Pension Reform & The Public Plan Contributory Experience

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NRTA
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Size and scope of public pensions in the U.S.

- ~$3.8 trillion in assets
- ~14 million active (working) participants
  - 13 percent of the nation's workforce
- 9 million retirees and their survivors receive ~$240 billion annually in benefits
- Of 4,000 public retirement systems, the largest 75 account for 80+ percent of assets and members
- Aggregate funding level = ~75%

US Census Bureau,
Public Fund Survey

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Distinguishing elements of public pension plans

- Mandatory participation
- Employee-employer cost sharing
- Targeted income replacement
- Assets that are pooled and professionally invested
- A benefit that cannot be outlived

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Legislative Pension Enactments

- Nearly every state has modified public pension benefits, raised employee contributions, or both, between 2009-2014
- Lower benefits
  - Higher retirement age
  - More required years of service
  - Longer vesting period
  - Reduced or eliminated COLAs
- Increased use of hybrid retirement plans
- Two new defined contribution plans
  - Oklahoma new hires as of 11/1/15
  - Elected officials in Arizona since 2013

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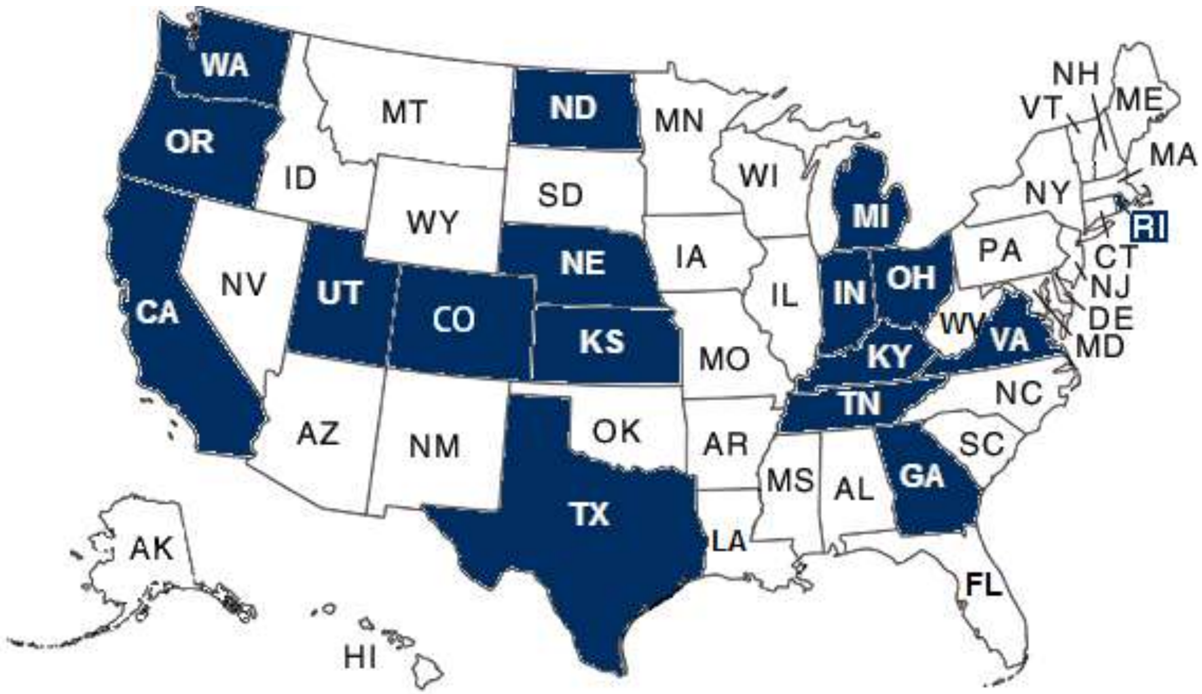
NASRA Issue Brief: State hybrid plans



- Many traditional pension plans contain hybrid-like features, such as employee contribution rates or benefits that reflect investment performance or the actuarial condition of the plan.

