the September 30, 1976, unfunded liability.

CURRENT APPROACHES TO FUNDING PENSIONS

Of the 72 pension plans we reviewed, only 2 were fully funded, meaning they had no unfunded liabilities. Eight others were amortizing their unfunded liabilities in 40 or fewer equal (level dollar) annual payments, the method that yields contributions that conform to the ERISA funding requirements for plans in existence at the time ERISA became effective.

Nineteen other actuarially funded plans were using the method called level percent of payroll--a method that provides a constantly increasing dollar amount in contributions if the payroll is increasing to amortize the unfunded liability over a specified period. Advocates of this method argue that, in an inflationary or dynamic economy, these increasing monetary amounts provide amortization payments of approximately equal real value after consideration for inflation. The level-percent-of-payroll method appeals to a jurisdiction contemplating systematic funding of its pension plans because payments in the early years are smaller than under the level-dollar approach to amortization. One jurisdiction--to further reduce initial payments to its two plans--has adopted a stepped-in period of several years for gradually increasing the percentage of payroll to the chosen level percentage.

The following table shows the methods of amortization for the 72 plans we reviewed.

Methods of Amortization for 72 Plans

Method	Amortization periods (years)						Not	No unfunded	Total
	30 or less	40	50	60	70	Total	amortizing	liability	plans
Level-dollar amortization	5	3			1	9			9
Level percent of payroll amortization	6	9	1		1	17			17
Level percent of payroll amortization with stepped-in period		2				2			2
Infinite amortization (note a)		1				1			1
Interest on unfunded liability							1		1
Contributions not sufficient to amortize (note b)							23		23
Pay-as-you-go							17		17
Fully funded								2	2
Total	11	15	1	-	2	29	41	2	72

a/For this plan a new 40-year amortization period begins each year.

b/Two of the plans in this group--Firemen's Relief and Pension Fund in Wagoner, Oklahoma, and Firemen's Relief and Pension Fund in Okmulgee, Oklahoma--paid reduced benefits over various periods because of insufficient assets.

Different approaches to funding pensions mean different annual pension contributions for employers. As an example, see the following table, prepared for an actuarial evaluation of the Chicago Policemen's Annuity and Benefit Fund as of December 31, 1976. The table compares yearly contributions to this plan for alternative funding methods over a 40-year period.

Funding method	Normal cost	Amortization payment	Total
	(000,000 omitted)		
Level-dollar amortization	$20	$42	$62
Level percent of payroll (first year)	20	20	40
Normal cost plus interest on unfunded liability	20	38	58

Under the level-dollar method, the yearly amortization payment would remain the same for the 40 years; under the level-percent method, the amortization payment would increase as the payroll increases. Both methods are designed to eventually amortize the liability. Paying the normal cost plus interest would not amortize the unfunded liability, but would keep it from increasing.

Critics of the level-percent-of-payroll method point out that in the early years the unfunded liability actually increases because the contributions do not even pay the interest on the liability. Further, attaining the objective (amortization of the unfunded liability over a specified period) requires an accurate projection of future payroll. More significantly, because this method postpones the payment of large amounts into the pension fund, future taxpayers will be asked to pay for commitments made many years before.

The city of Los Angeles found this method appealing. It had been amortizing the unfunded liabilities of its three plans using the level-dollar approach. 1/ The total contributions for these plans for the year we reviewed were greater than the minimum amounts that would be required on an ERISA basis. However, as of July 1, 1977, the city decided to change its method of amortizing the unfunded liabilities to the level-percent-of-payroll basis. As a result of this change, for the next several years the annual contribution will not meet the ERISA standard. For example, the estimated pension contributions for the fiscal year starting July 1, 1978, computed on a level percent-of-payroll basis total $240,521,000, or about $59,450,000 less than would be required on an ERISA basis.

1/One of these plans covers department of water and power employees. It is funded entirely with contributions from employees and the department. The department's contributions are made from revenues from the sale of water and electricity.

Most of the pension plans we reviewed were underfunded using an ERISA standard, even though State and local officials were aware of both the risks of future financial trouble and the alternative ways of dealing with unfunded liabilities. Chapter 3 discusses these officials' views about financing pensions and looks at what some State and local governments have done about pension reform.

CHAPTER 3

STATE AND LOCAL GOVERNMENT ACTIONS

AND THEIR LIMITATIONS

A number of State and local governments have begun to tackle the problem of pension funding. Pension reform actions taken range from attempting to identify the problem, to adopting and implementing measures to solve it.

A major obstacle to pension reform is the immediate cost impact. Because of voter opposition to tax increases, State and local governments are using or considering other approaches to finance pension reforms. Some jurisdictions are reexamining their pension provisions and looking for ways to control or reduce pension costs.

RANGE OF PENSION REFORMS

Nationwide, there is a general lack of information about the funding of local retirement systems. In California, for example, the public retirement systems--of which there are about 136--were only recently required to report to the State how they were being funded and the amount of their unfunded liabilities. A California law effective January 1, 1978, required all public retirement systems in the State to submit annual audited financial reports 6 months after the close of each fiscal year and to have actuarial studies at least every 3 years. The State controller, with an advisory board composed of enrolled actuaries and public retirement systems administrators, will publish an annual report of the systems' financial condition, giving particular consideration to the adequacy of each system's funding.

Similarly, Pennsylvania enacted legislation in 1972 requiring periodic submission to the State of actuarial studies of all municipal pension funds. And, to assist it in considering the need for pension reform, the Oklahoma Legislature contracted in 1978 for actuarial studies of local firemen and police retirement plans, among others.

In Wisconsin, on the other hand, all but one of the pension plans we examined met the ERISA funding standard. Both normal costs and amounts necessary to amortize unfunded liabilities over 40 years, using the annual level-dollar approach, are paid into trust funds. The exception is the city of Milwaukee, which is amortizing the unfunded liability of its Employees' Retirement System over 50 years. This plan could meet the ERISA standard with only a small increase in annual contributions.

Three centralized pension funds in Wisconsin provide about 90 percent of the pension coverage for State and local public employees. Recent studies have shown that these funds are among the most financially sound in the Nation. This model condition has been shaped by legislative concern and actions dating back to 1945.

OBSTACLES TO PENSION REFORM

State and local officials have often found it expedient to postpone pension reform, leaving it to future office-holders to raise taxes and increase government contributions to retirement trust funds. And the constituency of the greatly expanded body of State and local employees, including expanded collective bargaining, has brought pressure for enlarging fringe benefits, including pensions. Hence, pensions are often increased without providing adequate funding, a concession that does not raise current costs significantly, but does raise unfunded liabilities.

For example, Florida governmental units, before a 1977 State constitutional amendment prevented the practice, had the power to increase pension benefits without providing for the funding on a sound actuarial basis. A June 1977 actuarial review of the Florida Retirement System, which covers employees of the State and participating local governments and agencies, disclosed that the system's unfunded liability had more than doubled over the preceding 5 years. According to the latest actuarial report, the reasons for this steep increase were (1) inadequately funded benefit liberalizations, (2) changes in actuarial assumptions between the 1972 and 1977 valuations, and (3) insufficient payments into the fund to prevent increases in the unfunded past service liability.

In Illinois, pension reform has long been the subject of reports and recommendations by two State agencies, the Department of Insurance and the Public Employees Pension Laws Commission. Despite recommendations and even statutory requirements for actuarial funding of State-level pension plans, these plans are not being funded on a full actuarial reserve basis. Between fiscal years 1974 and 1977, the State's contributions to the State Employees' Retirement System were less than the amounts paid out to retirees and beneficiaries. During the same period, the State's contributions to the Teachers' Retirement System were less than the amount paid out in fiscal year 1974, but slightly greater in the subsequent 3 years.

The Illinois Department of Insurance commented in its 1977 report:

> "* * * it has become increasingly apparent in recent years that sufficient revenue is not being provided to fund the benefit obligations on a full actuarial reserve basis as contemplated by law. Pressure to abandon the full funding concept has increased from some areas of state and local government. This pressure has obviously resulted from increased financial demand in other areas of state and local government as well as rebellion from the public to additional or new areas of taxation."

Our review showed that, to cover future pension costs to meet an ERISA funding standard, Illinois--in the long run--would have to either raise taxes or levy new ones.

Voter resistance to tax increases

Nationwide voter resistance to tax increases has been spotlighted by the much publicized Proposition 13, the initiative overwhelmingly passed by California voters in June 1978. Proposition 13 drastically cut back and limited local property taxes, a major source of revenues for pension financing by local governments. In Los Angeles, for example, 53.5 percent of the property taxes collected in 1977 went into contributions to retirement systems. Los Angeles and Oakland officials said that Proposition 13 would severely hamper any compliance with an ERISA funding requirement. In both cities, services and personnel would have to be cut in order to fund pension costs.

Another effect of Proposition 13 is a delay in the projected reform of the State Teachers' Retirement System, according to an official of the plan. Among the California State-administered pension systems we reviewed, the teachers' system carries by far the greatest unfunded liability (about $8.6 billion in 1977). That sum is not being amortized, and because the employee-employer contributions of 16 percent of compensation are not enough to cover even the normal costs, the unfunded liability is increasing. A June 30, 1977, actuarial valuation of the teachers' plan indicated that contributions greater than 21 percent of covered payroll will ultimately be required merely to allow the unfunded liability to grow at the same rate as the payroll.

A bill to increase the employer and State rates of contribution to the teachers' plan was passed by the California Legislature in the 1977 session to take effect on July 1, 1979, provided that funds were appropriated, which they were not. More recently the legislature passed legislation to gradually increase contribution rates by employers and employees to 21 percent and to provide additional State contributions. These funding provisions are to become effective on July 1, 1980.

Proposition 13 was only the latest, most drastic manifestation of the California voters' fight for property tax relief. The Property Tax Reform Act of 1972 set property tax rate limits for local governments. In return, the 1972 law committed the legislature to reimburse localities for any increased costs resulting from State-mandated programs. Under this principle of reimbursement, if California imposes increased costs on localities, the State pays those costs.

Voters in Wilmington, Delaware, have also expressed their resistance to further tax increases. The city has been granted unlimited taxing authority by law and is required to balance its budget annually. Nevertheless, a city official doubted that, in the present political climate, taxes could be raised to pay for funding city pension plans on an ERISA basis. Likewise, a New Castle County, Delaware, official expected citizen opposition to any tax increase to fund pension costs.

Many local governments look to the State to solve their pension funding problems

For funding pensions--as for other expenses that local taxes cannot cover--local governments everywhere look to the State for relief. For example, local officials in Massachusetts do not feel able to institute pension reform without State financial help. The State administration is committed to establishing actuarial funding of pension obligations. In 1978 Massachusetts set up a pension reserve account for the two retirement systems that it administers--the State Employees' Retirement System and a retirement system for teachers employed by local governments. Together they account for over half of the statewide total unfunded liability.

The Massachusetts Retirement Law Commission, after making actuarial valuations of the State Employees' Retirement Systems as of 1974 and 1976, recommended 40-year amortization of the unfunded liability, using the percent-of-pay method, phased in over 5 years. State officials believe that actuarial funding should be phased in gradually, or else taxes will have to be sharply increased and services reduced.

In fiscal year 1978 the Retirement Law Commission proposed legislation to the Massachusetts Legislature to require actuarial funding of pensions by all the public employee retirement systems. The legislation was not enacted, and the Commission expects to resubmit it in the fiscal year 1979 session.

Most of the 99 locally managed pension plans in Massachusetts are on a pay-as-you-go basis. State law prescribes in detail all aspects of the public employee retirement systems (benefit levels, funding method, administration, etc.) making them uniform throughout the State. Until recently, pay-as-you-go financing of pensions was mandatory for municipalities. In 1977, however, the law was amended to permit the municipalities to voluntarily amortize the unfunded accrued actuarial liability, but only a few small and affluent cities and towns have set up pension reserve funds.

Officials of the three cities we visited--Boston, Worcester, and Fall River--were not willing to begin funding their pension systems on a voluntary basis, and they opposed the very idea of actuarial funding out of local resources. They said that, without State or Federal financial support, the burden of funding would raise local property tax rates that were already too high. The point was underscored by Massachusetts voters on November 7, 1978, when they overwhelmingly passed an initiative to prevent sharp increases in residential property taxes.

The deputy mayor of Boston viewed the problem of pension reform in light of the principle of political and fiscal accountability: that those who mandate costly measures should bear some of the costs that they would impose on local governments. The deputy mayor pointed out that, because the State wrote the pension law that mandated pay-as-you-go financing in the past, it should help local governments with the resulting financial burden. The Boston city auditor commented that city administrators are interested only in present costs, not in the costs 15 years hence. He expects none of the larger Massachusetts cities to voluntarily fund pensions if they have to increase taxes to do so.

DIFFERENT SOURCES OF FUNDING

Given the obstacles to overt tax increases, some States are using or considering other approaches to finance pension reforms:

1. Continuing expiring taxes.

2. Substituting user charges for tax revenues.

3. Using Federal Revenue Sharing funds.

Massachusetts provides examples of the first two approaches. As noted above, in 1978 it set up a reserve for the two State-administered pension systems, those for State employees and teachers. The fund was started with a $10 million appropriation. Although the budget for fiscal year 1979, as approved by the legislature, included a $50 million appropriation for the pension reserve account to be paid from a one-time Federal reimbursement due for past social services, Massachusetts is considering as a continuing source of pension funds the extension of two tax increases--on cigarettes and alcoholic beverages--that expire June 30, 1980.

The Massachusetts Retirement Law Commission plans to cut down the unfunded liability of the State Employees' Retirement System by detaching organizations that serve a distinct set of users. The relevant unfunded liability would be transferred to the new pension plan by "unbundling," that is, separate pricing of pension costs. The chairman of the Retirement Law Commission estimated that in this way $200 million could be transferred from the State employee plan's unfunded liability ($1,622 million on Jan. 1, 1976).

As of January 1, 1979, the Massachusetts Port Authority employees, among the first to be unbundled from the State employees' plan, became members of a new Massachusetts Port Authority Employees' Retirement System. The law establishing this system requires actuarial funding, to come entirely from the Authority revenues, which in turn come from the users of its services.

As an example of the third approach, Delaware in 1977 added all of its annual Federal Revenue Sharing funds to the contribution to the State Employees' Pension Plan, the major State-administered pension plan. In that year, Revenue Sharing funds made up 27 percent of the State contribution to this plan, which covers all State employees and teachers.

ATTEMPTS TO CONTROL PENSION COSTS

In addition to devising new sources of pension funding, State and local governments have sought to reduce the costs of public pensions by reducing benefits. Such efforts have at times run into legal barriers because pension benefits are contractual by law in some jurisdictions. Accrued pension benefits thus protected cannot be canceled unilaterally. Other jurisdictions have statutorily limited any rights to pension benefits, arguing that, because pensions are essentially gratuitous, they can be reduced.

In some States--Illinois, for instance--the State constitution makes the accrued financial benefits of a pension plan a contractual obligation. Similarly, some State courts have ruled that earned pension benefits are contract rights that cannot be reduced retroactively. In 1973 the Massachusetts Supreme Court concluded that a proposed increase in the employee contribution rate would violate the contractual rights of the pension plan members. However, in the same year the Michigan Supreme Court ruled in a similar case that the legislature could raise the employee contribution rate. In general, although State court interpretations vary, there are legal barriers limiting efforts to reduce pension costs.

Underfunding and financial problems have caused temporary reductions in benefits. For example, in two cities we visited in Oklahoma--Okmulgee and Wagoner--firemen pensions were temporarily reduced for lack of funds. A State law provides that any municipality, when retirement funds are insufficient to meet demands, may reduce pension benefits. The pensions of retired Okmulgee firemen were reduced during the period from January 1975 through June 1978. In Wagoner benefit payments were reduced during 4 months in 1975 and 1 month in 1977.

Some jurisdictions, in looking for ways to soften the future impact of unfunded pension benefits, have reexamined their pension provisions and found that they could reduce pension costs by:

1. Controlling benefits subject to annual adjustment, such as cost-of-living increases.

2. Imposing tighter eligibility standards.

3. Establishing new plans with lower benefits for new hires.

4. Integrating pension plan benefits with social security benefits.

As an example of the first approach, in fiscal year 1976, the Massachusetts Legislature acted to limit the cost-of-living increase added to retirement checks. Before that year the first $6,000 of pension benefits had been increased annually at the same rate as the previous year's change in the Consumer Price Index. After the index rose by 11 percent in fiscal year 1975, the legislature acted to limit the cost-of-living increase of State employees' pensions to 5 percent in the following year. Since then the legislature has determined the rate of increase each year.

Florida approached pension reform from several angles--restraining unfunded benefit growth, reducing certain future benefits, and increasing income. A State constitutional amendment effective in 1977 required that any increase in pension benefits be actuarially funded. And, effective in 1978, the legislature reduced the benefits for policemen, firemen, and prison guards and raised employer contribution rates for all classes of pension plans, in order to meet the requirements for funding as outlined in the 1977 actuarial review. The Florida legislature has the authority to reduce benefits without the approval of voters or pension plan members.

