JAMES L. McINTIRE
State Treasurer

State of Washington
Office of the Treasurer

April 25, 2013

Raymond W. McDaniel Jr., President and Chief Executive Officer
Marcia Van Wagner, Vice President, Senior Analyst
Moody's Investors Service
7 World Trade Center
250 Greenwich Street
New York, New York 10007

Dear Mr. McDaniel and Ms. Wagner:

I am disappointed. Despite the concerns and objections that have been raised from many perspectives (including our own – see attached) you say that you are still moving ahead with a characterization of state and local government pension liabilities and costs to which no one else, including, in particular, the experts in this field ascribe. I had hoped you would reconsider before continuing on this path that materially misrepresents Washington state's pension system. If you persist in this course of conduct, you will mislead investors, policy makers, and the public in violation of your obligations to them and to us.

We rely on professional actuarial analysis conducted by experts with specific and extensive training and experience. Measuring pension costs and liabilities requires an understanding of the unique aspects of each of our plans. Applying generic assumptions to our state's plans as you do in your revised methodology is not considered "best practice" by any governmental accounting or actuarial association. While the goal of comparing issuer credits may be laudable, it should not trump accuracy.

Your drive to create transparency and comparability in an area as complex as public pensions has created misleading and irrelevant results instead of transparency and comparability. It appears you understand that no single methodology can produce apples-to-apples comparisons when your own publications say that "[o]ther factors are important in evaluating the credit implications of a state's pension finances" and that "[a]nalysts will be able to adjust the placement into rating categories of the pension metric to reflect [other] factors." By conceding that your methodology does not provide the comparability you want you have made your purpose in moving forward with this methodology even more unclear and troublesome.

National news stories and editorials about strapped state budgets often point to public pensions as a serious challenge for state and local governments. This is not a problem in our state. Washington ranks fourth highest in the country for funding our pension programs. Our ongoing pension plans are funded at 113 percent of future liabilities based, on independent actuarial analyses used to determine the value of benefits, the assets available to pay them, and plan funding rates.

Your methodology fails to account for prudent pension funding, proper actuarial work and a consensus-based rate setting process all of which are essential to management of state pension systems. I am glad Moody's and peer rating agencies all have recognized that Washington state uses these things – and more. We have strong funded ratios, solid pension plan fundamentals, and excellent pension fund investment strategies that we will rely on in the future. Our Legislature has periodically stepped up as needed to enact legislation to strengthen the integrity of our plans, improve the state's fiscal position, and protect retirees. We fully disclose all of this in detail to rating analysts, investors, and the public. And, in keeping with our past successful practices we will continue to use appropriate, professional actuarial valuations when creating consensus funding rates and investment return assumptions.

Benefits are modest and predictable. Our plans cover over 293,000 employees and 138,000 retirees. Over 95 percent of these retirees get annual benefits below $50,000. People in our more generous PERS/TRS1 plans that closed in 1977 could retire at any age after 30 years of service and now get an average of $22,900 per year. Benefits were trimmed again last year by the Legislature to control their growth. Most public employees since 1977 are in plans where they can retire with full benefits at age 65 – and for 30 years of service they get an average of $20,300 per year.

Contributions are shared and well-funded. Unlike many other states, contributions to Washington's public pensions are shared equally by employees and employers. About 8 cents out of every dollar in pension benefits paid today is contributed by employers (taxpayers), and this is matched by employee contributions from wages and salaries. The remaining 84 cents of every benefit dollar is paid from pension fund investment returns! Although contributions lagged ten years ago, they have since returned to 100 percent of the actuarially required contribution, even under difficult budget circumstances.

Investment performance is excellent. Washington's State Investment Board (SIB) invests over $66 billion in its pension fund by accepting a prudent level of risk while maximizing returns for both retirees and the public. The SIB has regained all of the value lost in the 2008-09 financial crisis. Through smart, global, long term investing, the SIB has averaged more than an 8.5 percent annual return rate over the past year, the past 3 years, the past 10 years, and the past 20 years. These returns distinguish the SIB as one of the top performing pension funds in the country.

There are good reasons for not treating public pensions the same as private sector pension plans. Unlike private companies, state governments are sovereign entities that can't go bankrupt, won't go out of business, and aren't going to be merger or acquisition targets. This allows our state to invest over a longer time horizon for higher returns. Private companies must use "high-grade" corporate bond rates to evaluate their pension plans because they have a risk of being acquired or merging with another firm – or going bankrupt – during the long course of a defined benefit system. To force sovereign entities in the public sector to use a "risk free" rate ignores this fundamental difference and is wholly inappropriate. If accepted, this false assumption could nearly double taxpayer's costs for funding pension benefits that are otherwise already well-funded based on professional, rigorous actuarial standards.

Over the past two years, the national Government Accounting Standards Board has conducted a thorough review and revision of its standards for reporting the funding status of public pensions. These new reporting standards, the first of two standards taking effect next year, will better reflect the actuarial funding of future benefits that have been properly funded *as well as the risk of insolvency arising from unfunded future liabilities* – in one evaluative measure. Washington will begin reporting this measure in 2015 as part of our periodic actuarial analysis. This is the measure to which your attention should be drawn. We join with you in looking forward to implementing GASB's new reporting standards because they will add important transparency, comparability and clarity to public pension analysis.

Sincerely,

James L. McIntire,
Washington State Treasurer and Chair, Washington State Investment Board

Cc: Membership, National Association of State Treasurers
National Association of State Retirement Administrators
David Schumacher, OFM Director
Matt Smith, State Actuary
Marci Frost, DRS Director