Combination hybrid plans

- Combo DB-DC plans feature a traditional, more modest pension combined with a defined contribution plan
  - Mandatory: GA, IN, MI, OR, RI, TN, UT, and VA
    - All but Indiana were established since 2004
  - Optional in OH, WA

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Statewide cash balance plans

- Cash balance plans feature pooled assets with notional accounts that pay a guaranteed minimum interest rate, with possibility of sharing "excess" investment earnings
  - Texas, for county and many municipal employees
  - Nebraska, for state and county workers
  - California, for some community college employees and as a supplement for K-12 teachers
  - Kentucky, for state and local workers (not teachers)
  - Kansas for all new hires since 1/1/15

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Pension Reform in Utah

- New hires since 7/1/11 may choose from a hybrid or a defined contribution plan
- Employer contribution is 10 percent of pay
- For the DB plan, the retirement multiplier is 1.5 percent
- Employees pay any costs of the DB plan above 10 percent (12 for public safety)
- If the cost of the DB plan is below 10 percent, the difference is deposited into the employee's defined contribution account.

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Legal Rulings

- Most state pension reforms that affected current plan participants provoked lawsuits
- An unprecedented number of legal rulings on public pension issues have been handed down since 2010
- Rulings have run the gamut, from affirming states' authority to reduce benefits and increase contributions, to rejecting reform bills
- Rulings in some states have contradicted rulings in other states
- Federal bankruptcy rulings in 2014 in Detroit and Stockton, CA permitted reductions in pension benefits despite strong pension legal protections in those states

Spotlight *on*

The Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13

Keith Brainard and Alex Brown
National Association of State Retirement Administrators
March 2015

Executive Summary

After its creation in the 1990s, the annual required contribution (ARC) quickly became recognized as the unofficial measuring stick of the effort states and local governments are making to fund their pension plans. A government that has paid the ARC in full has made an appropriation to the pension trust to cover the benefits accrued that year and to pay down a portion of any liabilities that were not pre-funded in previous years. Assuming projections of actuarial experience hold true, an allocation short of the full ARC means the unfunded liability will grow and require greater contributions in future years.

This study evaluates the ARC that was received by 112 state public pension plans, including the District of Columbia, from fiscal years 2001 to 2013. This study finds that although variation exists in ARC effort among states and other pension plan sponsors, i.e., cities, school districts, etc., most governments made good-faith efforts to fund their pension plans, and only a few severely neglected their pension funding responsibilities. This ARC experience unfolded during a tumultuous period, as capital markets declined sharply in 2000-02 and again in 2008-09, and states and local governments twice experienced economic recessions. Combined with other factors, the market declines caused required pension contributions to rise significantly, while the economic recessions challenged the ability of states and local governments to respond.

States and their political subdivisions establish and maintain funding policies in the form of statutes, ordinances, board rules, and case law that prescribe how public pension benefits will be funded. While federal regulations governing private sector pension plans often are cited as onerous and creating volatility and uncertainty,[i] funding policies for public plans typically are designed to establish contributions that will remain approximately level as a percent of payroll over time. This objective is intended to promote intergenerational cost equity and budget predictability.

Although many factors play a role in determining how a pension plan is financed, this study finds that plans with strong required contribution governance arrangements generally have received a significantly higher portion of their ARC during this study's measurement period. Some states, however, have consistently received a high portion of their ARC even without a statutory requirement to do so. Conversely, some of the plans that have received a small portion of their ARC, have statutory requirements but failed to receive their ARC. Nevertheless, even in the periods of recession during this study, most state and local governments increased pension contributions and continued to provide pension benefits for former, current and future employees.

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The ARC Experience of State Retirement Plans, FY 01 to FY 13: Key Findings

- Most plan sponsors made a good-faith effort to fund their pensions during one of the most fiscally challenging decades in history
- Policies (statutes, constitutional provisions, retirement board requirements) that require payment of the ARC generally produced better pension funding outcomes than polices that do not.
- The drivers of contribution shortfalls were diverse and dependent on various circumstances within states that underfunded their pensions
- Pension costs are declining (for many plans) and funding discipline is showing signs of restoration