The second and third approaches may be examined together. Standards of eligibility for normal retirement refer to age at retirement and years of service in some combination. Recent trends for eligibility standards generally have been toward liberalization; i.e., earlier retirement with fewer years of service.

The State of Delaware and the city of Los Angeles both have escalating liabilities in some of their pension plans. The two jurisdictions, despite having very different locations and different size populations, have similar problems with their pension plans. The Delaware State Police Pension Plan, according to the latest actuarial valuation, is now one of the most liberal police plans in the United States. And the Los Angeles Fire and Police Pension System was described by the city's chief administrative officer as among the most generous and expensive offered by any safety system.

Both plans automatically increase pensions each year based on the previous year's change in the Consumer Price Index. Both permit retirement on the basis of service alone (20 years) with no minimum age. And the Los Angeles Fire and Police Pension System pays retirement benefits keyed to the highest salary attained, an unusually generous feature.

Officials in both Delaware and Los Angeles point to the cost-of-living adjustment as the major reason for the steep increases in the unfunded liabilities of their safety pension plans. The Delaware State Police Pension Plan's unfunded liability more than doubled during the 5 years ended September 30, 1976--date of the latest actuarial study. And the Los Angeles Fire and Police Pension System saw its unfunded liability triple over the last 10 years. Officials of both jurisdictions expressed concern over the high annual and future costs of these plans, although Delaware contemplates no immediate reform.

Los Angeles, however, is considering establishment of a new fire and police pension plan with lower benefits for new hires. Such an approach would be used because California courts have held that retirement benefits, once granted, may not be reduced unless replaced by equivalent benefits. A report from the Los Angeles chief administrative officer proposed creating a new pension plan for future hires. The plan would have a maximum annual cost-of-living adjustment of 3 percent, a minimum retirement age of 50 years, and benefits based on the last 1 year average salary rather than on the highest salary attained.

Some governments are looking to control their pension costs by correlating retirement plan benefits with social security benefits. This correlation can provide current and new workers with adequate income security at a more reasonable and controlled cost.

In May 1978 the council of New Castle County, Delaware, authorized a study for designing and developing a revised retirement system for county employees. The council believed that a modified pension plan taking social security into account could be designed to provide retirement benefits at least equal to average take-home pay at a substantial cost savings to both the county and its employees. 1/

In Pensacola, Florida, a pension study task force, set up at the direction of the city council, issued a report in April 1978 recommending that the city's pension plan be coordinated with the primary social security benefit to provide an equitable, reasonable retirement income. The task force recommended that, at time of retirement, the combined benefits (city pension award and social security benefits) not be permitted to exceed 80 percent of the employee's final average earnings. It further recommended that no automatic cost-of-living adjustments be added to the plan. Instead, the social security system should be relied on for cost-of-living increases in the coordinated benefits.

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The U.S. Department of Labor believes that pension costs can be reduced without affecting benefits by (1) increasing emphasis on the maximization of plan asset investment return, (2) consolidating local plans into larger State-administered systems to realize economies of scale in plan administration, and (3) tightening plan fiduciary practices to restrict the use of plan assets to capitalize local debt, a practice which may jeopardize future benefits and, as a result, require greater future funding. (See app. XXXI.)

1/In commenting on our draft report, officials on May 11, 1979, informed us that the county had recently established a pension plan integrated with social security. This plan will become operational on November 1, 1979, and will be available for all new employees. Current employees will be given the option to join this new plan or remain in the old plan.

CHAPTER 4

THE FEDERAL GOVERNMENT AND STATE AND LOCAL GOVERNMENT PENSION PLANS

The Pension Task Force report cited a compelling need for a revised and expanded set of Federal standards for public pension plans to protect participants' rights. The Task Force concluded that, although a number of Federal constitutional and statutory provisions (e.g., the Internal Revenue Code) significantly affect public pension plans, the effects are not clear. The Task Force also concluded that the protection the Internal Revenue Code offers to plan participants has been sharply limited by inconsistent interpretation and enforcement.

The Federal Government is heavily involved in State and local government pension plans through its grant programs. We estimate that, under these programs, about $1 billion in pension plan contributions are being reimbursed yearly to State and local governments. We expect this amount to increase considerably if ERISA funding standards are made applicable to public pension plans.

THE FEDERAL AUTHORITY TO REGULATE STATE AND LOCAL GOVERNMENT PENSION PLANS NEEDS TO BE SCRUTINIZED

There is a question as to the extent of the Federal Government's authority to regulate State and local government pension plans, particularly in view of the Supreme Court's decision in National League of Cities v. Usery (426 U.S. 833) (1976). This decision raised real but unresolved questions about whether the Federal Government can regulate such pension plans under its authority to regulate interstate commerce under the Commerce Clause of the U.S. Constitution. Yet this decision does not appear to preclude Federal regulation of State and local government pension plans under other sources of constitutional authority, such as the taxing power, the spending power, and the powers to protect property rights.

In the National League of Cities case, the Supreme Court held that extending the minimum wage and maximum hour provisions of the Fair Labor Standards Act to State and local government employees, based on the Congress' power to regulate interstate commerce under the Commerce Clause, was an unconstitutional interference with State sovereignty as reserved to the States under the 10th amendment. The Court recognized that regulation of wages and hours of State employees affects interstate commerce, but held that the Congress' authority to regulate activities under the Commerce Clause could not be used "to displace the States' freedom to structure integral operations in areas of traditional governmental functions."

The Court reasoned that determining State and local government employees' wages and hours was an attribute of State sovereignty and that these functions were essential to States' separate and independent existence. The latter point was based on an analysis of the effect the Federal legislation would have on State and local government functions. 1/ For several reasons (e.g., substantial increase in costs and displacement of State decisions in other areas), the Court felt that the legislation substantially interfered with traditional ways in which State and local governments carried out their internal affairs.

Employees' wages and employees' pension benefits are closely related. Pensions may reasonably be considered a form of deferred compensation. Therefore, there is a real question as to whether the Congress could, under its authority to regulate interstate commerce, establish standards for State and local government pension plans. Legal authorities may differ on this question. As indicated in the National League of Cities case, any definitive judicial resolution of this question would necessarily depend on the effect of the Federal legislation on State and local government functions, which in turn would depend on the nature of the legislation. The greater and more adverse the effect, the more likely it is that the Federal legislation could be declared an impermissible intrusion on integral State functions.

1/The Court cited other examples of "integral governmental functions":

> "* * * areas as fire prevention, police protection, sanitation, public health, and parks and recreation. These activities are typical of those performed by State and local governments in discharging their dual functions of administering the public law and furnishing public services. Indeed, it is functions such as these which governments are created to provide, services such as these which the States have traditionally afforded their citizens."

The Pension Task Force report addressed this question. With regard to the Congress' authority to regulate interstate commerce as a basis of jurisdiction, the Task Force stated that only a full, immediate funding requirement would even begin to affect the fiscal or other operations of State and local governments so as to threaten State sovereignty. The Task Force also stated that even Federal vesting requirements, in the absence of strict funding requirements, would probably not reach the level of intrusion in basic State functions that the Supreme Court found in the National League of Cities case.

Further, the Task Force noted that legislation mandating a relatively long-term funding requirement (e.g., 40 years to fund past service liabilities) might be permissible under the Commerce Clause. The Task Force believed that enacting this type of Federal legislation pursuant to the Commerce Clause is limited by the 10th amendment only when it so vitally affects a basic State or local government function that the capacity of the State to function as a sovereign in the Federal relationship is severely threatened.

The National League of Cities case only concerned the exercise of the Congress' power to regulate interstate commerce. The Court left open the question of whether other powers would provide sufficient authority for regulating certain State and local governmental activities. The Court stated:

> "We express no view as to whether different results might obtain if Congress seeks to affect integral operations under other sections of the Constitution such as the spending power, Art. I sec. 8, cl. 1, or sec. 5 of the Fourteenth Amendment."

The Pension Task Force report discussed several other bases on which the Congress could constitutionally regulate State and local government employee retirement systems: (1) the Federal taxing power (e.g., condition the tax-exempt status of State and local government pension plans on observance of funding standards), (2) the 14th amendment (i.e., treat pension benefits as property rights that the Congress may protect), and (3) conditions attached to Federal spending programs (e.g., require that State and local governments conform to certain funding standards as a condition of receiving Federal funds). These approaches offer possible alternatives for requiring or encouraging conformance with Federal public pension plan standards.

THE FEDERAL GOVERNMENT IS INVOLVED IN FINANCING STATE AND LOCAL GOVERNMENT PENSION PLANS

An estimated $1 billion 1/ in State and local government pension contributions are being charged annually to Federal grant programs. Although the ground rules for Federal reimbursement vary by agency and by grant program, the general policy for reimbursement is expressed by the Office of Management and Budget's Federal Management Circular 74-4. In essence, the Federal Government's policy is to reimburse under grant programs a proportionate share of the pension contributions made by the State or local government. Thus, Federal grant programs would bear a proportionate share of the increase in pension contributions if State and local governments had to fund their pension plans on a basis that would meet an ERISA-type funding requirement.

1/Although we cannot state that this estimate is statistically valid, we believe it provides a reasonable indication of the magnitude of charges to Federal grant programs. For 49 of the pension plans reviewed, we determined that, of the total employer contribution of $924.8 million, $120.4 million (13 percent) was charged to Federal grant programs. At this rate, we estimate that $1.3 billion of the $10.1 billion in employer annual contributions, as shown on page 174 of the Pension Task Force report, would have been charged to Federal grant programs.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATION

CONCLUSIONS

On the basis of our examination of 72 pension plans in 8 States and 26 local governments within those States, we believe that the funding of State and local government pension plans needs to be improved. Many public pension plans are becoming a financial burden, and this burden will grow in the future.

A number of jurisdictions have not systematically provided, on a current basis, adequate funding for retirement benefits accruing to their employees. Most of the public pension plans we reviewed were underfunded or unfunded. As a result, large unfunded pension liabilities have accumulated.

The unfunded pension liabilities of public pension plans were estimated at $150 billion to $175 billion in 1975. Unless steps are taken to fund these plans on a sound actuarial basis, their liabilities will continue to increase. Of the 72 plans we reviewed, 53 were not receiving large enough contributions to satisfy the minimum funding standard prescribed by ERISA for private pension plans. Of these, 17 were on a pay-as-you-go basis. Annual government contributions to the 53 plans amounted to $1.8 billion; to meet an ERISA-type funding standard, another $1.4 billion in annual contributions would be required.

Increasing pension plan funding to meet the ERISA standard would have a serious initial impact on some jurisdictions we visited. But to do nothing would have a more serious long-term impact. For instance, our 40-year projection of pension contributions for three plans on a pay-as-you-go basis in Boston, Delaware, and Pittsburgh shows that, after 40 years, failure to fund these plans actuarially would cause their current unfunded liabilities to more than triple and their yearly pay-as-you-go contributions to increase several fold. Thus, failure to fund pension plans on an actuarial basis may eventually place a number of jurisdictions in a more serious financial position.

Many governments believe they cannot afford actuarial pension funding. Voter resistance to tax increases could be an obstacle. Instead of raising taxes to provide for this purpose, personnel and services would have to be cut.

Passage of Proposition 13 in California drastically cut back and limited local property taxes, a major source of revenue for pension financing by local governments in that State. Voter resistance to tax increases for pension funding purposes is also expected by local government officials in Delaware, Massachusetts, and Pennsylvania.

The funding of public pension benefits has aroused widespread interest and controversy in recent years. The consensus is that some kind of actuarial funding is needed, and various approaches have been proposed. Some State and local governments have begun to tackle the problem of pension funding, with actions that range from attempting to identify the problem to adopting and implementing measures to solve it. Yet, other jurisdictions have not taken any steps to start funding their pension plans on a sound actuarial basis.

Illinois pension laws require actuarial funding of State pension plans, but these plans are not being funded on a full actuarial reserve basis. In Massachusetts a change in the pension laws allows local governments to voluntarily amortize the unfunded liability of their pension plans, but only a few small and affluent cities and towns have set up pension reserve funds.

A number of local government officials believe that the State government is responsible for bearing the cost of any pension reforms it mandates. For example, Massachusetts and Oklahoma officials we spoke to believe that, if the States write the pension laws and control and regulate pension plans, they should also pay for the reform measures mandated.

Pension reform at the State and local levels is moving slowly, and prospects for significant improvement in the foreseeable future are not bright. We believe that, to protect the pension benefits earned by public employees and avert fiscal disaster, State and local governments should fund on an annual basis the normal or current cost of their pension plans and amortize the plans' unfunded liabilities.

Although the sponsoring governments are responsible for the sound funding of State and local government pension plans, the Federal Government has a substantial interest in these pension plans. In recent years, these plans have grown rapidly in size and scope, and many jurisdictions have increasingly relied on Federal grant funds and revenue sharing to help meet the costs of such plans. These plans directly affect the continued well-being and security of millions of State and local government employees and their dependents. Thus, it might be in the national interest for the Congress to assure through legislation that the long-run financial stability of these pension plans is maintained through sound funding standards.

The constitutional question of the Federal Government's authority under the Commerce Clause and the practicality of using other sources of authority, such as the spending power and the taxing power, have not been resolved. As demonstrated in this report, an ERISA-like funding standard would have a substantial fiscal impact on State and local governments. But, in the long term, the alternative to adopting sound pension funding practices can be fiscal disaster and possible loss of employees' earned benefits.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress closely monitor actions taken by State and local governments to improve the funding of their pension plans to determine whether and at what point congressional action may be necessary in the national interest to prevent fiscal disaster and to protect the rights of employees and their dependents.

COMMENTS OF STATE AND LOCAL GOVERNMENTS, FEDERAL AGENCIES, AND OTHER INTERESTED PARTIES

We solicited comments from chief executives of the State and local governments we visited and from plan administrators of pension plans included in our review. We also solicited comments from the President's Commission on Pension Policy, the Office of Management and Budget, the Department of the Treasury, the Department of Labor, the Pension Benefit Guaranty Corporation, and officials of various State and local government associations. All of the comments we received as of July 31, 1979, were considered in finalizing our report and are included as separate appendixes.

Among those who commented on our report and specifically addressed the question of funding, there was a consensus that the problem of adequately funding public pension plans is serious; however, there was no clear consensus about what is the best solution. Some believed that any funding standard for public plans should be less demanding than that imposed by ERISA on private plans. The percent-of-payroll approach to pension funding was the one favored by many officials.

Opposition to Federal involvement in the establishment of a funding standard for State and local government pension plans came mainly from plan administrators. These officials believe that the Federal Government should not have a role in this issue. They argue that it has not adequately dealt with its own pension funding problems, as evidenced by the poorly funded Social Security system and the pension plans for Federal personnel. Yet, some believed that federally prescribed reporting and disclosure standards could have a beneficial influence on public pension plans.

Some officials questioned whether our report presents a current picture of the funding of State and local government pension plans, since our measurement of the potential financial effect of implementing an ERISA-type funding standard is based on a point in time. The National Association of Counties, the National Governors' Association, and an official of the city of Philadelphia, although not in disagreement with the conclusions, believed that significant improvements have occurred since our work was done.

To assess the potential financial impact of having State and local governments meet an ERISA-type funding standard, we obtained financial data on the latest completed fiscal year of each selected government available at the time of our fieldwork--between May and October 1978. In a few cases we used the financial information for fiscal years ended in 1976, but the information we used was generally for fiscal years that ended in 1977. For a national perspective, we resorted to the 1975 data developed by the House Pension Task Force--the most comprehensive data base available. However, our report reflects not only pension reform measures taken or contemplated by States and local governments as of the time of our fieldwork, but also actions and measures taken and contemplated after the completion of our fieldwork to the extent the governments brought these to our attention in their comments.

A Federal official commenting on our report expressed his concern about the adequacy of the actuarial evaluation we used as a basis for measurement. Essentially, we accepted the actuarial valuations as prepared. However, we do recognize that comprehensive standards do not exist for valuations prepared for public pension plans, and the House Pension Task Force believes that the standards currently being applied are not adequate.

