# State Retirement Systems: Recent Trends

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**The Council of State Governments' Southern Office**
**Southern Legislative Conference (SLC)**

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# Five Main Parts

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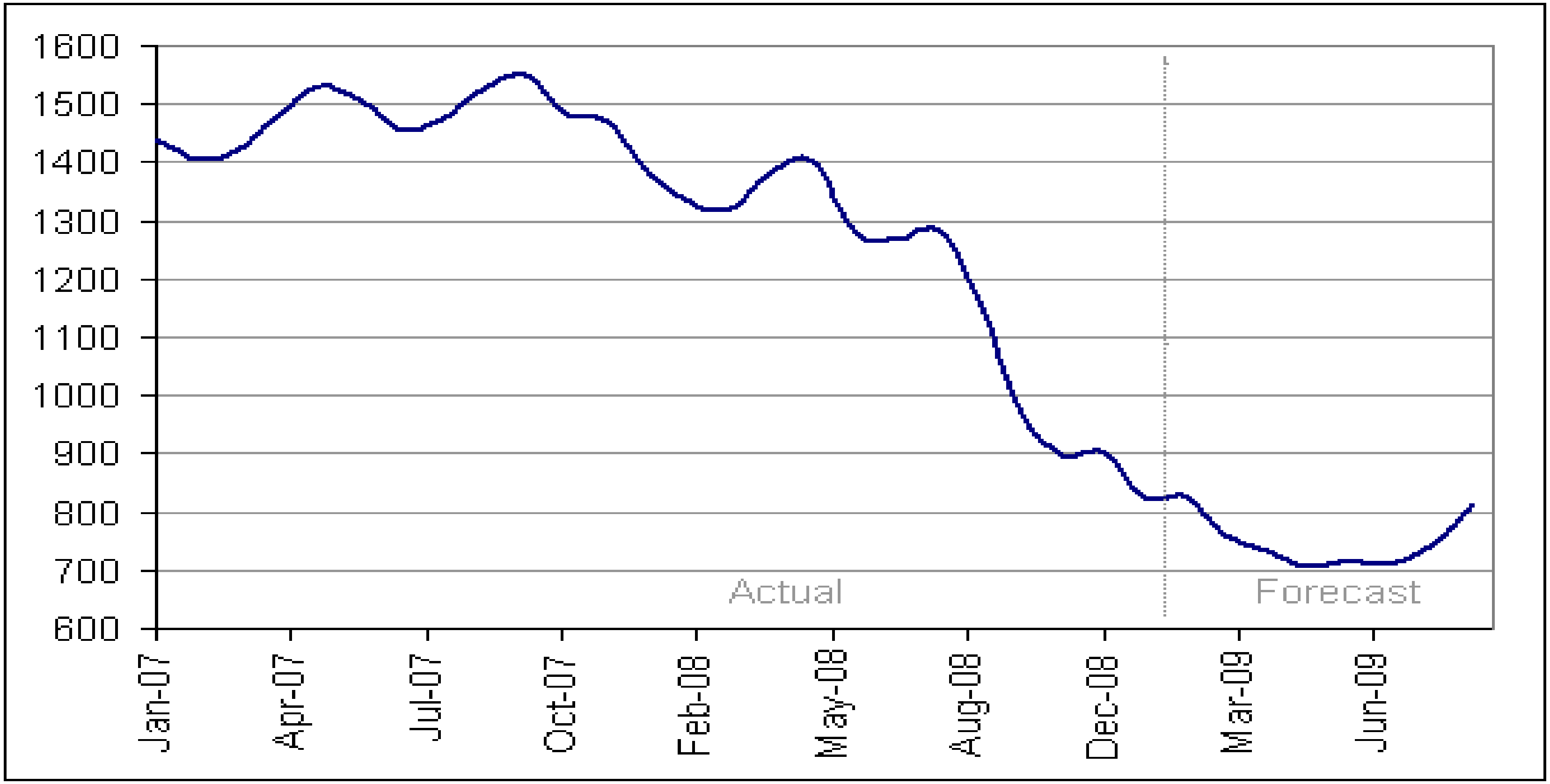
1. What is the Impact of Recent Market Losses on State Retirement Plans?
2. Why Focus on State Retirement Plans?
3. Where Public Pension Plan Finances Stand?
4. What Are Some Key Recent Trends in Public Pension Plans?
5. How Are States Bolstering their Pension Plans?

