# An Overview of State and Local Pension Issues

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# Comparison of Retirement Benefits in the U.S.

## Private Sector

- Between employers that do not sponsor a retirement benefit and employees that elect to not participate when one is sponsored, 65% of full-time private sector workers participate in an employer-sponsored retirement plan
- 50% when part-time workers are counted
- 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
- 85%+ participate in a traditional pension (DB plan)
- Three-fourths participate in Social Security

# Distinguishing elements of public pension plans

- Mandatory participation
- Employee-employer cost sharing
- Assets that are pooled and professionally invested
- A benefit that cannot be outlived, i.e., mandatory annuitization

# Bird's-eye view of public pensions in the U.S.

**Defined benefit plans for employees of state and local government in the U.S.:**

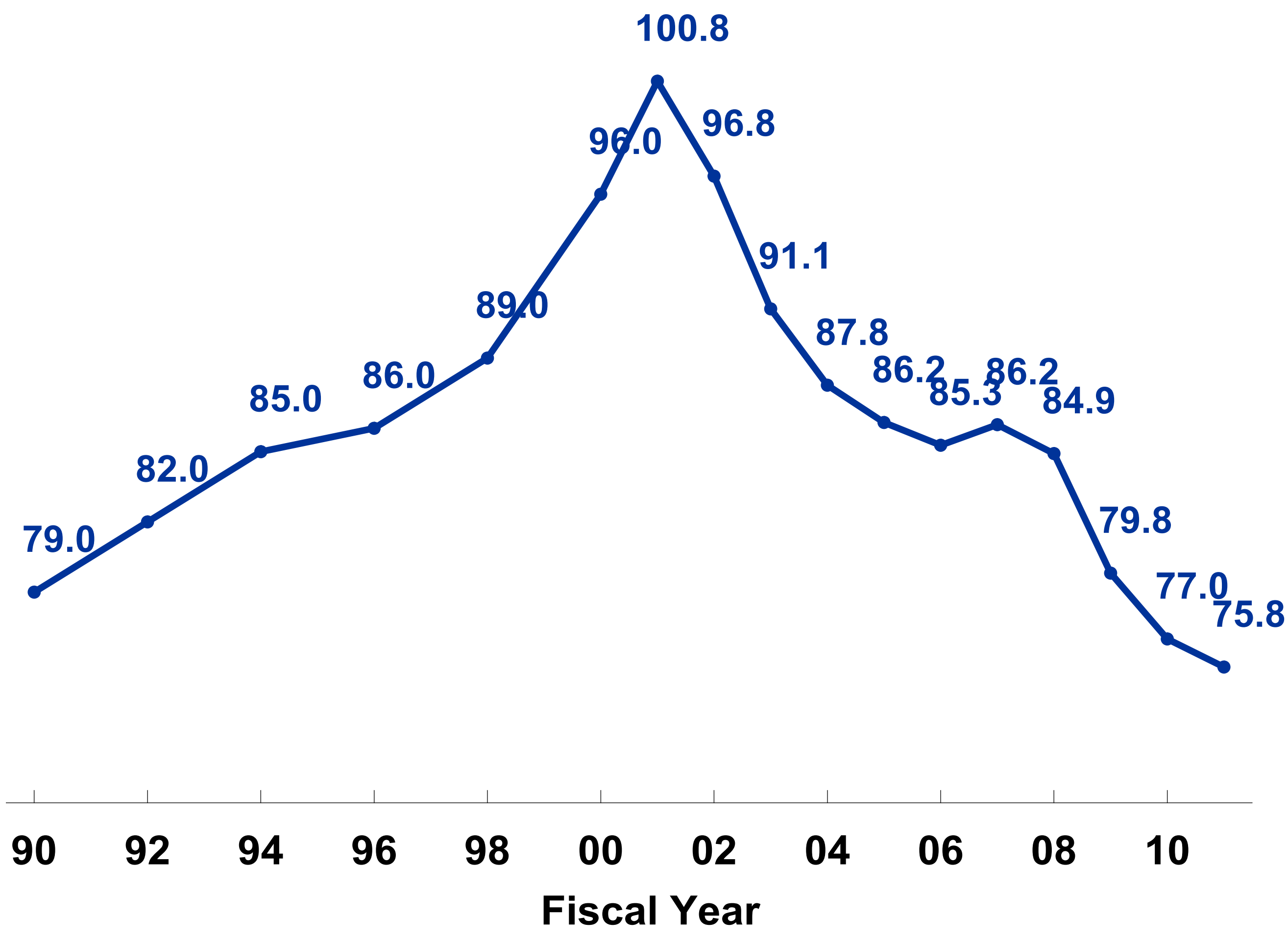
- ~$3.0 trillion in assets
- ~15 million active (working) participants
  - 12 percent of the nation's workforce
- 8.0 million retirees and their survivors receive $200 billion annually in benefits
- Of 3,000+ public retirement systems, the largest 75 account for 80+ percent of assets and members
- Aggregate funding level = ~76%