LIST OF PENSION PLANS SHOWING

MEMBERSHIP, EMPLOYER CONTRIBUTIONS,

ASSETS, AND UNFUNDED LIABILITIES (note a)

Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)--------		
California:						
Public Employees' Retirement System	182,708	51,378	Actuarial	$352,670	$3,772,894	$3,776,790
State Teachers' Retirement System	277,300	72,368	(b)	435,770	3,775,400	7,647,798
Judges' Retirement System	1,021	548	Pay-as-you-go	9,524	-	110,000
Legislators' Retirement System	183	158	Actuarial	1,235	2,628	28,572
University of California Retirement System	60,100	3,704	Actuarial	116,610	681,278	41,952
	521,312	128,156		$915,809	$8,232,200	$11,605,112
City of Los Angeles, California:						
Fire and Police Pension System:						
New Plan	9,972	3,570	Actuarial	$89,796	$357,644	$ 860,921
Old Plan	257	4,142	Actuarial	22,575	36,009	391,576
City Employees' Retirement Systems	21,547	5,074	Actuarial	56,606	437,758	418,195
Water and Power Employees' Retirement Plan	11,138	5,666	Actuarial	36,261	424,909	324,074
	42,914	18,452		$205,238	$1,256,320	$1,994,766

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)	--------	--------
City of Oakland, California:						
Police and Fire Retirement System	1,204	1,215	Actuarial	$18,438	$45,086	$299,310
Municipal Employees' Retirement System	33	702	Actuarial	791	21,407	7,020
	1,237	1,917		$19,229	$66,493	$306,330
Imperial County, California:						
Imperial County Employees' Retirement Association	982	213	Actuarial	$ 1,222	$14,597	$ 5,936
Delaware:						
State Employees' Pension Plan	24,094	4,394	Actuarial	$29,760	$60,111	$306,818
State Police Pension Plan	428	216	Pay-as-you-go	2,049	-	80,436
State Judiciary Pension Plan	28	11	Pay-as-you-go	82	-	3,820
	24,550	4,621		$31,891	$60,111	$391,074

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)--------		
New Castle County, Delaware:						
Employees' Retirement System	1,178	229	(c)	$ 1,592	$ 4,532	$20,964
Alternate (Closed) Plan	200	179	Pay-as-you-go	415	-	7,083
	1,378	408		$ 2,007	$ 4,532	$28,047
City of Newark, Delaware:						
The Amended Pension Plan for Employees of the City of Newark, Delaware	180	25	Actuarial	$192	$1,179	$871
City of Wilmington, Delaware:						
Pension Plan Covering Nonuniformed Personnel	1,105	408	(d)	$1,516	$ 849	$16,100
Firemen's Pension Fund	226	277	Pay-as-you-go	1,197	949	22,626
Police Pension Fund	254	247	Pay-as-you-go	1,082	412	20,678
	1,585	932		$3,795	$2,210	$59,404
Florida:						
Florida Retirement System (State portion)	97,764	11,708	Actuarial	$102,102	e/$720,247	e/$1,021,147

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)--------		
City of Jacksonville, Florida:						
General Employees Fund	4,784	2,590	Actuarial	$12,105	$20,447	$179,081
Policemen and Firemen Pension Fund	1,644	808	Actuarial	6,362	23,822	52,267
	6,428	3,398		$18,467	$44,269	$231,348
City of Pensacola, Florida:						
General Pension and Retirement Fund	803	237	Actuarial	$1,272	$6,181	$18,324
Firemen's Relief and Pension Fund	126	73	Actuarial	458	1,277	6,337
Police Officers' Retirement Fund (note f)	143	52	Actuarial	207	1,150	
	1,072	362		$1,937	$8,608	$24,661
City of St. Petersburg, Florida:						
Employees' Retirement System	2,067	610	Actuarial	$ 948	$18,528	$ 1,216
Firemen's Retirement System	307	124	Actuarial	1,264	4,515	18,321
Policemen's Retirement System	475	112	Actuarial	1,771	5,970	17,160
	2,849	846		$3,983	$29,013	$36,697

Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				-------------(000 omitted)--------		
Illinois:						
State Employees' Retirement System	77,784	47,816	(g)	$ 59,798	$ 581,531	$ 722,924
Teachers' Retirement System of the State of Illinois	103,216	60,495	(h)	161,649	1,479,116	1,849,862
	181,000	108,311		$221,447	$2,060,647	$2,572,786
City of Chicago, Illinois:						
Municipal Employees' Annuity and Benefit Fund	25,091	11,248	(i)	$ 32,837	$ 429,262	$ 555,126
Policemen's Annuity and Benefit Fund	13,353	7,019	(i)	31,474	287,350	655,149
Firemen's Annuity and Benefit Fund	4,321	3,286	(i)	12,661	197,469	247,678
Laborers' and Retirement Board Employees' Annuity and Benefit Fund	6,811	3,391	(i)	7,281	151,749	90,468
Public School Teachers' Pension and Retirement Fund	32,116	8,776	(j)	70,559	493,647	821,776
	81,692	33,720		$154,812	$1,559,477	$2,370,197

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				----------------(000 omitted)--------		
Town of Cicero, Illinois:						
Illinois Municipal Retirement Fund (Cicero portion)	253	Not available	Actuarial	$311	$1,270	$ 2,132
Police Pension Fund	90	88	(k)	325	860	9,701
Firemen's Pension Fund	81	72	(k)	300	341	9,918
	424	160		$936	$2,471	$21,751
City of Peoria, Illinois:						
Illinois Municipal Retirement Fund (Peoria portion)	417	(l)	Actuarial	$ 544	$ 2,456	$ 3,716
Police Pension Fund	227	140	Actuarial	1,132	5,290	14,460
Firemen's Pension Fund	188	141	Actuarial	1,216	4,660	17,851
	832	281		$2,892	$12,406	$36,027
Massachusetts:						
State Employees' Retirement System	72,000	22,594	Pay-as-you-go	$102,273	$424,413	$1,621,764
Teachers' Retirement System	(l)	(l)	Pay-as-you-go	118,160	516,000	2,291,000
	72,000	22,594		$220,433	$940,413	$3,912,764

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)-------		
City of Boston, Massachusetts:						
State--Boston Retirement System	26,193	15,692	Pay-as-you-go	$43,879	$225,242	$1,152,200
City of Fall River, Massachusetts:						
Contributory Retirement System	1,993	1,065	Pay-as-you-go	$ 3,826	$ 9,783	$ 64,700
City of Worcester, Massachusetts:						
Worcester Retirement System	4,847	1,725	Pay-as-you-go	$11,142	$23,117	$ 131,283
Oklahoma:						
Public Employees Retirement System	31,772	5,937	Actuarial	$26,021	$127,224	$ 159,837
City of Enid, Oklahoma:						
Employee Retirement System	172	37	Actuarial	$ 59	$ 388	$ 1,106
Police Pension and Retirement System	66	22	(m)	132	656	4,791
Firemen's Relief and Pension Fund	73	53	(m)	245	1,524	9,100
	311	112		$436	$2,568	$14,997

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)-------		
Oklahoma City, Oklahoma:						
Employee Retirement System	1,931	670	(n)	$1,130	$10,817	$15,787
Police Pension and Retirement System	639	221	(o)	1,917	9,298	54,143
Firemen's Relief and Pension Fund	586	408	(p)	2,818	6,140	74,713
	3,156	1,299		$5,865	$26,255	$144,643
City of Okmulgee, Oklahoma:						
Employee Retirement System	83	21	Actuarial	$117	$290	$ 901
Police Pension and Retirement System	23	5	(q)	28	255	1,290
Firemen's Relief and Pension Fund	26	29	(r)	88	66	2,755
	132	55		$233	$611	$4,946
City of Wagoner, Oklahoma:						
Firemen's Relief and Pension Fund	18	19	(s)	$24	$11	$610

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				(000 omitted)		
Pennsylvania:						
State Employees' Retirement System	128,000	36,000	Actuarial	$198,996	$1,459,312	$1,119,094
City of Philadelphia, Pennsylvania:						
Municipal Retirement System (note t)	38,136	15,126	Actuarial	$78,198	$313,465	$680,860
City of Pittsburgh, Pennsylvania:						
Municipal Pension Fund	2,531	1,648	Pay-as-you-go	$4,968	$ 59	$106,242
Policemen's Relief and Pension Fund	1,418	1,124	Pay-as-you-go	2,516	175	106,435
Firemen's Relief and Pension Fund	1,035	888	Pay-as-you-go	2,443	31	86,821
	4,984	3,660		$9,927	$265	$299,498
City of Reading, Pennsylvania:						
Officers and Employees Retirement System	543	307	Pay-as-you-go	$ 723	$2,001	$16,199
Police Pension Fund Association	171	98	Pay-as-you-go	347	616	13,252
Paid Firemen's Pension Fund	86	12	Pay-as-you-go	68	334	3,924
	800	417		$1,138	$2,951	$33,375

Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)	---------	---------
Wisconsin:						
Wisconsin Retirement Fund (State portion)	33,725	(1)	Actuarial	$53,490	e/$394,135	$105,130
State Teachers Retirement System (State portion)	13,228	(1)	Actuarial	24,902	e/280,820	e/61,213
	46,953	(1)		$78,392	$674,955	$166,343
Dane County, Wisconsin:						
Wisconsin Retirement Fund (Dane County portion)	1,445	(1)	Actuarial	$2,731	(1)	$5,155
City of Madison, Wisconsin:						
Wisconsin Retirement Fund (Madison portion)	2,751	(1)	Actuarial	$5,025	(1)	$9,761
City of Milwaukee, Wisconsin:						
Employees' Retirement System	14,029	3,165	Actuarial	$27,671	$299,444	$200,684
Policemen's Annuity and Benefit Fund (Closed)	77	1,042	Actuarial	2,758	14,058	21,145
Firemen's Annuity and Benefit Fund (Closed)	109	705	Actuarial	1,697	15,538	17,047
	14,215	4,912		$32,126	$329,040	$238,876

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Jurisdiction/plan	Active members	Inactive members, retirees, and beneficiaries	Employer contribution Basis	Employer contribution Amount	Plan assets	Unfunded liability
				---------------(000 omitted)--------		
Milwaukee County, Wisconsin:						
Employees' Retirement System	10,727	2,761	Actuarial	$18,312	$137,956	$131,099
Grand total	1,354,632	424,884		$2,422,663	$18,347,948	$28,976,195

NOTES TO SCHEDULE

a/The financial data shown in this appendix are for the latest completed fiscal year of each jurisdiction for which complete information was available. Plan membership data are the latest available.

b/Employer contribution set by State law at 8 percent of covered payroll.

c/Employer contribution set by the county's pension code at 9.73 percent of covered payroll.

d/During fiscal year 1977, the city contributed $935,941 on a pay-as-you-go basis and an additional $580,000 into a reserve fund.

e/The plan assets and unfunded liabilities shown in this appendix for the Florida Retirement System and the Wisconsin State Teachers Retirement Fund, and the plan assets for the Wisconsin State Retirement Fund (State portion) were derived by GAO.

f/In Pensacola, police are provided basic benefits under the General Pension and Retirement Fund. The Police Officers Retirement Fund is a supplemental plan with optional membership.

g/The contribution rate for the year ended June 30, 1977, was fixed by the State at 6.7 percent of payrolls. For that year the actuary recommended a contribution rate of 9.2 percent to meet the fund's normal cost requirement. An additional contribution of 4.7 percent would have been required to amortize the unfunded liability over 40 years on a level dollar basis.

h/The State's contribution to this plan is prescribed by statute to amount to not less than 1.2 times the member contributions.

i/Employer contributions to these plans are required by State law to be multiples of the employees' contributions 2 years before. For the year ended December 31, 1976, the multiples for each plan were:

Municipal Employees' Fund	1.56
Policemen's Fund	1.97
Firemen's Fund	2.23
Laborers' Fund	1.28

j/Employer contributions come from two sources: a tax levy by the Board of Education, which in fiscal year ended August 31, 1977, was specified by law to be 0.90 of the members' contributions 2 years before, and a State appropriation to be not less than 1.2 times the members' contributions.

k/Employer contributions to each of these plans consisted of an amount on a pay-as-you-go basis and an additional $50,000.

l/Not available.

m/The city's contributions for these plans match the employees' contributions: 6.05 percent for policemen and 4 percent for firemen. These systems also receive contributions from the State.

n/The city is not required to make any contribution to this plan. According to the city code, the city may contribute up to 10 percent of covered salaries. In 1977, the city contributed about 5.27 percent of payroll.

o/The city is not required to make any contributions, although the city code allows city contributions up to 10 percent of salary. In 1977, the city contributed 8-1/2 percent of covered salaries. In addition, the State contributed about $1.2 million.

p/In 1977, the city contributed 4 percent of covered salaries, in accordance with the city code. In addition, the State contributed $2.5 million.

q/In 1977, the city contributed 2 percent of covered salaries. In addition, the State contributed about $24,000.

r/In 1977, the city contributed 4 percent of covered salaries, as required by city ordinance. In addition, the State contributed about $79,400.

s/In 1977, the city contributed 4 percent of covered salaries, as required by city ordinance. In addition, the State contributed about $23,000.

t/Includes municipal employees, police, and firemen.

POTENTIAL IMPACT, MEASURED AGAINST STATE AND LOCAL GOVERNMENT

TAXES, OF FUNDING PUBLIC PENSION PLANS ON ERISA STANDARDS (note a)

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
California:						
Public Employees' Retirement System (State portion)	$352,670	15.29	$168,000	7.29	1.34	47.64
State Teachers' Retirement System	435,770	9.44	575,151	12.46	4.59	131.98
Judges' Retirement System	9,524	19.42	3,303	6.73	.03	34.68
Legislators' Retirement System	1,235	20.46	-	-	-	-
University of California Retirement System	116,610	12.08	-	-	-	-
	$915,809		$746,454			
City of Los Angeles, California:						
Fire and Police Pension System:						
New plan	$ 89,796	b/ 41.53	c/$ -	-	-	-
Old plan	22,575	b/420.86	c/ 1,645	30.67	.28	7.29
City Employees' Retirement System	56,606	16.38	c/ -	-	-	-
Water and Power Employees' Retirement Plan	36,261	20.03	c/ -	-	-	-
	$205,238		$1,645			

APPENDIX II

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Additional pension contributions as a percent of: Tax revenues	Additional pension contributions as a percent of: Current contributions
	(000 omitted)		(000 omitted)			
City of Oakland, California:						
Police and Fire Retirement System	$18,438	72.08	$17,925	70.08	22.81	97.22
Municipal Employees' Retirement System	791	184.38	-	-	-	-
	$19,229		$17,925			
Imperial County, California:						
Imperial County Employees' Retirement Association	$1,222	11.24	-	-	-	-
Delaware:						
State Employees' Pension Plan	$29,760	11.30	$4,737	1.80	1.22	15.91
State Police Pension Plan	2,049	32.41	6,468	102.29	1.66	315.67
State Judiciary Pension Plan	82	7.29	384	34.13	.10	468.29
	$31,891		$11,589			
New Castle County, Delaware:						
Employees' Retirement System	$1,592	10.33	$1,787	11.59	11.18	112.25
Alternate (Closed) Plan	415	16.22	43	1.68	.27	10.36
	$2,007		$1,830			

APPENDIX II

APPENDIX II

Jurisdiction/plan	Pension contributions Amount	Pension contributions Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of Payroll	Additional pension contributions as a percent of Tax revenues	Additional pension contributions as a percent of Current contributions
	(000 omitted)		(000 omitted)			
City of Newark, Delaware:						
The Amended Pension Plan for Employees of the City of Newark, Delaware	$192	7.32	-	-	-	-
City of Wilmington, Delaware:						
Pension Plan Covering Nonuniformed Personnel	$1,516	13.29	$ 411	3.60	1.58	27.11
Firemen's Pension Fund	1,197	32.35	1,195	32.30	4.61	99.83
Police Pension Fund	1,082	21.99	1,441	29.27	5.55	133.18
	$3,795		$3,047			
Florida:						
Florida Retirement System (State portion)	$102,102	9.25	$30,338	2.75	.83	29.71
City of Jacksonville, Florida:						
General Employees Fund	$12,105	22.00	$6,904	12.52	6.68	57.03
Policemen and Firemen Pension Fund	6,362	27.56	452	1.96	.44	7.11
	$18,467		$7,356			

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Additional pension contributions as a percent of: Tax revenues	Additional pension contributions as a percent of: Current contributions
	(000 omitted)		(000 omitted)			
City of Pensacola, Florida:						
General Pension and Retirement Fund	$1,272	13.59	$342	3.66	8.73	26.89
Firemen's Relief and Pension Fund	458	22.55	206	10.14	5.26	44.98
Police Officers' Retirement Fund (note c)	207	(d)	-	-	-	-
	$1,937		$548			
City of St. Petersburg, Florida:						
Employees' Retirement System	$ 948	4.66	$ -	-	-	-
Firemen's Retirement System	1,264	36.35	504	14.50	1.78	39.91
Policemen's Retirement System	1,771	31.17	50	.87	.18	2.81
	$3,983		$554			
Illinois:						
State Employees' Retirement System	$ 59,798	6.70	$63,706	7.20	1.32	106.54
Teachers' Retirement System of the State of Illinois	161,649	10.48	44,753	2.90	.93	27.69
	$221,447		$108,459			

APPENDIX II

APPENDIX II

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
City of Chicago, Illinois:						
Municipal Employees' Annuity and Benefit Fund	$ 32,837	10.13	$ 18,554	5.73	3.96	56.50
Policemen's Annuity and Benefit Fund	31,474	12.90	32,223	13.21	6.87	102.38
Firemen's Annuity and Benefit Fund	12,661	15.11	13,262	15.83	2.83	104.75
Laborers' and Retirement Board Employees' Annuity and Benefit Fund	7,281	8.05	3,006	3.32	.64	41.29
Public School Teachers' Pension and Retirement Fund	70,559	12.80	44,562	8.09	60.23	63.16
	$154,812		$111,607			
Town of Cicero, Illinois:						
Illinois Municipal Retirement Fund (Cicero portion)	$311	14.65	$ 77	3.64	1.12	24.76
Police Pension Fund	325	25.57	424	33.36	6.13	130.46
Firemen's Pension Fund	300	24.67	525	43.14	7.59	175.00
	$936		$1,026			