# 1. What Is the Impact of Recent Market Losses?

- State Pension Funds Have Taken a Beating Like Every Other Investment Category.
- 2008, A Devastating Year for the Equity Markets
  - ✓Dow Jones Industrial Average Lost 34 Percent, Worst Year for the DOW since 1931;
  - ✓Standard & Poor’s 500 Stock Index Lost More than 38 Percent;
  - ✓Nasdaq Lost Nearly 41 Percent, Worst Year Ever.

# 1. What Is the Impact of Recent Market Losses?

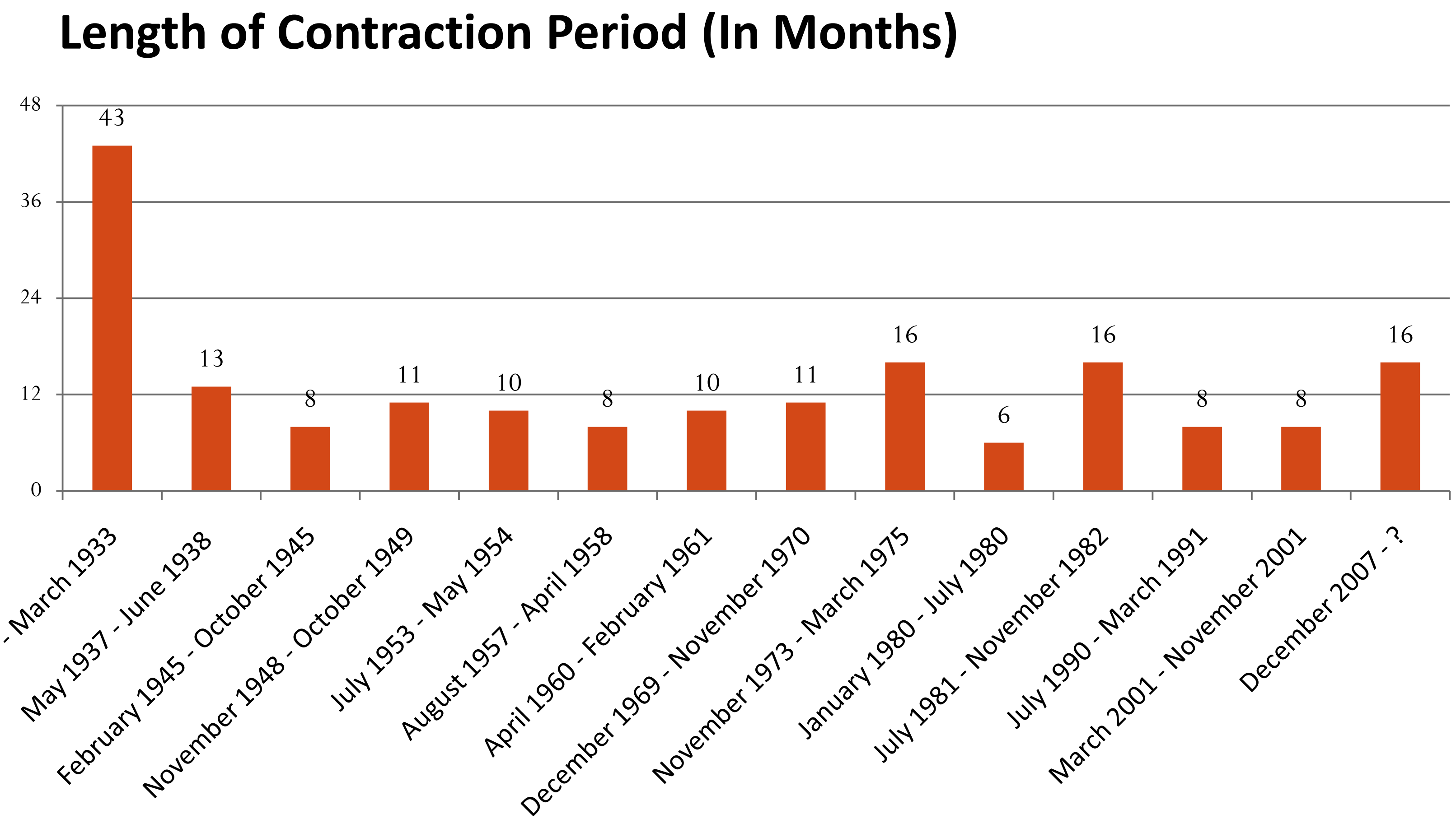
## Trajectory of the S & P 500 Stock Index, January 2007 to June 2009



