A National Perspective of State and Local Pensions

Keith Brainard
Research Director
National Association of State Retirement Administrators

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Comparison of Retirement Benefits in the U.S.

**Private Sector**
- 60% of full-time private sector workers participate in an employer-sponsored retirement plan; 21% of part-time workers participate.
- 49% of all private sector workers participate in an employer-sponsored retirement plan.
- Fewer than one in five have a traditional pension (DB) plan.
- Social Security coverage is universal.

**Public Sector**
- Nearly all full-time workers have access to an employer-sponsored retirement benefit; most have access to a traditional pension (DB plan).
- 82% participate in a DB plan; virtually all others are in a DC plan.
- Three-fourths participate in Social Security.
Question: Why do public employers provide a retirement benefit?

Answer: To meet stakeholder objectives

Question: Who are the primary public retirement plan stakeholders?

Answer: Public employers, who seek to attract and retain qualified workers

Public employees, who seek a competitive compensation package, including a sound retirement benefit

Taxpayers and those who rely on public services, who seek public services provided in a cost-effective manner
Public pension governance

State and local pension plans are authorized by state government, constitutions, statutes, or both.

Unlike private pension plans, which are subject to extensive federal oversight, federal oversight of public pensions is limited chiefly to Internal Revenue Code provisions.

Public retirement boards are responsible for ensuring the plan complies with relevant laws and administrative rules.
Public pensions in the U.S.

- ~$3.82 trillion in assets
- ~14 million active (working) participants
  - 13 percent of the nation’s workforce
- 10 million retirees and their survivors receive $250+ billion annually in benefits
- Annual contributions = $180 billion
  - $132 billion from employers; $48 billion from employees
  - Approximately 5.0 percent of all state and local government spending goes to public pensions
- Of 6,000+ public retirement systems, the largest 75 account for 80+ percent of assets and members
- Aggregate funding level = ~74%
Public pensions in California

- ~$800 billion in assets
- ~1.8 million active (working) participants
- ~1.2 million retirees and their survivors receive $45 billion annually in benefits
- Annual contributions = $35 billion
  - $25 billion from employers; $10 billion from employees
- 88 retirement systems
  - CalPERS and CalSTRS account for $500 billion
  - Largest other plans: UCRP, LA County; LA Fire & Police, LACERS
Sustained low interest rates are fundamentally changing the pension finance calculus.

An unprecedented spate of pension reforms occurred from 2009 to 2014, and reform continues, at a slower rate.

After a lengthy period of decline, pension funding levels and costs have stabilized, although not for all plans.

The number of public employees and their salaries have stagnated since the Great Recession.

Federal interest in expanding public pension oversight and regulation looms.
Pension reforms in recent years

Every state modified public pension benefits or financing arrangements, or both, since 2009

Lower benefits:
- higher retirement age
- more required years of service
- lower multiplier
- longer vesting period
- reduced, suspended or eliminated COLAs

Increased use of hybrid retirement plans

Newly-hired state employees in Oklahoma as of 11/1/15 have only a defined contribution plan

Many municipal plans also have been reformed
A quick note on closing a plan

Most public pension plans have an unfunded pension liability, which is a pension obligation for which funds have not yet been accrued.

Closing a pension plan does not relieve the plan or its sponsoring government of responsibility for paying accrued pension benefits.

Closing a plan will reduce the amount of contributions flowing into the plan, which results in a higher cost as a percentage of payroll.

Partly for this reason, few states and cities have elected to close their pension plans, opting instead to modify and reform the existing plan.
States that reformed pension plans, by year, 2007-2015
States that increased employee contributions
States that reduced pension benefits
States that reduced automatic COLAs

“Significant Reforms to State Retirement Systems,” NASRA 2016
States that established new hybrid plans

Plan Type  | Combination hybrid | Cash balance
---|---|---

“Significant Reforms to State Retirement Systems,” NASRA 2016
Aggregate Public Pension Funding Level, FY 01 to FY 15
Median Change in Actuarial Value of Assets and Liabilities, FY 02 to FY 15

Public Fund Survey
July 2016

NASRA
Latest Public Pension Funding Levels

Size of bubbles is roughly proportionate to size of plan liabilities

LACERS = 71.4%
The meaning and implications of an actuarial funding ratio

An actuarial funding ratio is the most popular and recognized metric of a pension plan’s condition.