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
City of Peoria, Illinois:						
Illinois Municipal Retirement Fund (Peoria portion)	$ 544	7.56	$ 279	3.88	1.74	51.29
Police Pension Fund	1,132	27.15	253	6.08	1.58	22.35
Firemen's Pension Fund	1,216	34.74	593	16.94	3.70	48.77
	$2,892		$1,125			
Massachusetts:						
State Employees' Retirement System	$102,273	12.58	$117,201	14.41	4.12	114.60
Teachers' Retirement System	118,160	9.07	205,791	15.80	7.23	174.16
	$220,443		$322,992			
City of Boston, Massachusetts:						
State-Boston Retirement System	$43,879	20.30	$28,912	13.37	6.78	65.89
City of Fall River, Massachusetts:						
Contributory Retirement System	$3,826	20.77	$3,429	18.61	9.97	89.62
City of Worcester, Massachusetts:						
Worcester Retirement System	$11,142	25.16	$4,003	9.04	5.64	35.93

APPENDIX II

APPENDIX II

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
Oklahoma:						
Public Employees Retirement System	$26,021	11.89	-	-	-	-
City of Enid, Oklahoma:						
Employee Retirement System	$ 59	3.40	$ 49	2.82	1.85	83.05
Police Pension and Retirement System	132	17.32	487	63.92	18.35	368.93
Firemen's Relief and Pension Fund	245	28.06	752	86.14	28.34	306.94
	$436		$1,288			
Oklahoma City, Oklahoma:						
Employee Retirement System	$1,130	5.27	$ 588	2.74	1.48	52.04
Police Pension and Retirement System	1,917	22.10	3,605	41.56	9.06	188.05
Firemen's Relief and Pension Fund	2,818	31.86	4,049	45.78	10.18	143.68
	$5,865		$8,242			

Jurisdiction/plan	Pension contributions Amount	Pension contributions Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
City of Okmulgee, Oklahoma:						
Employee Retirement System	$117	16.20	$ -	-	-	-
Police Pension and Retirement System	28	12.84	153	70.18	13.92	546.43
Firemen's Relief and Pension Fund	88	36.21	205	84.36	18.65	232.95
	$233		$358			
City of Wagoner, Oklahoma:						
Firemen's Relief and Pension Fund	$24	99.34	$29	116.00	6.73	120.83
Pennsylvania:						
State Employees' Retirement System	$198,996	11.46	-	-	-	-
City of Philadelphia, Pennsylvania:						
Municipal Retirement System	$78,198	15.39	e/$3,000	.59	.46	3.84

APPENDIX II

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
City of Pittsburgh, Pennsylvania:						
Municipal Pension Fund	$4,968	18.77	$3,439	13.00	4.51	69.22
Policemen's Relief and Pension Fund	2,516	12.08	6,888	33.06	9.03	273.77
Firemen's Relief and Pension Fund	2,443	15.84	5,031	32.63	6.60	205.94
	$9,927		$15,358			
City of Reading, Pennsylvania:						
Officers and Employees Retirement System	$ 723	15.56	$ 707	15.22	9.50	97.79
Police Pension Fund Association	347	14.58	793	33.32	10.65	228.53
Paid Firemen's Pension Fund	68	5.09	322	24.10	4.33	473.53
	$1,138		$1,822			
Wisconsin:						
Wisconsin Retirement Fund (State portion)	$53,490	12.23	-	-	-	-
State Teachers' Retirement System (State portion)	24,902	10.87	-	-	-	-
	$78,392					
Dane County, Wisconsin:						
Wisconsin Retirement Fund (Dane County portion)	$2,731	14.45	-	-	-	-

APPENDIX II

Jurisdiction/plan	Pension contributions: Amount	Pension contributions: Percent of payroll	Additional pension contributions needed to meet ERISA standard	Additional pension contributions as a percent of: Payroll	Tax revenues	Current contributions
	(000 omitted)		(000 omitted)			
City of Madison, Wisconsin:						
Wisconsin Retirement Fund (Madison portion)	$5,025	16.47	-	-	-	-
City of Milwaukee, Wisconsin:						
Employees' Retirement System	$27,671	19.46	$314	.22	.29	1.13
Policemen's Annuity and Benefit Fund (Closed)	2,758	306.79	-	-	-	-
Firemen's Annuity and Benefit Fund (Closed)	1,697	154.41	-	-	-	-
	$32,126		$314			
Milwaukee County, Wisconsin:						
Employees' Retirement System	$18,312	15.34	-	-	-	-
Grand Total	$2,422,673		$1,433,250			

a/The appendix shows the effect of applying the ERISA standard on each plan we reviewed for only the latest year for which we had complete financial and actuarial information. It does not reflect decisions regarding these plans that might have been made by State and local government officials affecting years after the one we reviewed.

b/These percentages were derived by GAO by dividing the contributions by the payrolls for the year we reviewed (ended June 30, 1977). For that year the total payroll for members of the new plan amounted to $216,223,791, and for the old plan $5,363,546. The contribution rates recommended by the actuary for that year were 40.3 percent of payroll for the new plan, and 14.7 percent plus a lump sum of $21,459,975 for the old plan.

c/On July 1, 1977, the city of Los Angeles changed its method of amortizing the unfunded liabilities of these plans from the level dollar to the percentage of payroll basis. See page 18 for details.

d/This is a supplemental plan with optional membership. Payroll data for members were not available. Basic benefits for police are provided under Pensacola's General Pension and Retirement Fund.

e/This amount is based on data for the fiscal year ended June 30, 1977. Starting with the fiscal year beginning July 1, 1977, the city of Philadelphia adopted a funding method which provides for amortization of the unfunded liability over 40 years on a level dollar basis.

APPENDIX II

METHODS USED FOR PROJECTING THREE PENSION PLANS ON PAY-AS-YOU-GO VERSUS ACTUARIAL FUNDING

The three plans selected--the Massachusetts State-Boston Retirement System, the city of Pittsburgh Policemen's Relief and Pension Fund, and the Delaware State Police Pension Plan--are all operating on a pay-as-you-go basis, but all have recent actuarial valuations. We used the existing actuarial valuations to estimate the normal cost and the unfunded liability, the two essential features of actuarial funding. The payroll was projected to increase a constant percentage each year, with the percentage selected being consistent with the plan salary scale assumption. Implicit in our method is the assumption of a constant work force. This means that any time an active plan member dies, retires, becomes disabled, or is terminated, he is replaced by a new entrant. Other assumptions that are made are that the actuarial experience will coincide with expected experience and that there is no change in the benefit structure. The unfunded accrued liability is amortized over 40 years using a level dollar amount.

In calculating the pay-as-you-go outlays, we used recent statistics and blended them in with the ultimate rate of increase, which will coincide with the assumed increase in payroll. For the Delaware State Police Pension Plan, we had an age and service distribution, which we used by superimposing a 20-year cycle over all the other factors.

As a result of being constrained to the assumptions used in the actuarial valuations, the calculations for the various plans are not necessarily consistent with each other. The following factors generally result in deferring the crossover point (the time when pay-as-you-go cost first exceeds the actuarially funded cost): (1) the salary scale projected by the actuary in the valuation is higher than the interest rate projected by the actuary, (2) the pension plans contain a provision for increasing the benefits of retirees generally based on increases in the cost of living, (3) the plans have an "immature population," or a population with few retirees whose average age will increase in the future, and (4) an increasing work force which will bring in a lot of new entrants in the future is projected. As noted above, we assumed a constant work force.

STATE OF CALIFORNIA — BOARD OF ADMINISTRATION
EDMUND G. BROWN JR., Governor

PUBLIC EMPLOYEES' RETIREMENT SYSTEM
1416 NINTH STREET, P.O. BOX 1953
SACRAMENTO, CALIFORNIA 95809
Telephone (916) 445-7629

May 29, 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

Thank you for the opportunity to review the draft report entitled "The funding of State and Local Government Pension Plans: A National Problem". Although our review of necessity was not as thorough as we would wish, the report appears to be a fair treatise on the current status of state and local government public pension plan funding.

The application of ERISA funding standards to public pension plans may not be the appropriate yardstick, but your proposed report is not the proper forum to discuss that issue.

We have only one suggestion for improvement. The report contains several appendices which list retirement systems by name. The report states that 32 plans (see Page 14) are actuarially funded but does not list them or detail the funding method. Such a listing would make the report more meaningful, in our opinion.

The draft report is returned herewith.

Sincerely,

Carl Blechinger

CARL J. BLECHINGER
EXECUTIVE OFFICER

HAS:CJB:aes

Enclosure

GAO note: Any page references in appendixes IV through XXXVIII may not correspond to page numbers in this final report.

UNIVERSITY OF CALIFORNIA

BERKELEY • DAVIS • IRVINE • LOS ANGELES • RIVERSIDE • SAN DIEGO • SAN FRANCISCO SANTA BARBARA • SANTA CRUZ

UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

2111 BANCROFT WAY, ROOM 301
BERKELEY, CALIFORNIA 94720

May 17, 1979

Mr. Gregory J. Ahart
Director, Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

This will respond to your letter of April 25 to President Saxon.

Thank you for sending a draft of the proposed report on public pension plan funding for our review. Although we do not have any specific comments, we found the draft to be of considerable interest, and agree that the present and future financing of public pension plans is an appropriate matter for concer.

We will look forward to receiving a copy of your final report to Congress on this matter.

Sincerely,

Morley Walker

Morley Walker
Director of University
Benefit Programs

cc: President Saxon

APPENDIX VI

STATE OF CALIFORNIA

EDMUND G. BROWN JR., Governor

STATE TEACHERS' RETIREMENT SYSTEM
P.O. BOX 15275-C
SACRAMENTO 95813
916-920-7000

June 14, 1979

Mr. Gregory J. Ahart, Director
Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

We have reviewed the draft copy of your report to Congress entitled "The Funding of State and Local Government Pension Plans: A National Problem." As we understand the report, it addresses primarily funding/benefits/actuarial problems. It demonstrates there is a serious problem. We were surprised to see there was not a specific recommendation for legislation to control this situation.

We are heartened by efforts to improve reporting and disclosure by the FASB, AICPA, and the Municipal Finance Officers Association of the United States and Canada, which will in a relatively brief length of time make visible on the state and municipal level, reports which will display the problems you address in your report in a manner understandable at the local level where they ultimately must be handled.

Thank you for the courtesy of sending us a draft for review.

Sincerely,

Michael N. Thome

MICHAEL N. THOME
Chief Executive Officer

APPENDIX VII

COUNTY OF IMPERIAL
THE WINTER GARDEN OF AMERICA

RON LEMON
COUNTY TREASURER

PHONE:
352-3610
Ext. 223 & 224

COURTHOUSE
EL CENTRO, CALIFORNIA 92243

June 29, 1979

Gregory J. Ahart, Director
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

A retirement plan should indeed be maintained on a sound actuarial basis in accordance with the provisions adopted by the governing bodies as set forth in the respective laws governing the plan. Total benefit payments + expenses - investment income = the cost of all retirement plans; therefore, an actuarial investigation and valuation should be conducted under the supervision of a competent actuary, not exceeding three year intervals, covering the mortality, service, and compensation experience of members and beneficiaries together with a valuation of the assets and liabilities of the retirement plan for the purpose of providing a systematic means of funding the cost of a plan on a current "Pay as you owe" basis. (Govt. Code, Ch. 3, Pt. 3, Div. 4, Title 3 - County Employees Retirement Law of 1937)

It has been noted, the G.A.O.'s Draft of a Proposed Report concerning "The Funding of State and Local Government Pension Plans: A National Problem," a number of State and Locals Government plans are not being funded on a sound financial basis and a number of plans face a more serious funding problem in the future unless remedial steps are taken.

In view of this fact, perhaps the Federal Government should write into law "Minimum Funding Standards" based on sound Actuarial recommendations; however, each State Legislature would be the logical governing body to closely monitor actions taken by public retirement plans within the State (State writes pension laws) to

 APPENDIX VII

assure the soundness of each plan to protect pension benefits.

It is impossible to adequately comment on Funding Pension Plan Problems without additional information.

Respectfully submitted,

Dorothy Ehmke

DOROTHY EHMKE, RETIRED
IMPERIAL COUNTY TREASURER

P. S. Please feel free to contact me if you have any questions concerning the above comments.

Copy: U. S. Dep't Labor, G. A. O.
Room N 1509
200 Conn Aven. N. W.
Washington, D. C. 20548

DE:amb

APPENDIX VIII

CITY OF LOS ANGELES

CALIFORNIA

C ERWIN PIPER
CITY ADMINISTRATIVE OFFICER

ROBERT E CHASE
JOHN R COOMBS
WILLIAM R McCARLEY
JEROME R SELMER
THOMAS K SHIELDS
ASST CITY ADMINISTRATIVE OFFICERS

TOM BRADLEY
MAYOR

July 17, 1979

Mr. Gregory J. Ahart, Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

We have received your draft of the proposed report on "The Funding of State and Local Government Pension Plans: A National Problem". The draft appears to be a comprehensive, factual and unbiased report of some of the major problems facing state and local government pension plans.

We believe the wait and see attitude of the recommendation is appropriate. State and local governments have only recently recognized the problems future funding requirements will have on their operations and financial stability. Given this recent awareness, state and local agencies should have the opportunity to correct those problems which are unique to their own circumstances. We especially appreciate the section discussing the impact Proposition 13 has on our ability to meet ERISA standards.

We have only three comments concerning the draft. On page 25 of the draft, the level percent-of-payroll funding method currently being used by our Fire and Police Pension System, as well as by many of the other systems that were reviewed in your study, is discussed. The draft points out that the appeal of such a funding method is that payments in the early years are smaller than under the level dollar approach to amortization of unfunded liabilities. The draft lists some of the common criticisms of the level percent-of-payroll, funding method stating that (1) under such a funding method, unfunded liabilities increase in the first funding years, (2) such a funding method requires accurate projections of future payroll and (3) such a funding method postpones the payment of large amounts into the pension fund for future taxpayers to pay for commitments made many years before. No conclusions are drawn as to the appropriateness of this funding method other than to point out that for a number of years this method will not conform to ERISA standards.

AN EQUAL EMPLOYMENT OPPORTUNITY—AFFIRMATIVE ACTION EMPLOYER
300 CITY HALL EAST, LOS ANGELES, CALIF 90012 TEL 485-2881

We believe the report might also point out that, although the unfunded liabilities do increase in the early years, they will still be amortized over a planned period of amortization. Furthermore, such a funding method does not require an accurate projection of future payroll. While the goal would be to have a level percentage of payroll contribution in future years to amortize the unfunded liability, the actual experience of the system is still reviewed frequently and, if needed, the percentage contribution can be increased or decreased if and when it becomes obvious that the assumptions used in initially determining the appropriate rate were incorrect. Finally, the report does not point out that the relative burden of funding the unfunded liabilities is shared equally by all generations under this funding method, whereas the level dollar amount of amortizing liabilities places the greatest relative burden on the taxpayers in the current year and provides a reduced burden in each subsequent year during the amortization period.

A second consideration that might be incorporated in your report concerns the standards the Federal government believes are appropriate for private, state and local pension plans and the standards it applies to its own pension plans. While we recognize that the Federal government's sources of revenue are virtually unlimited, we believe that whatever standards may be imposed on state and local governments should at the same time be imposed on the Federal retirement plans. The problems that are identified as existing in trying to fund state and local governments apply to the Federal system. It would be hypocritical of the Congress to set one standard for private, state and local pension systems and to set no similar standards to govern the funding of its own pension plans.

Finally, there is one minor error in the draft as concerns the City of Los Angeles. On the bottom of page 43, the report says that a minimum retirement age of 50 to 55 years with benefits based on a final average salary of one to three years are proposed for the new Safety Members Pension Plan that is currently under consideration. Actually the proposed plan would provide a minimum retirement age of 50 years and would base benefits on the last one year average salary.

Thank you for the opportunity to review the draft. We regret the delay in responding. It was a pleasure to work with your staff representatives who visited Los Angeles. They were very professional and were receptive to the input we wished to make concerning this project.

Very truly yours,

C. Erwin Piper

C. Erwin Piper
City Administrative Officer

CEP:CWM:gdm

CITY OF LOS ANGELES

CALIFORNIA

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MAYOR

FIRE AND POLICE PENSION SYSTEM
501 CITY HALL SOUTH
LOS ANGELES CALIF 90012
485-2833

M LEWIS THOMPSON
MANAGER-SECRETARY

May 9, 1979

Mr. Gregory J. Ahart, Director
Human Resources Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Ahart:

Thank you for forwarding the draft of the General Accounting Office report on "The Funding of State and Local Government Pension Plans: A National Problem".