# 1. What Is the Impact of Recent Market Losses?

- VA = Lost $14.5 Billion Between7/08 to 1/09;
- MD = Lost $10.3 Billion Between 7/08 to 1/09;
- NV = Lost $4 Billion Between 6/08 and 12/08;
- NJ = Lost $24 Billion Between 6/08 and 11/08;
- AR (Teachers) = Lost $1.17 Billion Between 6/08 and 9/08;
- WV = Lost $2.5 Billion or 25% Between 7/08 and 11/08;
- CA (Teachers) = Lost $33 Billion Between 10/07 and 12/08;
- WI = Lost $25 Billion Between 1/08 and 10/08;
- DE = Lost $2.3 Billion or 29% Between 10/07 and 10/08.

# 2. Why Focus on Pensions?



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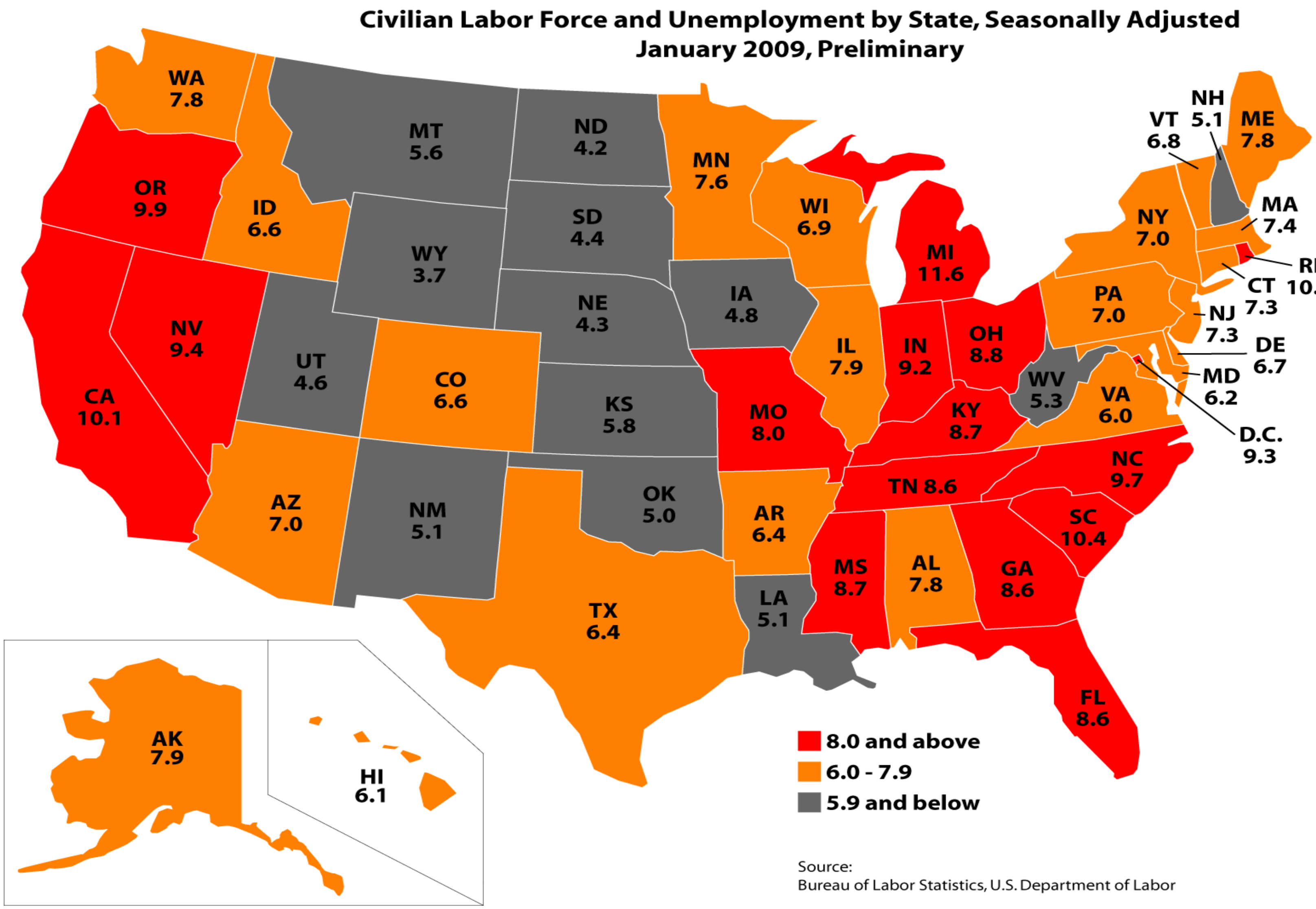