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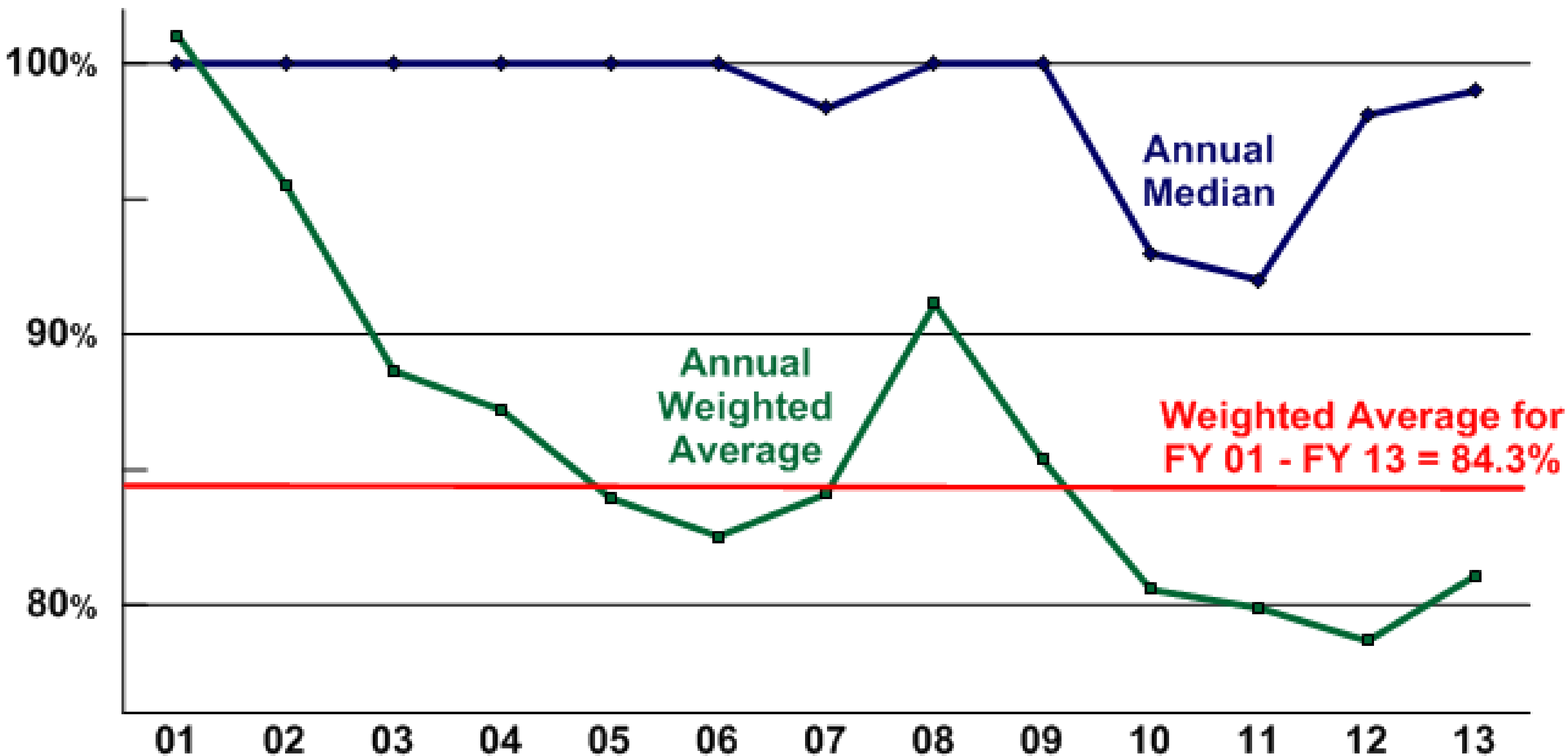