*US Census Bureau, Public Fund Survey*

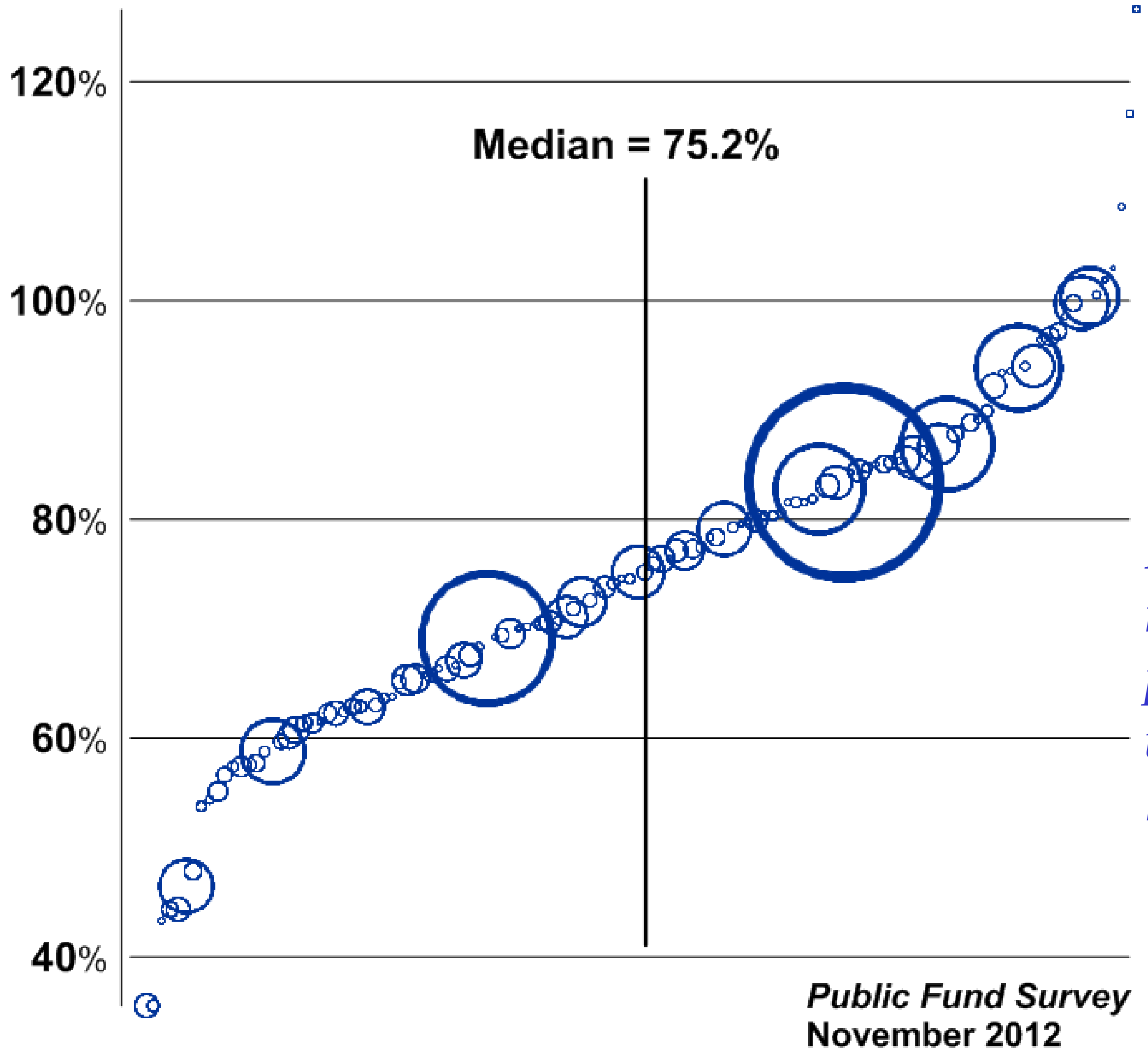
# Overarching Public Pension Issues

- Since 2009, an unprecedented:
  - number of legislative changes made to public pensions
  - number of legal challenges in response to legislative changes
  - level of attention to public pensions and public employee compensation
  - reduction in state and local government employment (3.5%)
- New pension accounting standards will change the way pensions are accounted for
- Scrutiny and challenging of investment return assumptions

# Historical aggregate public pension funding levels



# Distribution of public pension actuarial funding levels and relative size




*Bubbles are roughly proportionate to size of plan liabilities*

# Legislative pension enactments in recent years

- Higher employee contributions
- Lower benefits
  - higher retirement age
  - more required years of service
  - longer vesting period
  - reduced or eliminated COLAs
- Risk-shifting to employees
- Increased use of hybrid retirement plans

*No shift to defined contribution plans as the primary retirement benefit*

# Growing use of hybrid plans

- Two main types of hybrid plan:
  - "Combination" DB-DC, and cash balance
- DB-DC plans feature a traditional, more modest pension, combined with a defined contribution plan
  - Mandatory: GA, IN, MI, OR, RI (VA as of 1/1/14)
  - Optional in OH, WA
- Cash balance plans feature pooled assets with notional accounts that pay a guaranteed minimum interest rate, with possibility of sharing "excess" investment earnings
  - In use in TX, for workers of all counties and many cities; NE, for state and county workers, and CA, for community colleges

# More on hybrids

- This year, KS approved a new cash balance plan for all new hires beginning in 2015
- LA approved a CB plan for all new hires beginning next year (still under legal challenge)
- Retirement benefit for Wisconsin public employees has two parts: base benefit and a benefit tied to investment performance
  - The portion tied to investment performance can go up and down, and has gone down the last three years
- Oregon's DB-DC plan pools the DC plan assets and invests them in a fund like the DB plan