# 2. Why Focus on Pensions?

States still have to contend with surging expenditures in a number of major categories:

- Healthcare
- Education
- Emergency Management
- Corrections
- Unemployment Insurance
- Transportation
- Infrastructure
- Public Pensions

# 2. Why Focus on Pensions?

## Three Legs of the Metaphorical Retirement Stool (Main Sources of Income in Retirement)

- ✓ Social Security and Medicare
- ✓ Pension Income (Private and Public Sector)
- ✓ Personal Savings

Unfortunately, all these elements are on shaky ground

# 2. Why Focus on Pensions?

- Social Security has large “reserves” in its trust funds now. In 2017, benefits owed will be more than taxes collected, and Social Security will need to begin tapping the trust funds to pay benefits. The trust funds will be exhausted in 2041.
- The projected date of Medicare’s exhaustion is 2019, when dedicated revenues would be sufficient to pay only 78 percent of costs.

# 2. Why Focus on Pensions?

- Corporate Pension Plans in Trouble
  - ✓According to Mercer Consulting, largest corporations underfunded by $409 Billion in 2008.
  - ✓Pension Benefit Guaranty Corporation (PBGC), the federally-chartered entity that shoulders pension obligations when corporations go bankrupt, reported a deficit of $11.5 Billion as of Sept. 2008.

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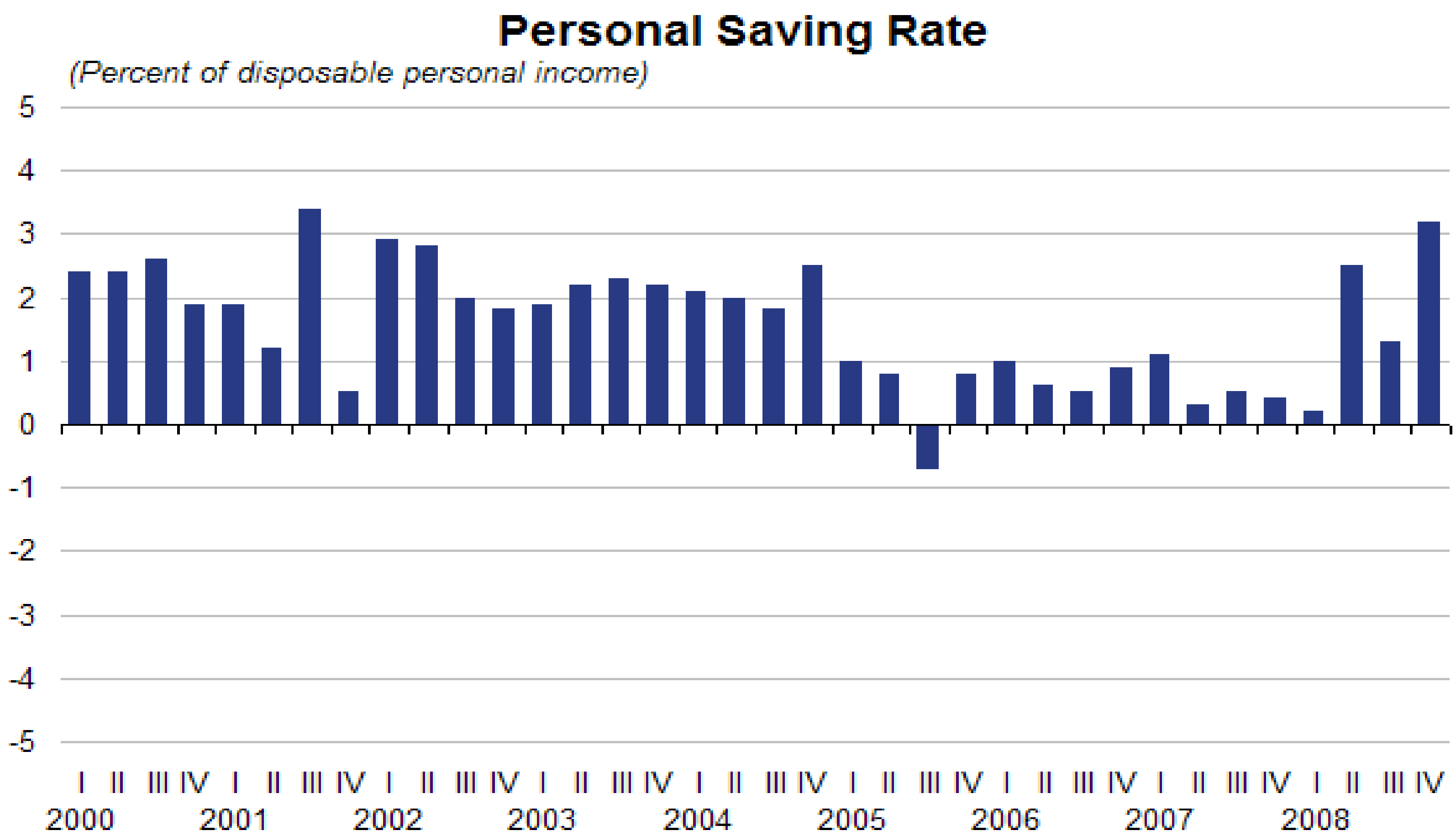
# 2. Why Focus on Pensions?