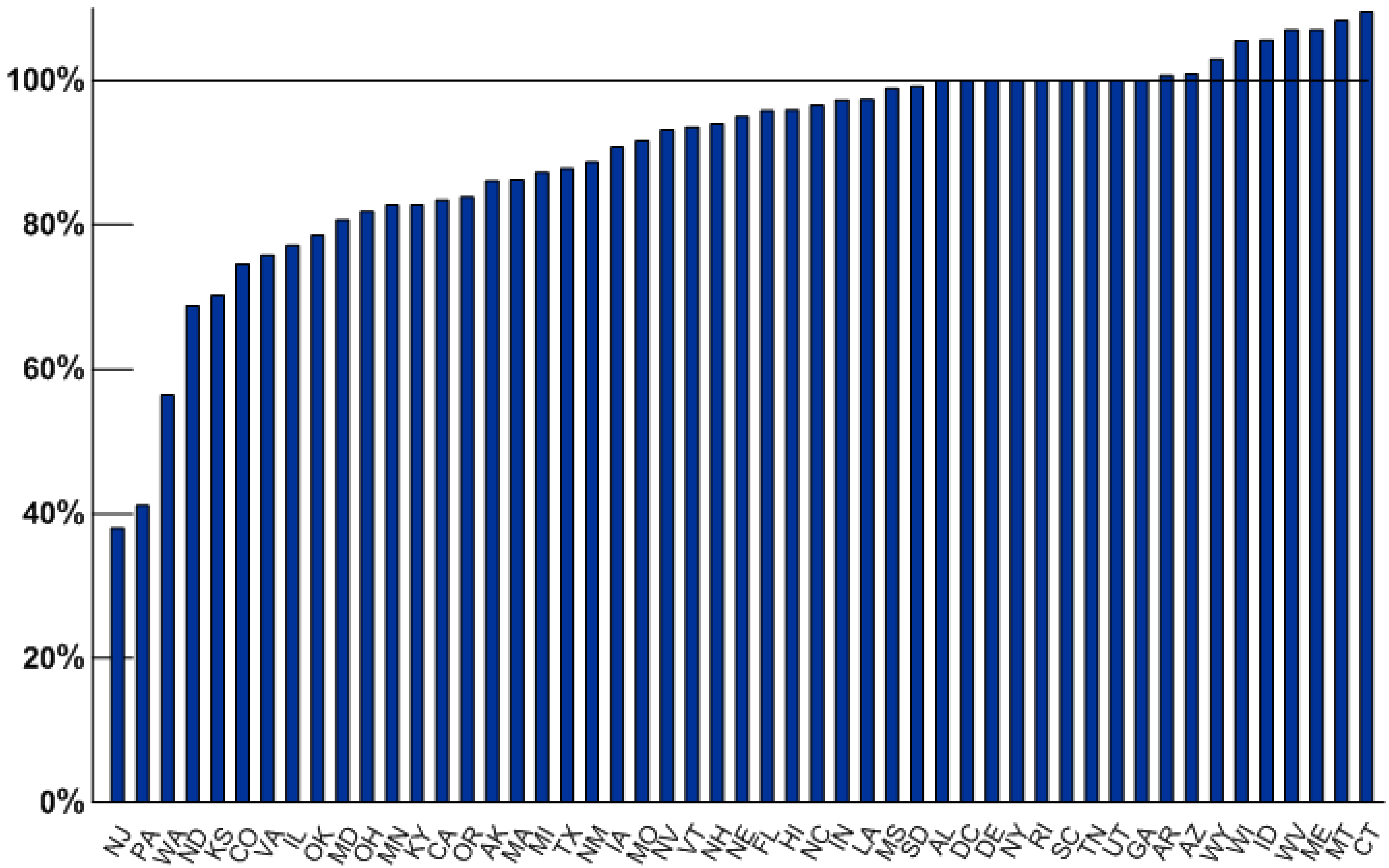
Median and annual weighted average experience, FY 01 – FY 13



