September 30, 2012

Moody's Investors Services
Attention: Marcia Van Wagner
7 World Trade Center
@ 250 Greenwich Street
New York, NY 10007

Sent via email at cpc@moodys.com

Dear Moody's:

This letter is submitted on behalf of the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR), as well as a number of our individual members, commenting on Moody's proposed adjustments to state and local government reported pension data.

The members of these groups are a broad mix of trustees, administrators, and public officials who collectively oversee, administer and manage a majority of the approximately $3 trillion in pension assets and benefits for some 21 million working and retired employees of state and local government.

We appreciate the opportunity Moody's has provided to comment on its proposed adjustments.

Moody's request for comments states "this proposal is part of our ongoing efforts to bring greater transparency and consistency to the analysis of pension liabilities."

We believe that Moody's proposed adjustments will actually reduce transparency and consistency in the analysis of pension liabilities.

One likely outcome of the new Governmental Accounting Standards Board (GASB) pension accounting standards will be the production by most public pension plans of two sets of actuarial calculations: one to meet GASB requirements and another to inform policymakers of the plan's funding requirements.

Actuarial measures are complex and often not well understood. The introduction of yet another set of calculations will result in increased, widespread confusion and misunderstanding of the meaning and implication of public pension actuarial measures. This, in turn, will be exacerbated by selective use: drawing on the funding level figure that best fulfills the objective of the user.

The introduction of yet another funding level figure, based on a third set of factors specified by Moody's, an organization with a high profile and degree of credibility, will compound the confusion, lack of transparency, and selective use. Confusion among policymakers about public pension funding conditions may lead to poor policy decisions affecting public pension benefits and funding provisions.

The Moody's request for comments states that Moody's is considering adjusting pension calculations "based on a high-grade long-term corporate bond index discount rate (5.5% for

2010 and 2011)", and "annual pension contributions will be adjusted to reflect … a common amortization period."

The public pension community is highly diverse: every plan is unique, with its own demographic composition, governance structure, investment policy, risk profile, asset allocation, and investment returns. The application of one-size-fits-all measures to public pension plans, particularly for their discount rate and amortization periods, belies the unique and diverse composition of these plans.

A range—in some cases, a wide range—exists in public pension fund risk profiles, target and actual asset allocations, and investment returns. Among plans in the Public Fund Survey, the current allocation to public equities spans from less than 15 percent to more than 70 percent; the allocation to fixed income ranges from 12 percent to nearly 60 percent; and the allocation to "alternatives" ranges from zero to 50 percent.

Actual public pension fund investment returns, as reported by Callan Associates, also vary widely. For example, for the 3-year period ended 12/31/2011, the difference in the annualized return between funds at the 10th percentile and the 90th percentile, was 3.68 percent. The difference was 2.33 percent for the 10-year period ended on the same date, and 1.6 percent for the 20-year period. Thus, even if Moody's proposed rate of 5.5 percent were to be realized, based on this experience, for the higher- and lower-performing funds over a 10-year period, the variance from the proposed rate would be more than 20 percent (half of 2.33 percent divided into 5.5 percent).

Investment performance and the discount rate have a considerable effect on a pension plan's current and projected cost and funding condition. Applying a single discount rate to measure these plans will result in distortion and confusion, not clarity and transparency, and any comparability among plans will not be meaningful.

As you know, GASB has just completed a comprehensive examination of public pension accounting that has taken more than six years to complete. As part of their review, GASB considered the issue of the discount rate, and after careful analysis and public comment, rejected the idea of a uniform rate in favor of a blended rate that more accurately reflects the unique composition of each pension system.

Applying a rate based on long-term corporate bonds not only ignores the fact that this metric has been deemed inappropriate for the public sector, but also the fact that such rates are currently at historic lows. This fact recently prompted Congress to implement stability measures for corporate plans based on 25-year averages, which for the 25 years ending September 30, 2011 of the first, second and third segments of the yield curve are 6.15%, 7.61%, and 8.35%, respectively.

Likewise, the application of a single, 17-year amortization period also fails to account for both the diversity of public pension plan demographic structures and the essentially perpetual nature of their plan sponsors.

Actuarial standards require the selection of actuarial assumptions to be consistent. Yet the replacement of plans' investment return assumption, without making a corresponding adjustment for inflation, could result in a distorted plan cost and funding level.

Finally, uniformity must not be confused with comparability. Providing a single, uniform discount rate and amortization period no more provides comparability among pension plans than would requiring the same market stress scenarios, or a common definition of credit risk, to be used by every credit rating agency in order to provide comparability among their ratings.

The Moody's request for comments states that under its proposed adjustments,"asset smoothing will be replaced with reported market or fair value as of the actuarial reporting date"

We believe the use of a point-in-time measure, in lieu of one that recognizes longer-term trends, will result in near-term volatility of pension plan funding conditions, potentially causing undue alarm or overconfidence. The primary cause of volatility in public pension funding conditions is investment returns, which is why nearly all public pension plans phase in, or smooth, their asset gains and losses, in most cases over a five-year period. For an entity with virtually a perpetual expected life, a smoothed asset value more fairly reflects the true condition of the plan than does a "spot price' as of the plan's fiscal year-end date.

We encourage Moody's to respect GAAP and the new GASB standards, and to give the new standards an opportunity to be used and evaluated. Short of that, the imposition of another set of methods to measure and report public pension funding conditions will not produce the greater transparency and authentic comparability that Moody's is seeking.

When the staff of the U.S. Securities and Exchange Commission (SEC) recently undertook an examination of the desirability of credit rating standardization, Moody's filed comments that urged the SEC to "consider whether there are existing or potential alternatives to standardization that could enhance users' ability to evaluate the performance of Credit Rating Agencies' ratings and their ability to use ratings as one of several tools in their decision-making processes."

In its response, Moody's noted that significantly increasing the amount of information made available about specific ratings, the meaning of rating systems, rating methodologies, and the aggregate performance of ratings, available to the public for free, "enables professional market participants to develop a thorough understanding of our approach to credit ratings, the rating rationale for specific rating actions, and how our ratings perform in the aggregate."

Moody's also noted that its "ratings cannot be reduced to an output from a formulaic methodology or model;" that "a single quantitative interpretation of credit factors "would miss a myriad of considerations that arise naturally in the rating process;" and that "a single-dimensioned definition likely would underemphasize ratings stability, which many investors value. Greater ratings volatility also could adversely affect the stability of the financial system."

We believe that these concerns about the application of uniform and standardized credit rating factors also apply to the analysis of public pensions. We also believe that the new GASB standards will permit the public to develop an adequate and consistent understanding of the public pension community's approach to the discount rate appropriate to each plan.

Thank you again for this opportunity to comment.

Sincerely,

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