We have a few comments to make on the report as follows:

1. On Pages 26 and 27 the funding of this Pension System is accurately described as the level percentage of salary method. Furthermore, it is stated that the annual contribution does not meet the ERISA standards. However, it is not clear whether the problem is the 70-year amortization period, or whether the level percentage of salary method itself is not consistent with ERISA standards, especially when annual contributions are less than the interest requirement.

2. You describe on Page 29, as an example of pension reform legislation, the California law requiring all public plans within the State to submit annual audited reports within six months after the close of the fiscal year, and to have actuarial studies at least every three years. The six month requirement is often impractical to meet because of the length of time required to close the books on the system, which must be accomplished including amortized values on bonds prior to obtaining (in our case) an annual actuarial valuation whose values are then incorporated by the auditors in the financial balance sheet. This Pension System has been completing annual actuarial valuations and independent audits for twenty years but we are rarely able to get this work done within six months because of the time sequence.

3. In Appendix I it appears that the figures involving this Pension System are inaccurate in that the membership and contribution figures are as of June 30, 1977 whereas the Asset and Unfunded Liability figures are as of June 30, 1975.

4. In Appendix II the figures involving this Pension System show 1977 contribution amounts whereas the contributions as a percentage of payroll more nearly approximate the 1975 contribution rates.

The foregoing are the only matters that we believe necessary to direct to your attention and generally we find the report to be well done and very interesting. Your draft is returned herewith.

Yours sincerely,

M. Lewis Thompson

M. Lewis Thompson
Manager-Secretary

MLT:bn

Enc.

WATER AND POWER EMPLOYEES'
RETIREMENT, DISABILITY AND DEATH BENEFIT
INSURANCE PLAN

TOM BRADLEY
MAYOR

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IRMA K. ZAHID
ADMINISTRATOR-SECRETARY

May 15, 1979

Mr. Gregory J. Ahart
Director
U. S. General Acctg. Office
Washington, D. C. 20548

Dear Mr. Ahart:

I have reviewed with interest the draft of your proposed report entitled "The Funding of State and Local Government Pension Plans: A National Problem". It appears to be thoroughly researched and documented.

I am in full agreement with the message of your report. Liabilities created by pension plans at the state and local level have reached such proportions that they may already exceed the capacity of the tax base which supports them.

You have quite thoroughly discussed the effects of Proposition 13 on the financial outlook of public systems in California. This is, of course, a major cause of concern for two of the three pension plans of the City of Los Angeles. The third, the Water and Power Employees' Retirement Plan, was not affected by Proposition 13. It is funded entirely with contributions made by employees and the Department of Water and Power. The Department's contributions are made from revenues generated through the sale of water and electricity.

Because you have included the Water and Power Employees' Retirement Plan in your sample, we request that in your final report you include a reference to the source of funds which support the Plan. We are aware that the City's ratepayers are no more an inexhaustible source of funds as are its taxpayers.

 APPENDIX X

However, the cost of the Water and Power Employees' Retirement Plan is less than 5% of the total revenues of the Department of Water and Power. This fact alone should assure everyone that this Retirement Plan will continue to be properly funded as it has been since its inception.

Sincerely,

Irma K. Zahid
Administrator - Secretary
Employees Retirement Plan

IKZ:nl

CITY OF OAKLAND

CITY HALL • 14TH AND WASHINGTON STREETS • OAKLAND, CALIFORNIA 94612

Office of the Mayor
Lionel J. Wilson
Mayor

June 7, 1979

Mr. Gregory J. Ahart, Director
Human Resources Division
United States General Accounting
Office
Washington, D. C. 20548

Dear Mr. Ahart:

I have received a copy of your proposed report to the Congress of the United States entitled "The Funding of State and Local Government Pension Plans: A National Problem". I have had our Retirement System Administration Manager review the draft. I would like to make the following suggestions to the report which, I feel, would alleviate its effect upon local governments facing financial difficulties.

Your report showed an analysis of the types of funding used by various plans including pay-as-you-go, actuarial, percent of salaries, and Employees Retirement Income Security Act (ERISA) type funding for private plans. The City of Oakland has been, and will continue to be, on record against certain elements of an ERISA type funding plan.

ERISA funding requires an employer to contribute annual equal installments of principal and interest amortized over 40 years for plans in existence prior to 1974, and 30 years for plans created subsequent to that date. As a result of the 1977 Actuarial Evaluation of the Police and Fire Retirement System, the City chose to eliminate the pay-as-you-go method of funding, increased its' rate of contribution to 71% of total payroll (to be amortized over 40 years) and enter all new uniformed employees in the State Safety System. However, our revised plan doesn't provide the ERISA type of funding, but it is a recognized type of actuarial funding and is a step in the direction toward eliminating the City's unfunded liability.

In order for the City to comply with the ERISA type funding method, it is estimated that an additional $17 million (of a $100 million budget) would have to be contributed to the Police and Fire Retirement System. The City's financial situation is one in which

APPENDIX XI

we are currently considering $7.9 million in reductions for Fiscal Year 1979-80. If ERISA were imposed on local governments, the City would have to consider further reductions in services and personnel which are untenable.

State and local pension plans should be closely monitored in the national interest of protecting employee rights. I believe the proposed House Bill 14138 entitled "Public Employee Retirement Income Security Act of 1978 (PERISA)", which would regulate state and local pension plans in the areas of reporting and disclosure requirements; participation and vesting standards; fiduciary requirements; and administration and enforcement requirements, is a viable agent to assist Congress eliminate some serious concerns.

In conclusion, I feel that state and local governments which are trying to eliminate their funding problems should not be compounded with a funding method (EIRSA) that is more costly than they can afford. However, Congress should consider uniform requirements in the areas of reasonable amortization and the elimination of pay-as-you-go funding.

Sincerely yours,

Lionel J. Wilson

LIONEL J. WILSON
Mayor

STATE OF FLORIDA
Department of Administration
Division of Retirement

Robert L. Kennedy, Jr.
STATE RETIREMENT DIRECTOR

MAILING ADDRESS
530 Carlton Building
Tallahassee, Florida 32304

LOCATION
Cedars Executive Center
2639 North Monroe Street
Tallahassee, Florida

Bob Graham
GOVERNOR

Jim Tait
SECRETARY OF ADMINISTRATION

June 6, 1979

Mr. Gregory J. Ahart, Director
U. S. General Accounting Office
Room N1509
U. S. Department of Labor
200 Constitution Avenue, N. W.
Washington, D. C. 20210

Dear Mr. Ahart:

This letter is in response to your letter dated April 20, 1979, requesting comments on your proposed report entitled "The Funding of State and Local Government Pension Plans: A National Problem". I am also writing at the request of Governor Graham to furnish you more detailed information regarding the provisions of the Florida Retirement System and the present posture Florida is in regarding the funding of local retirement systems. Also, attached are comments made by Mr. Larry Gibney, our State Retirement Actuary, which you may find helpful.

One of the major problems I have with the report is the method and procedures used in reporting the state-administered Florida Retirement System. On page 9 of the draft, you state that you examined at least one plan administered by the State government and all the plans under selected local governments. Yet, in your Appendices I and II, you have attempted to show the State portion of the Florida Retirement System by presenting figures purporting to be the State's share of the assets in the system and the State's share of the unfunded liability, together with the annual retirement contributions from the employer. I am sure that members of your staff who reviewed and studied Florida's Retirement System were aware that the State and County Retirement Systems were merged into one system in 1955 and that the consolidated Florida Retirement System was established in 1970, which brought together the Teachers' Retirement System, the Highway Patrol Retirement System, the State and County System, and later the Judicial Retirement System, all as plans within the Florida Retirement System. Members of these existing systems were permitted to transfer to the Florida Retirement System, and most of them have elected to do so.

You indicate in the appendices that the number of active members in the system at the state level is not available. You also indicate that the number of inactive members, retirees, and beneficiaries is not available. We do have available the number of active members in the system who are currently on the State payroll, and we can determine the number of retirees and the beneficiaries of State retirees on our retired payroll who retired from State service (although part of their benefit may have accrued from local service). We also can determine from our records the actual retirement contributions received each year from the State on behalf of State employees. However, since many State employees have service credits which were earned with local units of government or with the school boards, and vice versa, it is impossible to determine the total liabilities of the system which was generated by state, local or school board service; likewise, it is next to impossible to segregate the plan assets which may apply to these liabilities. You will note that the State Retirement Actuary has suggested that the consolidated Florida Retirement System be presented as a single plan, since any arbitrary division to indicate a State portion is pure speculation.

On page 31 of the report, you state that prior to the 1977 State Constitutional Amendment to prevent the practice, Florida governmental units had the power to increase pension benefits without providing funding on a sound actuarial basis. I note that this constitutional amendment, which was a major pension reform in Florida, is listed under a subtitle called "Obstacles to Pension Reform". It would appear that this at least should be noted under the range of pension reforms as a significant action by the State of Florida in addressing the funding problems of state and local retirement systems. Some states do have constitutional provisions relative to public pensions which are obstacles to pension reform, but Florida is not one of them.

On page 32 of the report, you state that the Florida Retirement System's unfunded liability more than doubled over a 5-year period, and you indicate that one of the primary reasons for this steep increase was the fact that the benefit accrual rate for our special risk members was increased from 2 percent to 3 percent per year of service. Since the special risk members constitute about 5 percent of our total membership, I believe that it is misleading to present this change in benefit accrual as a primary reason for doubling the accrued unfunded liability during this 5-year period. You will note on the attachment prepared by Mr. Gibney, the State Retirement Actuary, that he suggests that the reasons for this steep increase which are listed in the Actuarial Report should be reflected in your report in order for it not to be misleading.

On page 41 of the report, you state that "Florida approached pension reform from several angles--restraining unfunded benefit growth, <u>reducing payments</u>, and increasing income". I have underlined a portion of this statement since it may well be misleading. To my knowledge, Florida has never reduced any benefit payments after retirement. The case law in Florida holds that a public retirement benefit is not really vested until a person actually retires. Under this construction, a person's retirement benefit cannot be reduced after retirement unless the system from which he retired contained provisions to permit such reduction prior to his retirement. The case law also provides that prior to retirement, the legislative body can change the benefit formula and, at least, lower benefit accruals on a prospective basis. This being the case, your statement on the top of page 42 probably should be clarified by stating that the

Florida Legislature has the authority to reduce benefit accruals prior to retirement without the approval of the voters or pension plan members.

I believe that Governor Graham reported to you on many of the pension reforms which have been instituted in Florida in recent years. The 1979 Legislature has amended Part VII of Chapter 112, Florida Statutes, which greatly strengthens the minimum standards for the operation and funding of public employee retirement systems in Florida. These amendments, which become effective October 1, 1979, specify certain information which shall be included in each actuarial report on public retirement systems in Florida, which are required to be made at least once every three years. Each plan sponsor must adopt a plan to amortize any unfunded liability over a period of time not to exceed 40 years, and no local retirement system can agree to a proposed change in retirement benefits unless a statement of actuarial impact on the proposed change is issued, indicating that such change is in compliance with the constitutional provisions requiring actuarial funding of benefit increases and the funding requirements of Part VII of Chapter 112, Florida Statutes.

The Division of Retirement, Department of Administration, is given the responsibility to receive and comment on all actuarial reports covering local retirement systems. The Division is required to review and comment on the actuarial valuations and statements, and if it is determined by the Division that the actuarial review and statements are incomplete, inaccurate, or based on unreasonable assumptions, it may require the submission of another actuarial review, and if found necessary, the Division is required to perform the actuarial review or prepare statements of actuarial impact.

There are many other general provisions in the amendments enacted by the 1979 Legislature which makes it probably one of the first major pension reform laws enacted by any state. The fact that Florida has acted so swiftly and comprehensively in pension reform at the state and local level would raise questions about your statements in the report that such pension reforms are moving slowly, and your conclusion that the prospects for significant improvements in this area in the foreseeable future are not bright. I sincerely hope that the federal government will act with similar dispatch in straightening out the provisions and the funding problems of the Social Security Program, the Civil Service Retirement System, and the other retirement systems for which the federal government is responsible.

I appreciate very much being given the opportunity to comment on the draft of your proposed report to Congress, and I look forward to receiving a copy of your final report.

Sincerely,

Robert L. Kennedy, Jr.
Robert L. Kennedy, Jr.
State Retirement Director

RLKjr/na

Attachment

cc: Honorable Bob Graham

The Funding of State and Local Government Pension Plans: A National Problem

Prepared: By the Staff of the U. S. General Accounting Office.

Comments: By L. J. Gibney, State Retirement Actuary, Florida. (904) 488-2879

A. Page 21 - State - Boston Retirement System

I believe your comparison is misleading in that you have combined the normal cost payment (NC) with the amortization payment (AP). I would suggest the following format:

		PAY-AS-YOU-GO		ACTUARIAL
Initial Unfunded Liability		$1,152,000		$1,152,000
1st Year Cost	NC $64,788		NC $43,504	
	AP -0-	64,788	AP 85,088	128,592
At 17th Year	NC $168,894		NC 81,441	
	AP -0-	168,894	AP 85,088	166,894
At 41st Year	NC	490,098	NC only	215,827
Unfunded Liability:				
At 17th Year		2,260,460		988,651
At 41st Year		3,543,910		-0-

I know the $497,215 you cite is composed of $215,827 of normal cost and $281,388 of amortization payment. The uninformed may mistake the required payment to be $497,215 plus the contribution shown at the 41st year, i.e. $215,827. The $497,215 shouldn't appear too large since it is only $7,118 greater than the normal cost under the pay-as-you-go basis.

B. Page 31 Top Paragraph

I would suggest you omit the last two sentences, the first one beginning with . . . . . "However . . . especially during the 40 year . . . . . ".

C. Page 32 Top of Page

Delete: A primary reason for the steep increase, according to the State Actuary, was that . . . . . etc.

Substitute: The reasons for the steep increase as mentioned in their latest actuarial report were:

(1) Benefit liberalizations, without adequate funding increases.

(2) Changes in the actuarial assumptions upon which the 1972 and 1977 valuations were bases.

(3) Lack of payments sufficient to prevent increases in the unfunded past service liability.

APPENDIX XII

D. Page 28 Methods of Amortization

The benchmark in your analysis is the funding requirement of ERISA. Is the benchmark applicable to public plans which in essence may have infinite life? Admittedly, the same couldn't be said of many private corporations. Therefore, in light of this distinction, would it not be appropriate to recognize a level percent of payroll amortization so that governments could at least make a start in the right direction toward actuarial funding. Better still, permit the use of "increase in payroll assumption" to further ease the transitional burden from pay-as-you-go to actuarial funding.

E. Statistical Tables

The Florida Retirement System is a consolidated system made up of several systems that were in existence December 1, 1970. Both assets and liabilities were brought together and accordingly, any arbitrary division to indicate a so-called "state portion" is pure speculation. I would suggest the consolidated figures be used which are:

Active Members	350,186
Inactive Members, etc.	41,815
Employer Contribution	
Basis	Actuarial
Amount	$ 367,979,000
Plan Assets	$2,504,487,619
Unfunded Liability	$3,538,351,000

LJG:mn
5/18/79

 APPENDIX XIII

MAYOR
Corinne Freeman
COUNCIL
J W Cate Jr
Sally Wallace
Richard Martin
Betty Ray Finley
Peter A England
Charles L Fisher
CITY MANAGER
R E Harbaugh

CITY OF ST PETERSBURG
OFFICE OF THE CITY MANAGER

June 11, 1979

Mr. Gregory J. Ahart, Director
Human Resources Division
U.S. Department of Labor
General Accounting Office
Room N 1509
200 Connecticut Avenue
Washington, D.C. 21210

SUBJECT: "The Funding of State and Local Government Pension Plans: A National Problem"

Dear Mr. Ahart:

Thank you for submitting for our review a draft of the proposed report concerning public pension plan funding. We are pleased that St. Petersburg's retirement systems were included in the study, and we appreciate this opportunity to submit our comments.

This City endorses the interest which has developed at many levels to assure the security and appropriate funding of public retirement systems in the same manner that ERISA protects the rights and benefits of employees in the private sector. The Florida State Legislature has addressed this subject during the 1978 and 1979 sessions. In 1978, the laws of Florida were amended to create the "Protection of Public Employees' Benefits Act," Chapter 78-170, Laws of Florida - 1978. This statute provides valuable guidance for the overall operations of public retirement systems to achieve a common goal of sufficient funding, fiduciary responsibility and employee disclosure procedures.

Additional amendments were proposed in the 1978 Legislative Session, which adjourned on June 6, 1979. The City of St. Petersburg presented testimony during the drafting of these laws which agreed that suitable legislation could be beneficial. However, our testimony also recommended that this legislation should be flexible, should encompass generally-accepted actuarial and accounting principles, and should permit local government to fund retirement systems in coordination with other financial priorities rather than through mandated provisions.

The exhibits contained in your report demonstrate that in some instances, regulatory legislation would furnish a necessary impetus to state and local agencies to assure adequate funding of existing liabilities and also monitor future amendments to the Plan. Since 1968, the City of St. Petersburg has recognized the potential difficulties of insufficient funding for its Fire and Police Plans and has taken appropriate action to accomplish a suitable amortization program. It is very possible that other municipalities not included in your survey have heeded an early warning and are proceeding on this systematic basis.