Weighted average ARC experience by state



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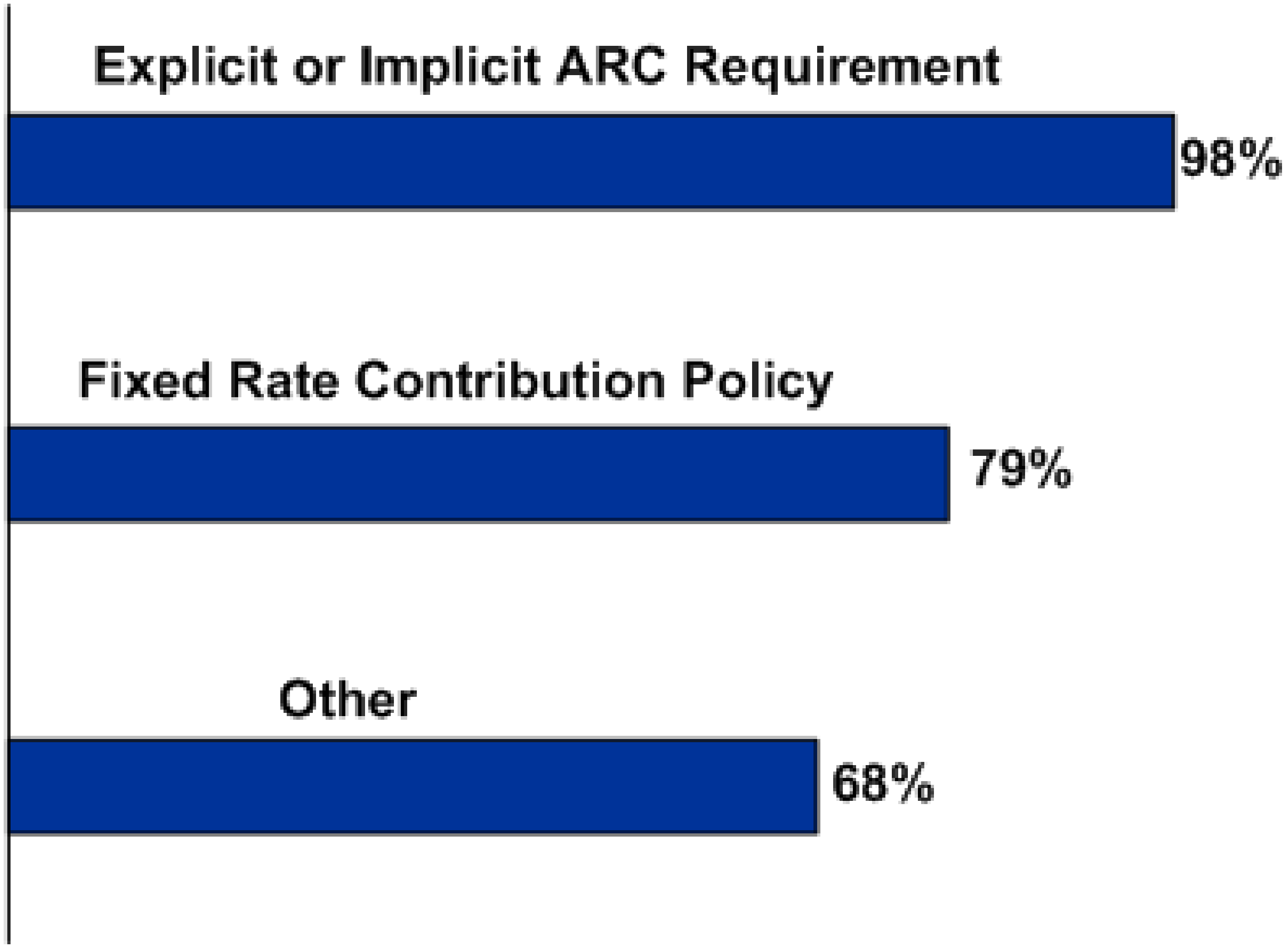
The ARC Experience of State Retirement Plans, FY 01 to FY 13: Key Findings

- Some plan sponsors consistently paid their ARC without a requirement to do so.

- Some states that have statutory requirements still failed to fund their pension plans.

