

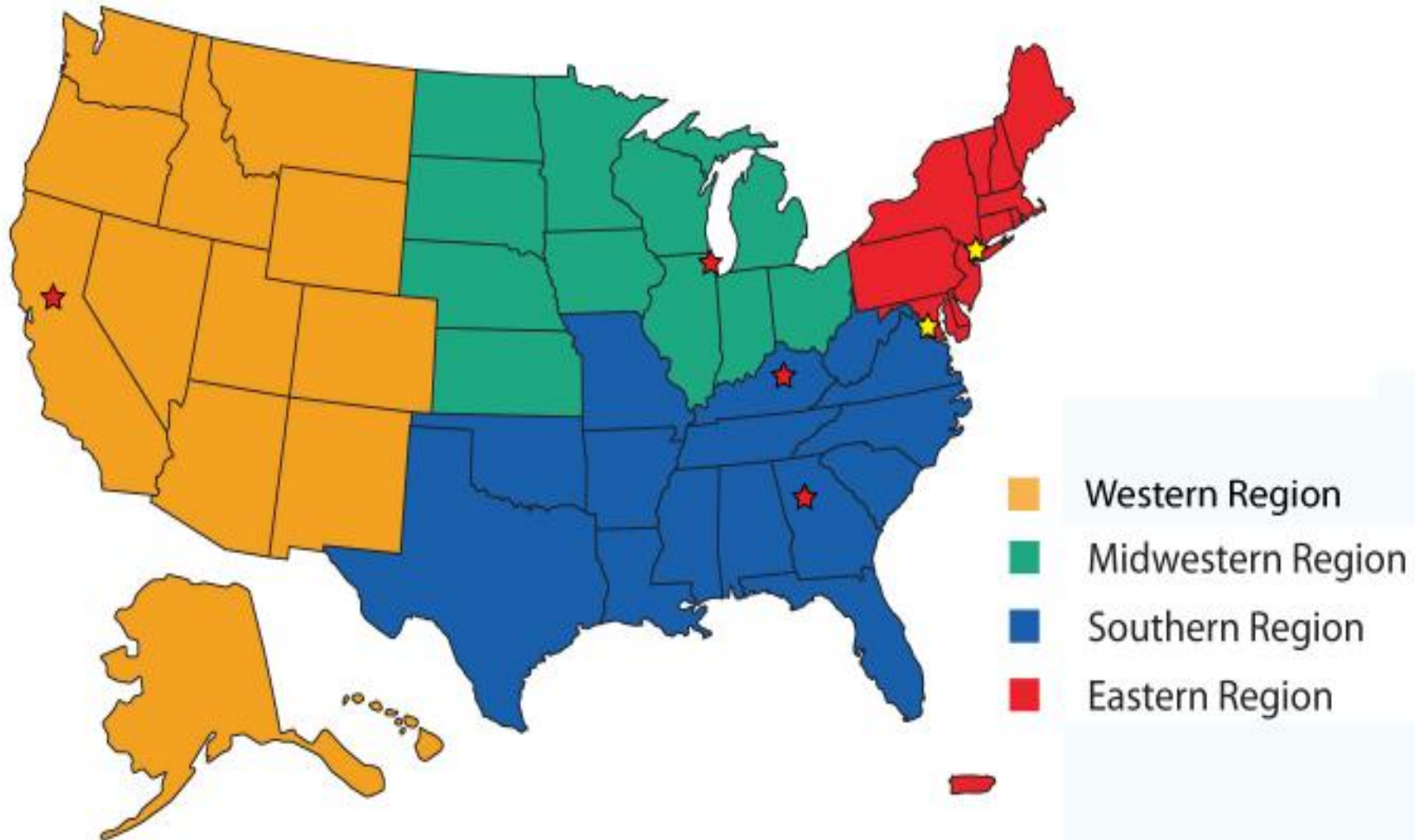
State Retirement Systems: Recent Trends

Sujit M. CanagaRetna

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

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2012 Alabama Legislative Symposium
Birmingham, Alabama
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Introduction to CSG