- See also NASRA's Issue Briefs on Hybrids

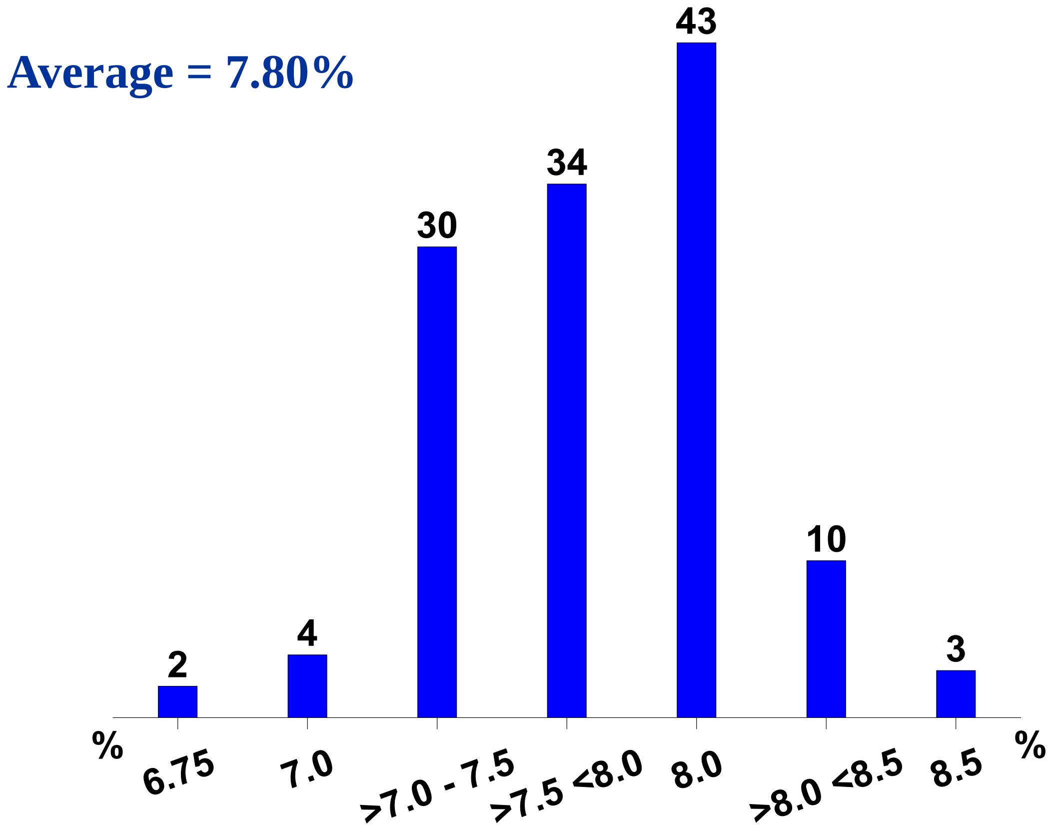
# Pension reform in Rhode Island

- All plan participants effective were moved from the traditional pension plan to a new DB-DC hybrid
- Reduced future rate of pension accrual
- Higher normal retirement age
- A portion of employee contribution is diverted to the DC plan
- COLA is suspended until funding level = 80%

# Pension reform in Utah

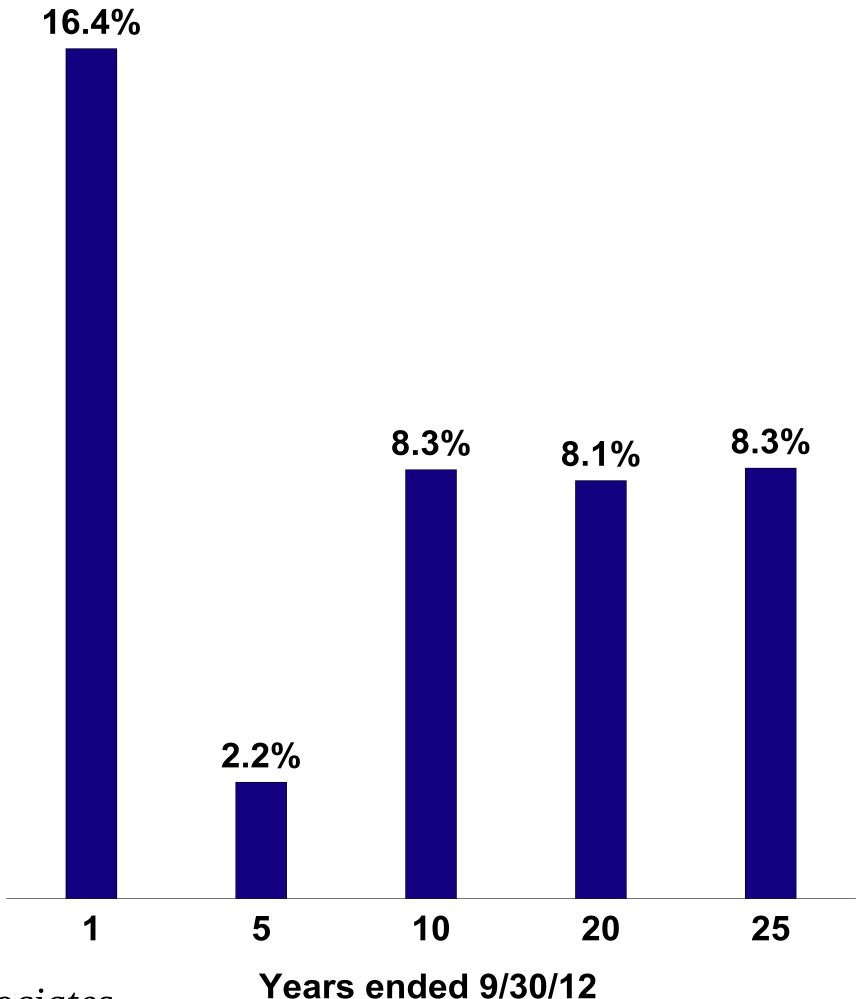
- New hires since 7/1/11 may choose from a defined benefit or defined contribution plan
- Employer contributes 10 percent of pay
- For the DB plan, retirement multiplier = 1.5 percent
- Total cost of the plan = 7.59 percent (10.45 percent for public safety)
- Remaining 2.41 percent (1.55 percent for public safety) is deposited into employees' defined contribution account
- Employees pay any cost of the DB plan above 10 percent (12 percent for public safety)
- Employers also contribute 5 percent to amortize UAL
- "A defined benefit plan with a defined contribution"