We would comment that your reference to a July, 1977 cost-of-living program for our general Employees' Retirement System (page 18) should perhaps also state that this program was developed in coordination with actuarial recommendations. Although the increase in the pension plan's unfunded liability from $1.2 million to $5.1 million within a year is essentially due to the creation of this program, the report does not reflect that this program is a pre-funded feature of a retirement system with an excellent funding posture since its creation in 1944. A valuation report completed October, 1978, reflects the City's contribution rate is less than 6 percent of payroll; and it is not anticipated that this program, which attempts to provide on an extremely conservative basis some defense to retirees for ever-increasing inflation rates, will become a detrimental cost burden to this retirement system.

This city's Fire and Police Retirement Systems have required a high contribution rate which is anticipated to continue for the next several years. In 1968, this city acted to reduce the increasing costs of these funds by developing less liberal programs in which the membership of all new employees is compulsory. The savings impact of the newer programs has been noted in the last several actuarial valuations, and costs for each system are expected to decrease in the next several years.

The proposed report demonstrates that many state and local plans require some intensive study to assure that benefits promised shall be benefits paid. This city's pension funds are subjected to an annual actuarial valuation and regular five-year experience studies. The frequency of this monitoring assures the identification of trends and facilitates the early correction of those which might become costly. A similar requirement for all public retirement systems would have the same beneficial effect, so long as the remedy of any funding deficiencies so determined shall be accomplished over a term which acknowledges both employee concerns and civic responsibility.

Cities such as St. Petersburg, which are cognizant of the potential difficulties and have taken corrective actions dictated by the best actuarial principles, should be encouraged to continue their programs without excessive governmental control. Certainly, those plans which are on a pay-as-you-go basis should be persuaded to consider the possible future financial constraints caused by taxpayers' sentiment and other economic uncertainties. The solution to the prevalent difficulties in the public sector may well be tied to actuarial funding, strict fiduciary responsibility, and restraint to benefit levels which may be in excess of reasonable assumptions.

 APPENDIX XIII

Again, we appreciate the opportunity to respond to the report and also that St. Petersburg was included as a test city. Please do not hesitate to contact us if we can be of assistance.

Sincerely,

R.E. Harbaugh
City Manager

REH/jmc

 APPENDIX XIV

STATE OF ILLINOIS

OFFICE OF THE GOVERNOR

SPRINGFIELD 62706

JAMES R THOMPSON
GOVERNOR

May 9, 1979

Mr. Gregory J. Ahart
Director
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

Thank you for sending me a copy of "The Funding of State and Local Government Pension Plans: A National Problem." I note that you have forwarded a copy of it to Dr. Robert Mandeville, Director of the Bureau of the Budget. I am sure he has found it to be as informative a document as I have.

Very truly yours,

James R. Thompson
Governor

JRT/cf

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

1201 SOUTH FIFTH STREET SPRINGFIELD, ILLINOIS 62706

Phone 217—782-7008

May 3, 1979

Mr. Gregory J. Ahart
Director, U.S. General Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart:

Thank you very much for furnishing me with a draft copy of the report entitled "The Funding of State and Local Government Pension Plans; A National Problem".

While I basically concur with comments contained in the report as well as the overall conclusions and recommendation, I would offer the following comments regarding specific references made to Illinois and more specifically the State Employees' Retirement System.

1. Based on your own definition of pay-as-you-go funding as contained in the first sentence of the second paragraph on page 8, I cannot concur with comments made in reference to Illinois such as contained on page VII. While I certainly agree that a financing problem exists which must be addressed, we certainly do not operate on a pay-as-you-go basis. Specifically, an actuarial valuation prepared as of June 30, 1977, recommending funding levels for FY'79 indicated that an employer contribution rate of 7.46% of payroll was necessary to meet the fund's normal cost requirement. The actual contribution rate certified by our Board of Trustees, which is now being collected, was 7.76%. While this level is certainly far below the normal cost and interest level of 11.17% or the 40-year amortization level of 11.78%, I do not believe it represents a pay-as-you-go situation. In addition, as indicated in your report, assets of the System as of June 30, 1976, amounted to nearly $600,000,000, a situation under a true pay-as-you-go philosphy which simply would not exist.

2. I believe the financial information contained in Appendix I for our System was inadvertently taken from two different fiscal years, FY'76 and FY'77. Statistical information regarding the number of members and the level of employer contributions was taken from our FY'77 Annual Report while plan assets and liabilities were taken from the FY'76 Report. I would suggest the following changes:

Plan Assets: $650,989,000
Unfunded Liability: $779,084,000

APPENDIX XV

3. I would suggest the following changes to information regarding our System as contained in Appendix II:

Pension Contributions: Percentage of Payroll 6.70%

Additional Pension Contributions needed to meet ERISA
Standard: $63,959,000
Percentage of Payroll 7.24%
Percentage of Current Contribution 106.96%

These changes are based on recommendations made by our Actuary as contained in the valuation report dated June 30, 1977, which contain a 40-year amortization requirement of $123,756,868. The payroll utilized to develop the above percentages was 884.5 M as contained in our FY'77 Annual Report. I would also point out that the payroll percentage of 5.1%, utilized on page 9 of the report, should properly be changed to 6.7%

I would appreciate your consideration of the comments I have made in this letter and should you have any additional questions, please feel free to give me a call at 217/782-7000.

Very truly yours,

Michael L. Mory

Michael L. Mory
Executive Secretary

MLM:jld

CITY OF CHICAGO
Jane M. Byrne, Mayor

DEPARTMENT OF FINANCE
City Hall, Room 501
Chicago, Illinois 60602

Clark Burrus
City Comptroller
312/744-7100

Robert E. Shaw
First Deputy Comptroller
312/744-3233

June 22, 1979

Mr. Gregory J. Ahart, Director
United States General Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart:

I apologize for any delay in responding to your letter of April 25th. However, I did not receive your draft until the end of May. As a trustee of four of this City's pension funds, Police, Firemen, Laborers and Municipal Employees, I viewed your draft in light of that relationship and also as Comptroller of the City of Chicago.

As I preceive it, your draft summerizes your sampling "Fact Finding" investigation as a criterion for one conclusion and one vague implication. Namely:

A. Federal Control and Regulation (PERISA)
B. Probable federal pension grants

I don't however, understand how laws or regulations, however judicious, can generate the immediate local tax monies that your report states are in such acute need. Ergo, a Federal local and state pension subsidy must, logically, follow.

On page 16 of your report you use the Chicago Municipal Employees' fund as a prime example of increasing unfunded liability. You purposely neglected to mention certain corresponding facts. The most salient of which are:

1. This fund assets increased from $284.8 million in 1970 to over $472.6 million in 1976 or over 65.9%

2. The funds annual surplus (yearly income less expenditures) increased over 189% ($15.003 million in 1970 to $43.374 million in 1976)

3. The four funds mentioned have, for years, approximated proposed PERISA funding standards.

Furthermore, in Appendix I, Note (f) of your doctrine draft you list the multiples for the four funds in 1976, but carefully omit the fact that these multiples are increased as actuarial requirements have dictated.

CITY OF CHICAGO
Jane M. Byrne, Mayor

DEPARTMENT OF FINANCE
City Hall, Room 501
Chicago, Illinois 60602

Clark Burrus
City Comptroller
312/744-7100

Robert E. Shaw
First Deputy Comptroller
312/744-3233

COPY

Continued - Page (2)

For example:

Fund	1974	1975	1976	1977	1978	1979
Firemen	2.23	2.23	2.23	2.23	2.23	?
Laborers'	1.19	1.235	1.280	1.325	1.37	?
Municipal	1.43	1.495	1.560	1.625	1.690	?
Police	1.90	1.97	1.97	1.97	1.97	?

Before making your final recommendations and conclusions, it might be a sagacious move to analyze sources of income for all the funds in your cursory investigation. The four Chicago funds have three major sources of income.

Contribution Source	1970	1976
A. Employee	38.4%	30.1%
B. Employer	37.3	38.5
C. Investments	24.3	31.4
	100.0%	100.0%

Note that an increase in (A) or (C) would lighten the tax burden on (B) and would allow more monies for local services. An increase in (C) is obviously most desirable. Our four funds have increased their investment income from $25.083 million in 1970 to over $77.728 million in 1977; over 209% in seven years. The funded ratio has gone from 44.6% in 1970 to 46.2% in 1977. In dollars, the unfunded amount has increased but so have total assets.

I will not pass judgment on the rectitude of your conclusions or recommendation, except to say that your prescription may not be the panacea for public pension funding that your draft implies.

Sincerely,

C Burrus

Clark Burrus
City Comptroller

CB:VH:jnk

Public School Teachers' Pension and Retirement Fund of Chicago

228 N La Salle Street • Chicago, Illinois 60601

Telephone 641-4464

June 8, 1979

Mr. Gregory J. Ahart, Director
United States General Accounting Office
Washington, D.C. 10548

Re: GAO draft report on funding of state and local pension plans.

Gentlemen:

This is in response to your request for comment.

The report states that Illinois plans are managed on a pay-as-you-go basis. This would not be entirely accurate. While Illinois plans are not fully funded, they are not completely pay-as-you-go, and would more accurately be called "modified reserve funded." For example, the security ratio of the Chicago Teachers' plan has risen eleven percentage points in the last ten years illustrating an improving long-term financial position.

While the GAO report contains some excellent research, the suggestion that the Federal government regulate state and local government raises some serious questions. Can or should Congress require full actuarial reserve funding for state plans when it seriously underfunds the Social Security System and the Federal Employee System . . . while at the same time inflates national currency thereby compounding problems for both federal and local retirees.

Current thought on possible regulation of local plans suggests a better approach than direct regulatory legislation. Federal legislation could define minimum reporting and disclosure requirements along with minimum funding requirements with the stipulation that only those local plans that do not meet the minimum reporting and disclosure requirements would be required to meet the funding requirements. In this way, local financing would remain an essentially local problem, as it certainly is, as long as such financing was fully disclosed to taxpayers and benefit recipients.

We trust these comments are helpful.

Sincerely,

James F. Ward
Executive Director

JFW/bt

cc. Natalie Vlacher

APPENDIX XVIII

MUNICIPAL EMPLOYEES' ANNUITY AND BENEFIT FUND OF CHICAGO
221 N LASALLE STREET ROOM 208
CHICAGO, ILL 60601
TELEPHONES 744-3785-3786-3787

B K WALTERS, EXECUTIVE DIRECTOR

June 20, 1979

Mr. Gregory J. Ahart,
Director, U.S. General Accounting Office,
Human Resources Division,
441 G N.W. Street - Room 6864
Washington, D. C. 20548

Dear Mr. Ahart:

We offer our comments on your outlined draft on the subject of "The Funding of State and Local Government Pension Plans" on which matter you intend to report to Congress.

We wish to state first, that you have covered the subject and its problems well.

In so far as the Municipal Employees' Annuity and Benefit Fund of Chicago is concerned, we should indicate that we have fought in the Legislature and otherwise, throughout the many past years for at least some reasonable degree of funding, and the fact that we are approximately 50% funded--in contrast to a far lessor degree of funding found in, for example the State Employees', State University, and Teachers' Retirement System, indicates that we have had some degree of success, and that it can be locally accomplished. We personally would like to see the effort for better funding eminate at the State and local level rather than get into the involvement of Federal legislation which inclusion in ERISA type legislation would bring.

We know that the argument is going to be that unless forced to some required standard of funding, some States and local units of Government will never come to the point of taking action to inaugurate such a measure and will sink deeper into financial difficulties in so far as their pension funds are concerned. We recognize the merit of this argument.

Nevertheless, we would urge Congress to proceed slowly before intervening in problems we feel should be in the province of State and local government. If the State or local governing subdivision elects (we think foolishly) to operate their pension system on a pay as you go basis, they will eventually be forced to tax heavily for this choice. We do not believe the public employee will lose his pension; certainly not in Illinois with the Constitutional guarantee.

APPENDIX XVIII

We are not at all convinced that the Courts will find that Congress has the authority to impose funding standards on State and local government pension plans. We fear the multitude of regulations that would be imposed on such plans if a ERISA type of law were enacted covering public employee pension plans. In the end it might result in causing denial of tax benefits to the employees and survivors, and even taxing the income of the Fund itself under a rule that a plan was unqualified. Anything that might be gained by grants of the Federal Government to States or cities or to the Fund itself, could be lost by taxation of pension fund income. What is the old saying? "What is saved at the spigot is lost at the bung."

In Illinois participation in public pension funds gives the employee participant an enforceable contractual right to his promised pension, by virtue of a Constitutional provision. Many other States have such guarantee by "Court" construed interpretation of the law governing participants rights in their public pension Funds.

To sum it up, your analysis and survey of the problem relating to the improper funding of many of the State and local public employee pension plans covers the subject thoroughly from every standpoint. But we caution against haste in seeking the remedy through Congressional mandate both because of the legality of such action, and because of a doubt it will produce the desired result--namely the safeguarding of the promised pension to the public employee.

Let's first see if we can't generate improvement in funding at the State and local level.

Yours truly,

B. K. Walters
Executive Director

BKW:dmc

APPENDIX XIX

STATE-BOSTON RETIREMENT SYSTEM

ROOM 224. NEW CITY HALL
BOSTON. MASSACHUSETTS 02201
725-4636-45

May 18, 1979

Mr. Gregory Ahart, Director
U. S. General Accounting Office
Human Resources Division
Washington, DC 20548

Dear Mr. Ahart:

I would certainly agree that whatever method is adopted to ensure financial soundness and provide the pension protection to which public employees and their dependents are rightfully entitled is a complex one. I am not an advocate of the full-funding concept nor do I defend the Massachusetts so called "pay-as-you-go plan" in its present form; rather, I suggest the following be given serious consideration:

1. *That partial funding be adopted for better short-term control plus the exploration of other revenue sources to help finance current pensions. For example, a users charge of city services through an affordable payroll tax with all monies to be specifically earmarked for the pension accumulation fund. Interest earned through the investment of retirement contributions be credited to such fund and reinvested.*

2. *I suggest certain sections of the retirement law governing the Massachusetts Public Employees Retirement System be amended.*

3. *The inclusion of prospective public employees under social security since public pay scales and fringe benefits have caught up to those now offered in the private sector.*

4. *Periodic reexamination of the statutes governing accidental disability and death benefits and employ a more sophisticated method of checks and controls of outside earnings by those receiving such benefits.*

5. *Have retirement allowances pegged at the degree of disability rather than the full allowance paid regardless of one's ability to engage in gainful employment.*

6. *Strict adherence to the retirement law by retirement boards awarding benefits.*

APPENDIX XIX

In conclusion, I am inclined to think that many retirement systems could be more closely guarded to make certain that benefits being legislated are not increased excessively.

I have only suggested a few changes that could well result in offsetting the impact of yearly pension costs and, in addition, lessen any unfunded liability.

Since I am aware of Massachusetts problems only, I have addressed those problems; however, I feel that more public retirement systems throughout the country have found themselves in the same financial bind and could benefit from the comments I have made.

Very truly yours,

Harold B. Sacks

Harold B. Sacks
Executive Officer

HBS/ek

APPENDIX XX

OKLAHOMA MUNICIPAL RETIREMENT FUND

June 13, 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

Reference is made to the draft copy of the "The Funding of State and Local Government Pension Plans". I carefully reviewed the draft copy of the above mentioned report and have the following comments which I feel are pertinent to your study.

Obviously, I don't think anyone in local government is interested in any additional controls from Washington. It is also quite obvious there needs to be some encouragement from the State and local governments that their funds become actuarially sound; however, I do not believe that additional National laws are the answer. Since you have been asked to review the problem, you might share this problem with the American cities and the State governments in order to make them aware of the problem.

The particular fund that I am associated with is the Oklahoma Municipal Retirement Fund and it has a definite funding system. The investments are carefully monitored and we have actuarial and legal supervision. This plan was set up in such a way that the actuarial review would be taken annually and the fee adjustment would be made bi-annually in order to make up any deficiency in the cost of providing the plan for the member city. We think we have a sound plan and one of the few public employee plans in the State of Oklahoma which we know to be actuarially sound. Since our plan was started out this way in the middle '60's, obviously we have had the advantage of bad reports from other plans.

*Paul Rice, Chairman * Post Office Box 219 * Bethany, Oklahoma 73008 * (405) 789-2146*
*David A. Davis * 715 Cravens Building * Oklahoma City, Oklahoma 73102 * (405) 235-3388*
*Liberty National Bank & Trust Company of Oklahoma City * 100 Broadway * (405) 231-6329*
*A. S. Hansen, Inc. * 1 Williams Center * Suite 1740 * Tulsa, Oklahoma (918) 587-0181*

APPENDIX XX

The problems I see with Federal intervention is the fact that penalty provisions might have to be included and who would suffer from such penalty provisions. Reporting requirements are a liability to the governments and the question is, for what use are they anyway? Are they not simply filed in Washington and never really looked at?