## Low National/Personal Savings Rate




U.S. Bureau of Economic Analysis

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# 2. Why Focus on Public Pensions?

According to federal population projections, by 2030:

- Only 2 states (UT, AK) will have less than 20 percent of its population younger than 60 years;
- 39 states will have between 20.2 percent and 28.4 percent of it population 60 years and over;
- 9 states (DE, VT, ND, WV, MT, WY, NM, ME and FL) will have more than 30 percent of its population older than 60 years;
- 28.4 percent of PA's population will be 60 years and older;
- 33.9 percent of FL's population will be 60 years and older, the highest percentage in the country.

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# 2. Why Focus on Public Pensions?

- Life expectancy rates inching up, 78.1 years, a new record.
- Declining worker to beneficiary ratio:
  - ✓1950 = 16.5 to 1
  - ✓2007 = 3.3 to 1
  - ✓2032= 2 to 1
- Declining 18-64 age cohort, the peak working cohort, from 63 percent of population in 2010 to 57 percent in 2030.

# 3. Where Public Pension Plans Stand?

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- 2007 Pew Center on the States Report – 85 percent of pension costs with about $731 billion in unfunded bills (mostly retiree healthcare) coming due;
- 2008 GAO Report – Only 58 percent of the 65 large pension plans reached the 80 percent threshold;
- 2009 Standard & Poor's Report – 83 percent mean funded ratio for state pension plans;
- 2009 Wilshire Report – 84 percent actuarial funding ratio, a decline from 96 percent in prior year;
- Latest NASRA Report – average funding level at 86.4 percent with a cumulative unfunded liability of $399 billion

# 3. Where Public Pension Plans Stand?

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- According to a February 2009 Standard & Poor's Report:
  - ✓Public Pension Plans Funded Over 100 Percent:

    DE, FL, ID, NY, NC, OR and UT
  - ✓Public Pension Plans Funded Less than 70 Percent:

    CT, IL, IN, LA, NH, OK, RI, SC and WV
  - ✓PA = 89.5 Percent

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# 4. Key Trends – Public Pension Plans

- Shift to Non-Governmental Securities (corporate stocks, corporate bonds, foreign stocks, real estate, hedge funds).
- In 1993, public pension plans had only 62 percent of their total cash and investment holdings in Non-Governmental Securities.
- In 2007, this percentage had ballooned to 78 percent.

# 4. Key Trends – Public Pension Plans

More Scrutiny and Oversight by Pension Plan Boards and State Lawmakers:

- In MD, after state pension plan ranked last earlier on this decade, lawmakers began inquiries, which along with a federal investigation, resulted in criminal prosecutions and convictions of plan officials;
- CA replaced investment officers;
- WY restructured retirement board;
- IA and ND have initiated reforms after discovering that their state pension plans were defrauded by WG Trading.