# Distribution of public pension investment return assumptions



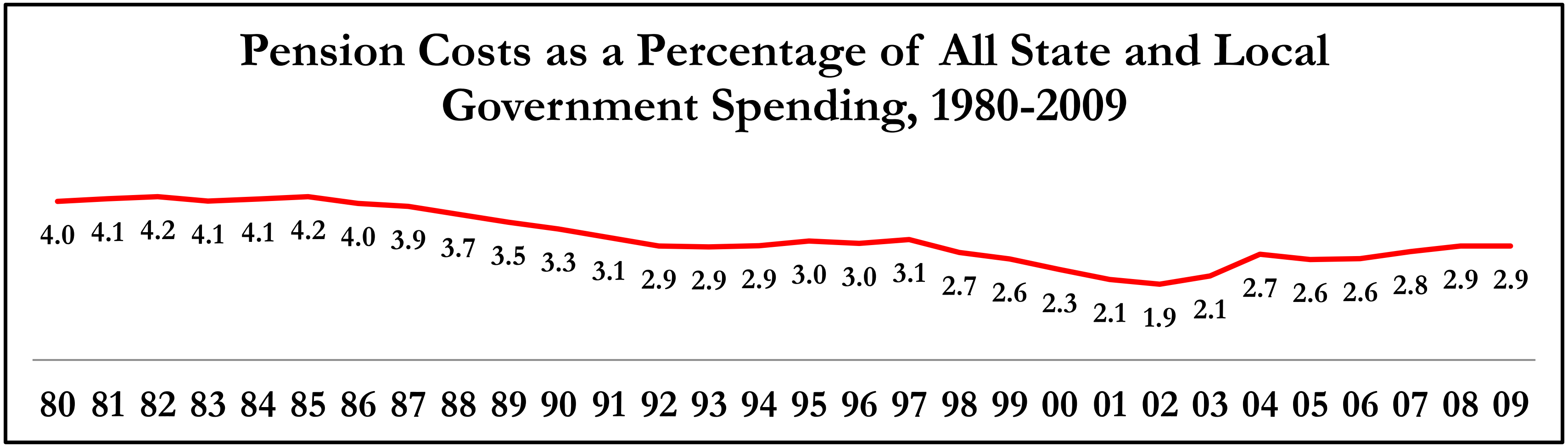

PUBLIC FUND SURVEY

# Median public pension investment returns for periods ended 09/30/12




*Callan Associates*

# Taxpayer spending on public pensions




***U.S. Census Bureau***

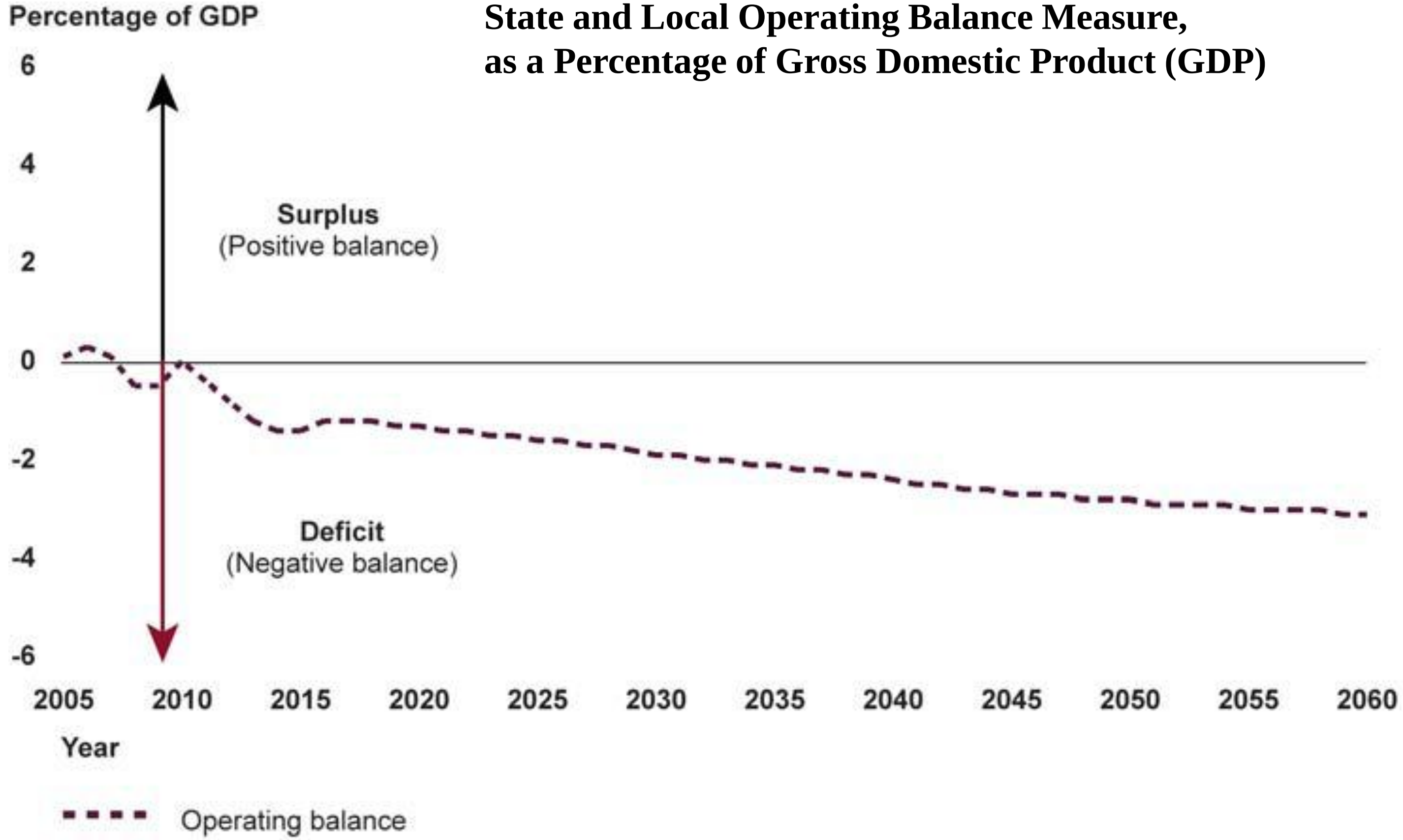
- Not all state and local government spending is discretionary
- Percentage spending for local governments is generally than for states
- Spending will need to rise to 4% to 5% on a national basis, and much higher for some states, to eliminate unfunded liabilities.

# GASB Changes

- New GASB standards focus on accounting for pension liabilities, not funding them
- New accounting standards do not change the way public pensions are funded
- State funding policies do not rely on GASB standards
- New standards alter pension reporting requirements, but do not change the cost of pensions
- For some plans and employers that sponsor them, new standards will cause increased scrutiny and possibly alarm

**According to the Government Accountability Office, (GAO) the state and local government sector faces a long-term structural deficit that is projected to gradually worsen. The primary sources of this deficit are Medicaid and health care costs for retired public employees.**

**State and Local Operating Balance Measure, as a Percentage of Gross Domestic Product (GDP)**




Source: GAO simulations, updated April 2012.

# Public pension outlook

- Focus on reforms will continue
- More risk shifted to workers
- Public pension legal protections will continue to be tested and clarified
- Defined contribution plans in lieu of pensions are possible—but unlikely