In general, I feel the Federal government, through whatever office, should be an informer of fact to the governmental agency and then let that agency handle their own problem in time. Units of government are quite different from private plans in that the units of government do continue in business and they will have to face the problem sooner or later regardless. It is quite obvious that I am writing from a point of view of the Chairman of the Board of a plan which has a good solid actuarially sound plan. Naturally, you will have to take that into consideration. In any event, however, I see no need for additional Federal regulations.

Sincerely,

Paul W. Rice

Paul W. Rice, Chairman
OMRF Board of Directors
City Manager, Bethany

PWR/wm

CITY of OKLAHOMA CITY OKLAHOMA CITY, 73102

MUNICIPAL BUILDING 200 NORTH WALKER

May 30, 1979

Mayor

PATIENCE LATTING

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

Thank you for providing The City of Oklahoma City with a copy of the draft of "The Funding of State and Local Government Pension Plans: A National Problem".

I have asked members of the City staff who met with the representatives of the General Accounting Office to review the draft, and they report that the presentation, insofar as Oklahoma City is concerned, is accurate.

The City of Oklahoma City would appreciate the final copy of the report and any other material pertinent to the program.

Sincerely,

Patience Latting

Patience Latting
Mayor

"PEOPLE Are Our Business"

APPENDIX XXII

CITY OF OKMULGEE, OKLAHOMA

115 NORTH MORTON P. O. BOX 250 74447 (918) 756-4060

CITY MANAGER

June 5, 1979

Mr. Gregory J. Ahart
United States General
Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart:

The City of Okmulgee appreciated the interest that the General Accounting office has shown in regards to our employee pension plans. The draft that you sent entitled "The Funding of State and Local Government Pension Plans: A National Problem" is a most interesting and enlightening report.

The City of Okmulgee is of the opinion that federal intervention into local employee pension plans would receive a negative reaction from both locally elected officials and the employees whom the plans affect. This is a state and local problem.

Locally, we are fully aware of the funding problems with each of our plans. We intend to carry out our responsibilities in regards to the plans. We feel that this can best be accomplished through a concerted effort between the state, the employees, and the City.

If you have any questions, please contact me at your convienence.

Sincerely yours,

Greg Harrison

Greg Harrison
City Manager

GH/mt

APPENDIX XXIII

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYES' RETIREMENT SYSTEM
204 LABOR & INDUSTRY BUILDING
HARRISBURG, PENNSYLVANIA
17120

Telephone
717-787-6293

May 21, 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

Thank you for the opportunity to review and comment on the preliminary draft of the GAO Report on State and Local Pension Plans. I found the Report well documented and well written at a level that should make this very complex subject comprehensible to an educated layman. There are, however, several points which I hope you will consider.

First, there needs to be a stronger distinction made between State and local pension plans. State plans are not simply larger versions of local plans as may be the case with corporate plans. There are important distinctions to be recognized in the sources of funds, the ease with which plan provisions can be modified, the expertise of trustees and administrators, and the per capita impact of funding decisions. I feel strongly that any attempt to analyze State and local plans as a single entity will lead to recommended solutions which would be inappropriate for one or the other level of government.

Secondly, your emphasis on ERISA funding standards is understandable and may be a useful yardstick for measuring where we are, but it must be recognized that the ERISA standard is not necessarily a barometer of where we should be going in terms of funding Other alternatives may be more appropriate for governments as plan sponsors. I was particularly dismayed by the negative view of the level percentage of payroll method of funding accrued liabilities. Certainly, some latitude needs to be afforded to governmental entities to recognize varying abilities to generate revenues. The object should be to assure a funding mechanism which will eventually solve the problem, not to prescribe one hard and fast rule which may prove too onerous to local jurisdictions

 APPENDIX XXIII

Third, there should be some distinction made betwen unfunded liabilities which arise as a result of deliberate plan changes and those which arise from faulty or outdated actuarial assumptions. The latter type is much more insidious than the former in that, even if a point in time liability is calculated and a theoretically correct funding schedule adhered to, the liability may continue to increase with each valuation due to unfavorable experience. Those responsible for prescribing regulations should be fully aware of these differences.

Finally, any recommendations for Federal regulation of governmental pension plans should take account of the administrative costs of compliance. The cost of actuarial and legal services may impose a severe financial burden, especially on small, local plans, unless assistance is offered by the Federal Government.

In summary, I am in complete agreement with your statement of the problems we face, but experience has made me very wary of Federal regulation which often uses a bulldozer to accomplish what might more easily be done with a shovel. I trust that your final report will reflect this concern.

Sincerely,

Richard L. Witmer
Secretary

enclosure (draft)

City of Pittsburgh

Pennsylvania

DEPARTMENT OF CITY TREASURER

David L. Donahoe
Treasurer

April 30, 1979

Gregory J. Ahart, Director
Human Resources Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

I have received and reviewed the draft of your department's report on state and local pension plans on behalf of the City of Pittsburgh-Municipal Pension Fund. It is one of three pension plans in the City the others being the Police Pension Fund (referenced and cited in the report) and the Firemen's Relief and Pension Fund.

The scope of the problem of municipal pension funds is, by now, well known. The solutions to the problems are, as you have pointed out, difficult particularly in light of the relative inelasticity of local government revenues.

Several actions have been taken by the City of Pittsburgh toward pension funding reform. The Municipal Pension Fund, representing about half of the employees, has gone on a funded basis for all employees hired after January 1, 1975. Employee contributions are being set aside in special trust to be kept on an actuarily sound basis. In addition, the city is in the process of establishing a special trust to begin accumulating assets to set against the unfunded liabilities of all three pension plans.

We find it hard to envision any national legislation which could cover the myriad of special circumstances involving municipal pension plans. This is particularly true in light of many local tax limit laws and state regulations. We would also urge that the Congress move cautiously in this area particularly if they are unwilling or unable to provide additional financial assistance to local governments to meet these financial burdens.

Very truly yours,

David L. Donahoe
City Treasurer
Executive Secretary-Municipal
Pension Fund

DLD:vj

APPENDIX XXV

CITY OF PHILADELPHIA

BOARD OF PENSIONS AND RETIREMENT
Room 1212 Two Penn Center, Philadelphia, Pa. 19102
ANTHONY WITLIN, Esquire
Executive Director

June 12, 1979

Mr. Gregory J. Ahart
Director
United States General Accounting Office
Human Resources Division
Washington, D.C. 20548

Re: Comments on Draft of a Proposed Report Entitled, "The Funding of State and Local Government Pension Plans: A National Problem"

Dear Mr. Ahart:

Thank you for your letter of April 25, 1979 forwarding a copy of the draft of your agency's report for my comments.

I am responding solely on my own behalf as Executive Director of the Philadelphia Board of Pensions and retirement. I would anticipate that you may receive a response both from the Mayor and from the Chairman of the Board, Irvin R. Davis (also the Finance Director). I found your report to be comprehensive in terms of the sample systems studied and fundamentally well-balanced in its approach. My only concern is that the data upon which it is based has become dated to a degree whereby I find that the recommendations themselves might be different were the data current.

The Municipal Retirement System of the City of Philadelphia is now moving into its third year of funding on a basis which would be in compliance with the provisions of the Employee Retirement Income Security Act of 1974, as amended, and its regulations. Unfortunately, the data in your survey was compiled prior to the commencement of this full funding program. This funding program, in accord with ERISA, may actually be overly-conservative in its utilization of a level dollar method as opposed to a level percentage method when cognizance is taken of our in-perpetuity existence.

I attach significance to our commencement of this full funding program on an entirely voluntary basis, i.e. not having been mandated or recommended by State law, Federal law or Court order. As a voluntary action on our part, I believe we serve as an example of why Congress should restrain from acting--particularly, the thought of including funding requirements in any final version of PERISA. I am without the hard data to discuss whether any of the other systems you studied have moved in the same direction, but my interplay with my colleagues suggests to me that we are not alone. The Congressional concern for the funding and fairness of administration of State and local retirement

APPENDIX XXV

systems is a legitimate one, although I do not mean to say that it has Tenth Amendment legitimacy; still, I do not believe that if there is a trend for accepting full responsibility for the consequences of the liabilities of these systems by State and local governments that the Federal Government should act in this area.

If we could assist in an update of the proposed report by furnishing current information, I would hope that you wouldn't hesitate to contact me. I thank you for the opportunity to address my comments to you.

Very truly yours,

Anthony Witlin, Esquire
Executive Director

AW/ld

POLICEMEN'S RELIEF AND
OF THE CITY OF PIT

CITY-COUNTY BUILDINC
PITTSBURGH, PENNSYLVANIA

May 11,1979

Mr. Gregory J. Ahart, Director
United States General Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart :

With regards to your proposed report to Co
liability of Pension Funds, the Board of
Relief and Pension Fund of the City of Pi
you that in February 1978 there was a let
by the Board of Managers requesting infor
City of Pittsburgh was going to take on t
liabilities.

Enclosed you will find a copy of the Boar
and the Mayors reply.

POLI
FUNE

W

Enclosures

WEJ/ajm

POLICEMEN'S RELIEF AND PENSION FUND
OF THE CITY OF PITTSBURGH

CITY-COUNTY BUILDING
PITTSBURGH, PENNSYLVANIA 15219

BOARD OF MANAGERS
PETER J. WALSH
~~President~~

William E. Jordan
Sec. Treas.
John Carroll
Patrick McNamara
Robert J. McCabe
John J. McGrady
City Controller

John E. Swearingen
~~Vice President~~
Eugene J. Conley
John J. Nee
Walter T. Carroll
~~Louis Mason Jr.~~
~~President Council~~

February 1, 1978

Honorable Richard S. Caliguiri
Mayor City of Pittsburgh
5th Floor Mayor's Office
City-County Building
Pittsburgh, Pennsylvania 15219

Dear Mayor Caliguiri :

The Office of the Auditor General, Commonwealth of Pennsylvania, conducted an examination of the books of account and records as they pertain to The Policemen's Relief and Pension Fund of the City of Pittsburgh. The records were examined for the period of January 1, 1974 to December 31, 1975. The field work was completed October 4, 1976.

At the completion of the audit, the Auditor General's report made several findings and recommendations in the line of Internal Control, Bond Coverage and City Contributions. The Board of Managers of The Policemen's Relief and Pension Fund have complied with the recommendations of Internal Control and Bond Coverage. It is the purpose of this letter to find out what the City is going to do, to meet the recommendation of City Contributions.

The Board of Managers of The Policemen's Relief and Pension Fund request that the City should increase its contributions to The Police Pension Fund to guarantee its solvency against unfunded liabilities, as the State Auditor General's office has recommended.

Would you please reply to us on what action you plan to take to meet the recommendations of Finding No.3 of the report of examination of The Policemen's Relief and Pension Fund of the City of Pittsburgh, for the period of January 1, 1974 to December 31, 1975 as conducted by the office of the Auditor General.

Respectfully,
Board of Managers
POLICEMEN'S RELIEF AND PENSION
FUND OF THE CITY OF PITTSBURGH

c: Auditor General

 APPENDIX XXVI

City of Pittsburgh

Pennsylvania

OFFICE OF THE MAYOR

RICHARD S. CALIGUIRI
Mayor

February 8, 1978

Board of Managers
Policemen's Relief and Pension Fund
City of Pittsburgh
City-County Building
Pittsburgh, Pennsylvania 15219

Dear Gentlemen:

This is in response to your letter of February 1, 1978 requesting information on the City's intentions in dealing with the unfunded past service liability of the Policemen's Relief and Pension Fund referred to in the Auditor General's report for the period of January 1, 1974 to December 31, 1975.

As you know, the City now has an annual actuarial report completed on each of its pension funds. In addition, the City's consulting actuary has provided technical advice in areas such as benefit design, funding mechanisms and future cost projections. In the past, this has led to a redesign of the Municipal Pension Fund and the start of putting it on a fully funded basis. In the next few months I will be seeking authorization from City Council to contract for the performance of the 1978 actuarial study. At that time, I will also ask the consulting actuary to provide guidance to the City on ways to decrease its unfunded past service liability for both the Policemen's and Firemen's Relief and Pension Funds, in such a way as to not have an overly adverse impact on the City's operating budget.

This problem did not arise overnight and neither will it be solved in any immediate fashion. In working out a long term solution I will seek your advice and cooperation in dealing with a situation that has too long been ignored.

Very truly yours,

RICHARD S. CALIGUIRI

RSC:fkn

cc Mr. John McGrady
City Council

APPENDIX XXVII

CITY OF READING, PENNSYLVANIA
DEPARTMENT OF ACCOUNTS AND FINANCE

Jeffrey C. White
City Accountant

CITY HALL
READING, PENNSYLVANIA 19601

June 6, 1979

Mr. Gregory Ahart, Director
Human Resources Division
Room 6858, U. S. General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Ahart:

I have completed reviewing the draft of the proposed report "The Funding of State and Local Pension Plans: A National Problem". I concur with all of the major areas of concern which relate to the question of adequate funding of state and local pension plans.

In the report you refer to the general lack of concern on the part of many elected government officials to seek improvements to the problem of inadequate funding of pension liabilities. I have seen this lack of concern on the part of government officials in this area. Some feel that there is no need for local governments to be concerned about the fiscal impact of future pension liabilities because either the state or federal government will provide necessary funds.

I feel Congress will have to eliminate this kind of thinking on the part of elected officials before they (Federal Government) can expect this massive fiscal problem to be approached and corrected in the environment so necessary for its success.

Please send me a copy of the final report upon its completion. Thank You.

Sincerely,

Jeffrey C. White

Jeffrey C. White

JCW/cm

 APPENDIX XXVIII

ET-18-3

State of Wisconsin \ DEPARTMENT OF EMPLOYE TRUST FUNDS

Gary I Gates
Secretary
201 EAST WASHINGTON AVENUE
MADISON WISCONSIN 53702
TELEPHONE 266-3285
AREA CODE 608

May 14, 1979

IN REPLY REFER TO

Gregory J. Ahart, Director
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart

You have requested my comments on your draft report entitled "The Funding of State and Local Government Pension Plans: A National Problem".

I find nothing in the report which justifies the title. Some states and localities have problems. It is not a national problem.

The report seems to stretch awfully hard to find some basis for federal interference. The repeated references to the fact that some federal grant money ends up in local retirement funds make no more sense than to note that some federal grant money is used to buy an employe's groceries.

The comment on page 31 about how "expensive" the retirement system is for Wisconsin taxpayers is contradicted by the figures in Appendix II which show Wisconsin to be below average in retirement costs as a percent of payroll. Wisconsin's high ranking in tax load clearly is not caused by its retirement contributions.

We appreciate the fact that the report recognizes that Wisconsin has handled its retirement programs on a financially sound basis. It is unfortunate the same cannot be said for the Federal government.

Sincerely

Gary I Gates

Gary I. Gates
Secretary

GIG:fc

HENRY W. MAIER
MAYOR

OFFICE OF THE MAYOR
MILWAUKEE

June 18, 1979

Mr. Gregory J. Ahart
Director
United States General Accounting Office
Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart:

In response to your request for comments on your proposed report "The Funding of State and Local Government Pension Plans: A National Problem," please note the following.

In general, I agree with the conclusion in the document. It is a complete and well illustrated piece.

Specifically, I do consider it reasonable and necessary for some type of standards to be applied guaranteeing all public pension system members and taxpayers that minimum actuarial funding methods be adhered to. Actuarial financing of benefits will result in additional tangible benefits to members and taxpayers.

This report represents the realities of public pensions today. I would hope that state and local governments would adopt a policy of actuarially funding their pension costs so that legislation would not be necessary.

Sincerely yours,

Henry W. Maier

Henry W. Maier
Mayor

County of Dane
Office of the County Clerk
Madison, Wisconsin
53709

FRANCIS R. HEBL
CLERK

COUNTY CONTROLLER
EUGENE G. NELSON
ROOM 104A
CITY-COUNTY BUILDING
608 266-4109

June 20, 1979

Mr. Gregory Ahart
Director, Human Resources Division
US General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

I have read and reviewed the copy of the draft of the proposed report to Congress in regard to the funding of local government pension plans.

I have only two comments on some of the suggested solutions in regard to the unstability in most of the plans.

1. The Federal Government should make these plans conform to the rules private companies must adhere to, or eliminate these rules entirely. I say this knowing full well that the Federal Governments own plan-Social Security-is probably the most unstable of all.

2. I would not like to see Federal subsidies involved as that would only penalize taxpayers of States, such as Wisconsin, that have handled thier plans in a sound fiscal manner.

Sincerely,

Joseph A. McGuire

Joseph A. McGuire
Assistant Controller
County of Dane, Wisconsin

JAM/mb

U. S. Department of Labor

Inspector General
Washington, D C 20210

MAY 23 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

We appreciate the opportunity to review your draft report entitled "The Funding of State and Local Pension Plans: A National Problem." Your study addresses this critical issue in a balanced, responsible manner and provides new and useful analyses which will contribute to addressing the problems confronting public pension plans. The report also correctly notes the lack of information currently available regarding the funding of public pension plans.