# 4. Key Trends – Public Pension Plans

- GASB Statement 45 requires that state and local governments account for and report the annual cost of OPEB (*other post-employment benefits*) – mostly health care – and the outstanding obligations and commitments related to OPEB in the same manner as they do for pensions.

# 4. Key Trends – Public Pension Plans

States with Highest Unfunded Actuarial Accrued OPEB Liabilities

- ✓ NJ = $68.8 Billion
- ✓ NY = $49.7 Billion
- ✓ CA = $47.9 Billion
- ✓ NC = $23.8 Billion
- ✓ CT = $21.7 Billion
- ✓ LA = $19.6 Billion
- ✓ TX = $17.7 Billion

Source: Center for State and Local Government Excellence, July 2008

# 4. Key Trends - Public Pension Plans

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- 33 states have notified the GASB that they have begun implementing Statement 43 or Statement 45:
  Alaska; Colorado; Georgia; Idaho; Indiana; Iowa; Kansas; Kentucky; Louisiana; Maryland; Massachusetts; Michigan; Minnesota; Mississippi; Missouri; Montana; Nebraska; Nevada; New Hampshire; New Mexico; New York; North Carolina; North Dakota; Oklahoma; Oregon; Pennsylvania; Tennessee; Texas; Utah; Vermont; Virginia; Washington; Wyoming.

# 5. Strategies Adopted: Pension Obligation Bonds

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- Racking up debt to meet essential expenditures has been popular among states recently, particularly since raising taxes is politically radioactive;
- Pension bond issues earlier on this decade in CA, KS, OR, IL, WI, were successful;
- In May 2008, AK authorized $5 Billion in pension obligation bonds and WI, also in 2008, authorized Milwaukee County, to proceed with a bond issue.

# 5. Strategies Adopted: Pension Obligation Bonds

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**Pros:**

- ✓ Interest rates currently at historic lows.
- ✓ Funds raised via bonds relieves immediate pressures on budget.
- ✓ Opportunity to reduce/eliminate state's unfunded liability level.

**Cons:**

- ✓ Possibility of investment earnings being lower than interest rate.
- ✓ Locked into making debt payments.
- ✓ Increases the state's net tax-supported debt level.
- ✓ Fiscally dangerous policy of borrowing to meet ongoing expenditures (possible credit rate lowering).

# 5. Strategies Adopted: Pension Obligation Bonds

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- In 1997, New Jersey borrowed $2.8 billion to, among other goals, clear its unfunded liability.
- Investment earnings exceeding 7.6 percent required to cover interest payments.
- In June 2000, pension plan was worth $83 billion; by June 2003, it had plummeted to $55 billion.
- NJ's pensions as of June 2007 had an unfunded liability of $28 billion; reports indicate that this amount has now soared to more than $52 billion, with roughly 45 percent of the obligation unfunded.

# 5. Strategies Adopted: Trimming Benefits

- Moving workers away from DB plans to 401(k)-style, DC plans (AK, CA, SC, MA, MI, NJ, IL, KY, OR, VA).
- Reviewing and Reducing COLA Increases (RI, KY, VT).
- Adjusting age at which retirees are paid full benefits (RI, KY, NY).
- Introducing different benefit tiers for current and future retirees (NY, IL, NV).

# 5. Strategies Adopted: Trimming Benefits

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- Capping annual retirement benefits (NH).
- Reducing percentage of pay retirees get each year (RI, WI).
- Eliminating DROPs and “Double-Dipping” (LA, FL, NM).
- Ending practice of employees serving a short period in a position to boost overall pension (MO).
- Debating and ending lucrative health plans to retirees (NC, MI, IN, KY).

# 5. Strategies Adopted: Other

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- Increasing the costs to state workers, counties and cities (KY, NJ, IA, WY).
- Consolidating retirement boards (WV, MN, VT).
- Matching, i.e., deliberately aiming for low, but guaranteed, investment income from conservative bonds (ME).
- Deferring pension contributions (NJ, KY).
- Unorthodox investments (AL, MA).

# State Retirement Systems: Recent Trends

## Thank You

For more information, please contact


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