- Drivers of contribution shortfalls were manifold and diverse

ARC Received Based on Funding Policy



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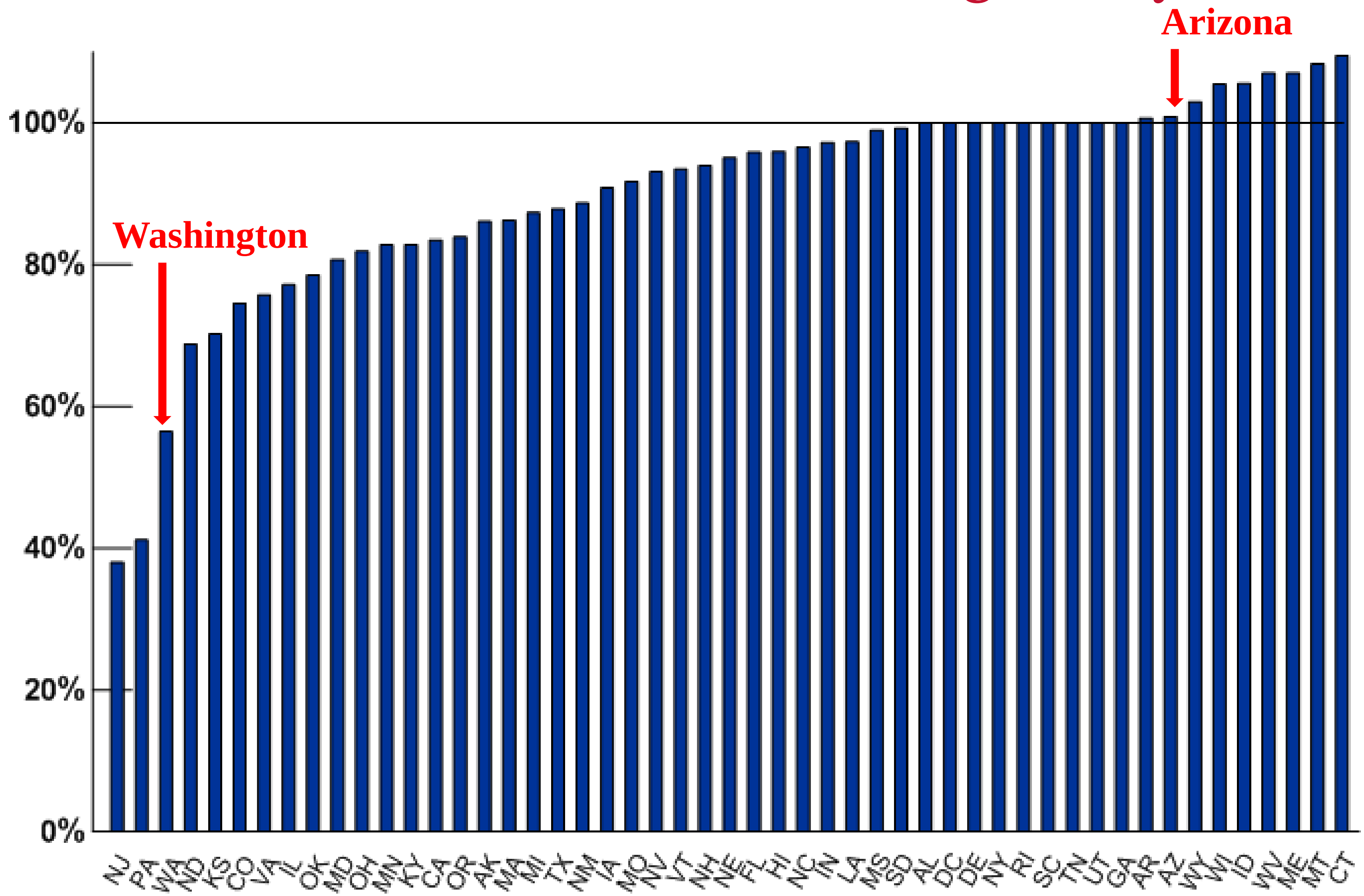
Arizona Pension Funding Policy

- Arizona State Constitution Article XXIX: "public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards."
- Arizona Revised Statutes 38-737: "The total employer contributions shall be equal to the employer normal cost plus the amount required to amortize the past service funding requirement over a rolling thirty-year period."

Washington State Pension Funding Policy

- Wash. Rev. Code § 41.45.060: "The [pension funding] council may adopt annual rate changes for any plan for any-rate setting period. The contribution rates adopted by the council shall be subject to revision by the legislature.

ARC Received Based on Funding Policy



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Final thoughts

- The pace of pension reforms has slowed sharply
- Pension costs are stabilizing for many plans
- Costs will continue to rise for some plans, especially those that traditionally have not received their ARC
- Reform battles remain in some states (e.g. IL, NJ and PA)
- Public pension problems are state and plan-specific, not systemic

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