The Department of Labor, recognizing this lack of information, has entered into a major joint agency agreement to study public plans. This research has the following major components:

- An examination of the sensitivity of individual plans to actuarial and funding assumptions and the construction of a fifty year forecasting model for the state and local sector as a whole;
- An examination of the public finance issues associated with public pension plan policy;
- An appraisal of public plan benefit levels;
- An analysis of public plan portfolio policy and management practices;
- Recommendations to improve the quality of public plan reporting and disclosure practices.

 APPENDIX XXXI

Other agencies participating in this research include: the President's Commission on Pension Policy; the National Institute of Education; the Office of Personnel Management; the Department of Housing and Urban Development; the Social Security Administration and the Universal Social Security Coverage Group. We anticipate that the results of our research will further enhance the level of understanding regarding this complex issue to which your study has made a valuable contribution.

The Department's technical comments on the draft report are attached. If we can be of further assistance please contact Ian D. Lanoff, the Administrator of Pension and Welfare Benefit Programs.

Sincerely,

Marjorie Fine Knowles

MARJORIE FINE KNOWLES
Inspector General

APPENDIX XXXI

GAO DRAFT REPORT
FUNDING OF STATE AND LOCAL GOVERNMENT PENSION PLANS

Page 8:

It would be helpful if a summary were provided of the characteristics of the plans studied. The summary should present the number of plans and participants distributed according to the following characteristics:

- The type of plan, (e.g., police and fire);
- Whether the plan is integrated with Social Security;
- Whether the plan provides for employee contributions.

It would also be helpful to provide a methodology section regarding plan selection criteria, actuarial assumptions employed and the nature of the valuations relied on by GAO.

Page 11:

In describing ERISA funding requirements it should be noted that ERISA generally requires 40 years amortization schedules.

Page 14:

This section should reflect that the plans selected for this study tend to use pay-as-you-go funding to a greater extent than is the practice for all public plans as reported by the earlier House Pension Task Force Study. The House Pension Task Force, which surveyed all plans, found that 17% of them were pay-as-you-go. However, this study, covering some 1% of all public plans, reports 19 of the 72 plans studied (26%) as funded on a pay-as-you-go basis.

As a result, the study may indicate a more severe funding problem than exists for the universe of public plans.

APPENDIX XXXI

Page 28:

It would be informative if companion tables were included showing the assets, numbers of participants and types of plans utilizing the different types of funding methods. Presentation of this information by numbers of participants covered would be especially useful since, in the universe of public plans, small plans greatly outnumber large plans but large plans cover most public sector employees.

Page 31:

A reference is made to the collective bargaining process as contributing to the increase in unfunded pension benefits. Because very few public plans are negotiated and in the overwhelming number of cases public plan benefits are established by legislative bodies, we suggest that the wording of this paragraph be changed as follows:

From: And the constituency of the greatly expanded body of State and local employees, through its collective bargaining, has brought pressure for enlargement of fringe benefits...

To: And the constituency of the greatly expanded body of State and local employees, including expanded collective bargaining, has brought pressure for enlargement of fringe benefits...

Page 31:

It should be noted that factors other than Wisconsin's model funding of employee benefits may have contributed to the state's high local tax load ranking.

Page 41-42:

This section should note that there are additional methods to reduce pension plan costs without adversely affecting the benefits under those plans.

For example, increased emphasis could be given to maximizing investment return of plan assets. Another method would be to consolidate local plans into larger state-administered systems, thus realizing economies of scale in plan administration. Finally, plan fiduciary practices can be tightened to restrict the number of plans which use plan assets to capitalize local debt, a practice which may jeopardize future benefits and require greater future funding as a result.

Page 50:

The footnote appearing on this page should be made part of the text to avoid misinterpretation concerning the validity of the $1 billion estimate. It would also have been useful to show the variation among plans relying on federal grants to supplement employer contributions.

Pension Benefit Guaranty Corporation
2020 K Street, N.W. Washington D.C. 20006

MAY 25 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General
Accounting Office
Washington, D. C. 20548

Dear Greg ~~Mr. Ahart~~:

Review of your proposed report, "The Funding of State and Local Government Pension Plans: A National Problem" has revealed a solid report which clearly confirms the existence of serious problems among public plans and the need for continuing Congressional interest.

You may wish to anticipate critical comment concerning the selection of states included in your study. Critics, for example, may question whether Florida plans adequately represent those in the South or California and Oklahoma adequately represent those in the West. They may also feel that plans in industrial states are a disproportionate part of the total. To the extent such criticism is valid, do you have any reason to believe your findings distort the general financial conditions and problems confronting state and local plans. If not, you may wish to so indicate.

I would like to compliment you on the quality of this report.

Sincerely,

Matt

Matthew M. Lind
Executive Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUN 1 1979

Mr. Allen R. Voss
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

Thank you for providing us with the opportunity to review and comment on the General Accounting Office draft report "The Funding of State and Local Government Pension Plans: A National Problem."

The report concludes that many State and local government pension plans are not being funded on a sound actuarial basis, and that the accruing unfunded liabilities could lead to severe fiscal problems in the future and possibly threaten the pension benefits earned by public employees. Local initiatives to address this problem have been slow to develop and may not be widespread nor substantive enough to yield significant improvement in the foreseeable future. Aside from concluding that State and local government pension plans should adopt sound actuarial funding procedures and deal with financing pension benefits on a current basis, no recommendations for specific congressional action, other than monitoring local efforts to implement pension reform, are included in the report.

The Office of Management and Budget agrees that pension plans should not promise more benefits to employees than they can afford. However, the interrelationships of State and local jurisdictions, and State and local taxing authority, make application of this standard more complex in the public sector than in the private. As your report notes, public employee pension plans are often authorized by State statute and changes mandated at the State level must be, in many cases, implemented by local jurisdictions. Whether a local jurisdiction should have to fund benefit increases without assistance from the State is an issue many States are reviewing at this time. Federal standards regulating public employee pension plans would add another party to this already complex relationship, and could raise a number of unresolved constitutional (and budgetary) issues.

The Office of Management and Budget agrees that the appropriate degree of Federal involvement with State and local pension plans at this time is a continuing review of the status of these plans. We believe it is preferable to allow the States to institute pension reform at the local level. As we note above, and as you state in your report, it is unclear whether or not there are constitutional barriers to the imposition of certain Federal standards for these plans. This is clearly an area that requires more analysis.

Again thank you for providing us with the opportunity to comment on the draft report.

Sincerely,

W. Bowman Cutter
Executive Associate Director
for Budget

DEPARTMENT OF THE TREASURY
WASHINGTON D C 20220

DEPUTY ASSISTANT SECRETARY

June 13, 1979

Dear Mr. Voss:

Thank you for the copy of the draft GAO report on "The Funding of State and Local Government Pension Plans: A National Problem." In general, we believe the report is good; it contributes to the visibility of the problem, which is an important first step to the resolution of the problem.

We are troubled, however, by the tendency in the report to generalize about the outlook for pension plan funding in the entire State and local sector based on a study of relatively few State and local pension plans. The report encompassed 72 State and local pension plans. On page 9 of the draft report, the 72 plans are described as representing only 13 percent of the active and retired members of all State and local pension plans; 17 percent of all plan assets; 17 percent of estimated unfunded liabilities of all plans; and 24 percent of the contribution made by State and local governments to all plans. Thus, we believe the report should be careful in treating these 72 State and local pension plans as case studies and avoid unjustified generalization about plans in the entire State and local sector.

Another of our concerns relates to the report's seemingly unqualified use of the pension plans' unfunded accrued liabilities. Page 10 of the draft report states that the study employed the existing actuarial studies on the 72 plans; for most plans, the three most recent actuarial studies received a cursory review and were found to be generally prepared in accordance with recognized actuarial procedures. In the few places where actuarial studies were not available, the GAO actuaries made estimates of the unfunded accrued liabilities. Many of the experts who are involved in or following the general State and local pension plan issue point out that existing actuarial studies cannot be used as the sources of the plans' unfunded accrued liabilities due to the differences among the assumptions that underlie the unfunded liability estimates and, in some cases, the dubious nature of the assumptions. For this reason, the HUD-financed three-year study by the Urban Institute is being regarded by some as the first definitive study on, among other things, the extent of unfunded accrued liabilities

APPENDIX XXXIV

of State and local pension plans. One part of that study will replicate the actuarial studies of a sample of State and local pension plans (with the sample specifically chosen because it will represent the entire universe of State and local plans) and then revise the actuarial studies so that they are comparable. Thus, with respect to the GAO draft report, we would suggest clarification of the quality of the unfunded accrued liability estimates that are cited.

Finally, we agree that the fungibility of Federal aid and State or local own-source revenues is a very important matter with regard to the issue of State and local pension plans. The use of Federal grants to fund State and local pension plans is important to both the analysis of the problem (e.g., that significant budgetary dislocation would occur if State and local governments were suddenly required to meet ERISA-type pension plan funding standards) and reasons for possible Federal regulation in this area. However, only one page in the text of the report (page 50) is devoted to a discussion of this point. Page 50 of the report estimates that $1 billion of Federal grant funds are being used annually as part of the State and local government contributions to their pension plans. We believe that the report requires much more discussion on this important point, even if this estimate cannot be said to be statistically valid. For example, under what conditions are Federal grant programs (other than general revenue sharing) sources of pension plan contributions?

I hope these suggestions are helpful to you. We look forward to the final report.

Sincerely,

Donald Haider

Donald Haider

Mr. Allen R. Voss
Director
General Government Division
General Accounting Office
Washington, D.C. 20548

APPENDIX XXXV

President's Commission on Pension Policy
736 Jackson Place, NW, Washington, DC 20006

Office of the
Executive Director

JUN 21 1979

Mr. Gregory J. Ahart
Director, Human Resources Division
U. S. General Accounting Office
441 G Street, N. W.
Room 6864
Washington, D. C. 20548

Dear Mr. Ahart:

This is in response to your letter of April 25, 1979 requesting our comments on the GAO draft report entitled "The Funding of State and Local Government Pension Plans: A National Problem".

The President's Commission on Pension Policy has no comment at this time because it is currently studying many of the same issues addressed in your report.

We thank you for offering us the opportunity to comment on the draft report.

Sincerely yours,

Thomas C. Woodruff
Executive Director

National Governors' Association

Julian M. Carroll
Governor of Kentucky
Chairman

Stephen B. Farber
Director

May 22, 1979

Mr. Gregory J. Ahart
Director
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

Thank you for sending me the draft of your proposed report to the Congress, "The Funding of State and Local Government Pension Plans: A National Problem". As you may know, the National Governors' Association has been quite active in the public pensions area through its Subcommittee on Public Retirement Systems chaired by Governor George R. Ariyoshi of Hawaii.

Your proposed report is an excellent piece of research on a timely and important subject. It provides useful data and a helpful overview of the status of state and local public pension plans in 1975, the year selected for review by the study group.

It would increase the accuracy of your report, however, to emphasize that it is largely a historical document rather than a current picture of public employee retirement systems. If the same group of plans were reviewed today, it would be clear that many of the problems cited in your report have been substantially ameliorated. While some public plans are not yet operating on a sound funding basis, many of the problem systems mentioned in your report have reevaluated and improved their funding plans because of the national interest in pension plans in recent years.

The existence of NGA's Staff Pensions Task Force, the National Conference of State Legislatures' Task Force on Public Pensions, and the good working relationship between the Big Seven Public Interest Groups and the President's Commission on Pension Policy all attest to the fact that state and local governments are devoting

HALL OF THE STATES • 444 North Capitol Street • Washington DC 20001 • 202 624 5300

 APPENDIX XXXVI

significant resources to studying and reforming their pension system. They have made real progress since the 1975 situation described in your report.

I appreciate the opportunity to review and comment on your draft report. When placed in its proper historical context, it will advance the national understanding of the complex and crucial issue of public pension funding.

Sincerely,

Stephen B. Farber

National League of Cities
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OFFICERS

June 13, 1979

Gregory J. Ahart
Director, Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

We appreciate your giving us the opportunity to review and comment on the draft of your report to the Congress entitled, "The Funding of State and Local Government Pension Plans: A National Problem."

For those of us who represent the interests of cities, your report is certainly not encouraging. However, your overall conclusion that State and local government pension plans are substantially underfunded is undeniable. Even though your study did not use a scientific sample, your results conform with what we generally know to be the case in most cities.

All of your estimates of underfundings are based on ERISA standards. We are not convinced that they are appropriate. Afterall, ERISA standards were developed for private sector plans in companies and businesses that can go bankrupt, that can be closed down, and that can be bought and sold. The need for protection of employees' pension assets through ERISA was clear. The situation is entirely different in the public sector. States and cities do not go out of business. Frankly, we do not subscribe to the opinion that an employee's assets in a public pension system are in any way imperiled when that system has an unfunded accrued liability. Perhaps, the standards should be different for public plans.

We think that your definition of "unfunded accrued liability" on pages 5-6 bears further elaboration. There is not total agreement on what that term means because of the assumptions that an actuary must make about future pension costs (page 7). It may also be instructive for the Congress if you would discuss what part high inflation plays in formulating those assumptions.

The report makes the point that several local government officials believe that the states should bear the costs of any pension reforms it mandates, (Page 53). We are not sure what is meant by "reforms," but if the intended meaning is new, more costly benefits that local governments must provide as a result of State law, then we would underscore the point. In addition, it would be helpful if your report examined the possibility that pension costs may be excessive because of State mandated benefits that have made local and State plans more generous than private plans.

Related to this last point is finding ways to cut costs which your report discusses on pages 40-44. We think that the idea raised by point (3) on page 41—establishing new plans with lower benefits for new hires—merits more discussion in your report than it received.

On page 37, we cannot believe that states are seriously relying on "windfalls from the Federal Government" to finance their pension systems. Massachusetts would seem to be a unique example. This suggestion would best be dropped from the report.

Although the report does make mention on page 11 that employee contributions may have to be increased to fund pensions, this possibility is given little attention elsewhere. What are the facts here? Have employee contributions been increased to keep pace with increasing costs and improvements in benefits? This information should be highlighted.

The report states that. "prospects for significant improvement in the foreseeable future are not bright." It is our understanding that significant increases in the funding of State and local pension plans have been made in the last few years. We think the report should identify this development and perhaps profile the trends in funding contributions vis-a-vis unfunded liability.

As a final comment, we cannot resist mentioning a supreme irony presented by this report. Your further substantiation of an earlier finding that State and local governments have underfunded their pension plans by $150 to $175 billion comes at a time when the Congress is criticizing so-called surpluses of State and local governments. Of course, what is usually ignored is the fact that most of the aggregate surplus that shows up in some accounting reports is funds set aside for pension plans. A great service could be done by your report if it will dispell the myth of the State and local surplus and identify the tremendous liabilities of those governments.

If you have any questions on these comments, please contact John Shirey on our staff. Again, thank you for the invitation to comment on this report.

Sincerely,

Alan Beals

Alan Beals
Executive Director

National Association of Counties

Offices • 1735 New York Avenue N.W., Washington, D.C. 20006 • Telephone 202/785-9577

June 19, 1979

Gregory J. Ahart
Director, Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

This responds to your written request for the views of the National Association of Counties (NACo) on the draft of a proposed General Accounting Office (GAO) report, entitled "The Funding of State and Local Government Pension Plans: A National Problem."

While we do not dispute the draft report's central conclusion that many state and local government pension plans are not funded on a sound actuarial basis, we believe the report, based primarily on 1976 financial data, significantly underestimates the magnitude of the pension reform efforts currently underway at the state and local levels. Several states have recently acted to reform their pension systems by establishing stricter financial and supervisory standards and consolidating smaller plans into larger systems. A March 1979 report prepared by the Advisory Commission on Intergovernmental Relations, entitled "State and Local Government Pension Reforms," documents some of these reforms and recommends two pieces of model state legislation in this area.

The draft report contains frequent references to ERISA funding standards and speculates about the impact of imposing such standards on local and state government plans. Unfortunately, it may lead the uninformed reader to the conclusion that there is no acceptable funding approach between pay-as-you-go and ERISA funding standards, a conclusion which is seriously disputed by many actuaries and pension plan consultants.

The draft report criticizes proponents of level percent of payroll amortization as favoring this funding method only because it lowers the current cost of a plan. However, it should be emphasized that many distinguished actuaries will strongly argue that level percent of payroll amortization provides for more equity between generations of taxpayers than can be afforded using level dollar amortization.

 APPENDIX XXXVIII

In conclusion, we believe the draft report fails to adequately recognize several of the important differences which exist between public and private sector plan contributions. For example, while private employers receive an immediate offset against taxable business income for their plan contributions which thus makes level dollar amortization considerably more attractive to the private sector, the public employer of course derives no such tax benefit. While NACo strongly supports sound financial and supervisory practices for local and state government pension plans, we recognize that the funding of such plans involves a series of difficult and complicated policy choices about which reasonable people can disagree.

We appreciate the opportunity to offer our comments on the GAO draft report. Should you require any additional information, do not hesitate to contact Chuck Loveless or Barbara Radcliff of the NACo staff.

Sincerely yours,

Bernard F. Hillenbrand

Bernard F. Hillenbrand
Executive Director

(207200)

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