By itself, this ratio is not a reliable indicator of the condition of a pension plan.

The actuarial funding ratio is akin to a single snapshot of a movie that last for decades.

Other key considerations in evaluating a pension plan’s condition:

- The fiscal condition of the pension plan’s sponsoring government
- The commitment of the sponsoring government to pay required plan costs
- The current and required cost of the plan
- The reasonableness of the plan’s actuarial assumptions and methods
- The trend, or direction of the plan’s funding condition
- The plan’s demographics
Annual median change in active and annuitant participants, FY 02 to FY 15

LACERS: 1.33
Annual change in wages and salaries, private sector and state and local government, 2006-2015

Data final as of Q4 2016

US Bureau of Labor Statistics
Annual median change in public pension payrolls, FY 02 to FY 15
Taxpayer spending on pensions

- Spending varies widely among states
- Pension benefit levels affect the spending number
- Social Security participation is an important factor
- Not all states contribute as much as they should
- Spending is higher for cities than for states
  - A larger portion of city budgets is spent on personnel
  - Municipal employees are more likely to be unionized and therefore to have higher wages and pension benefits
Employer (taxpayer) spending on public pensions, 1986 to 2015

California FY 14: 5.7%

Median employer pension contribution rates, Social–ineligible, FY 02 to FY 15*

*General employees and teachers only; also includes disability benefits for most plans

LACERS
Employer FY 15
23.21%
(Tier 1)

LACERS
Employee FY 15
7.0%
(Tier 1)

Employers and employees also contribute to the retiree health care benefit

Public Fund Survey
July 2016
Weighted Average of Required Contribution Paid, by State, FY 01 to FY 14

Median = 95.9%
Weighted Average = 84.6%
Change in Distribution of Public Pension Investment Return Assumptions, FY01 to FY18

Public Fund Survey, NASRA Jan-17

Fiscal Year *Preliminary

LACERS = 7.5%

Median = 7.50%
Legal Protections

- Public pension benefits already earned are protected by the US Constitution, particularly the property rights clause of the Fifth Amendment.
- The right to future benefits varies from state to state.
- Some states include specific pension protections in their constitutions.
- California relies heavily on case law to forbid changes that would diminish benefit levels for participants already in the plan; this is the “California Rule.”
- California’s pension legal protections are among the strongest in the nation.
- Challenges to the California Rule may be considered by the state supreme court.
Legal Rulings

- Many state pension reforms that affected current plan participants provoked lawsuits.
- An unprecedented number of legal rulings on public pension issues have been issued since 2010.
- Rulings have run the gamut, from affirming to rejecting states’ authority to reduce benefits and increase contributions.
- Rulings in some states have contradicted rulings in other states on the same basic issues.
- Federal bankruptcy rulings in 2014 in Detroit and Stockton, CA permitted reductions in pension benefits despite strong pension legal protections in those states.
Pension challenges facing state and local government

For some states and cities, adequately funding their pension will be a challenge, especially for those with large unfunded liabilities.

Funding challenges are exacerbated by:

- low interest rates
- declining projected returns, and
- improving mortality

Providing a retirement benefit that aligns with key stakeholder objectives.
Pension challenges facing state and local governments, continued

Understanding and responding appropriately to multiple pension measures (books, budgets, and bonds):

- Books: GASB statements provide standardized financial reporting
- Budgets: Actuarial funding calculations identify the amount needed to fund the benefit
- Bonds: Bond rating agencies assess the degree to which pension obligations affect a government’s ability to repay bonded debt

Possibility of federal oversight

- PEPTA: Public Employee Pension Transparency Act
- Would require state and local government sponsoring pensions to submit to the US Department of the Treasury calculations based on the use of a risk-free interest rate
- Creates a burdensome reporting requirement under the threat of losing access to municipal bond markets