Five Main Parts

1. How State Finances Impact 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. How State Finances Impact State



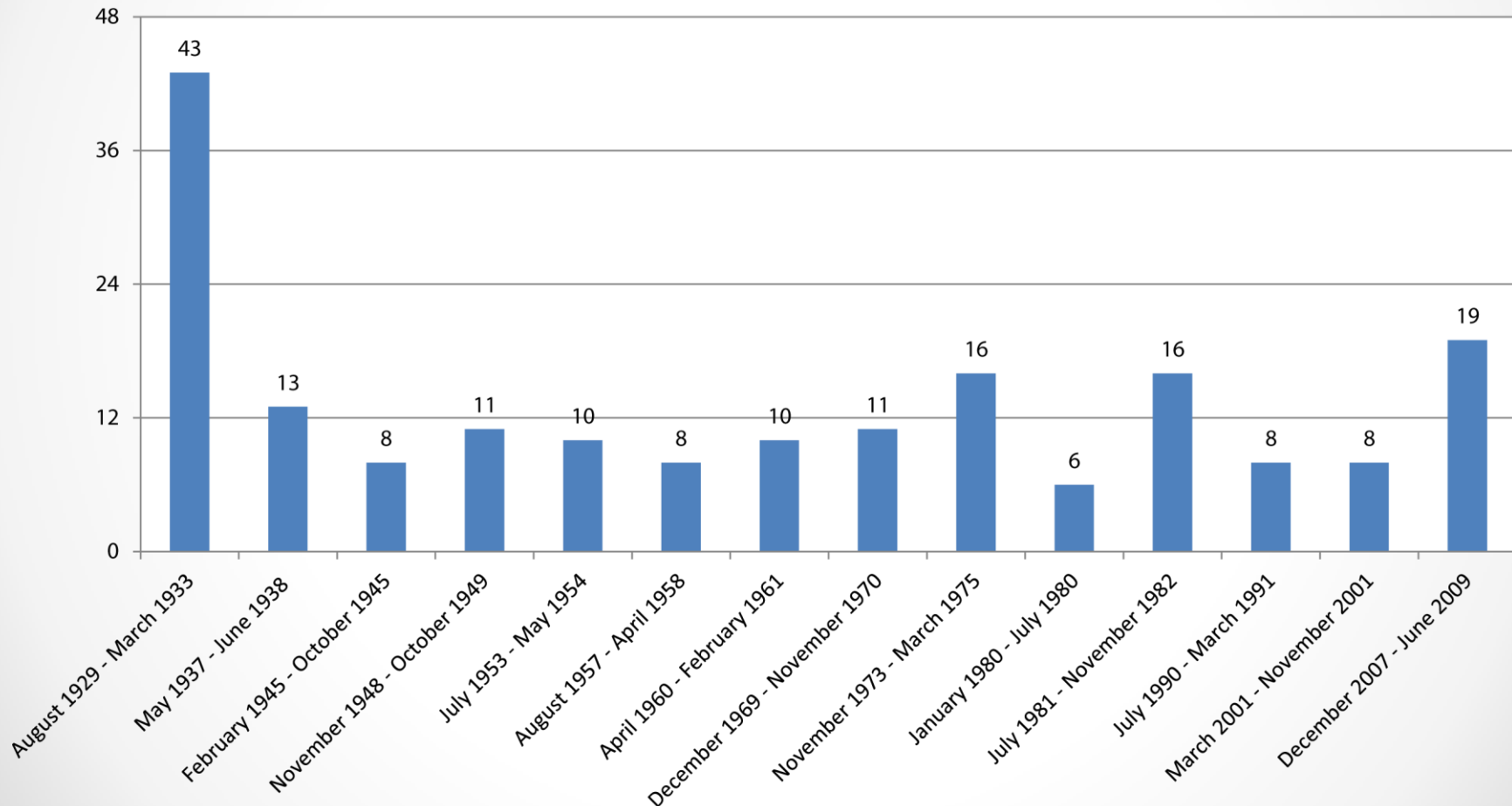
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Pension Plans?

Length of Contraction Period (in months)



Source: National Bureau of Economic Research (NBER)

1. How State Finances Impact State



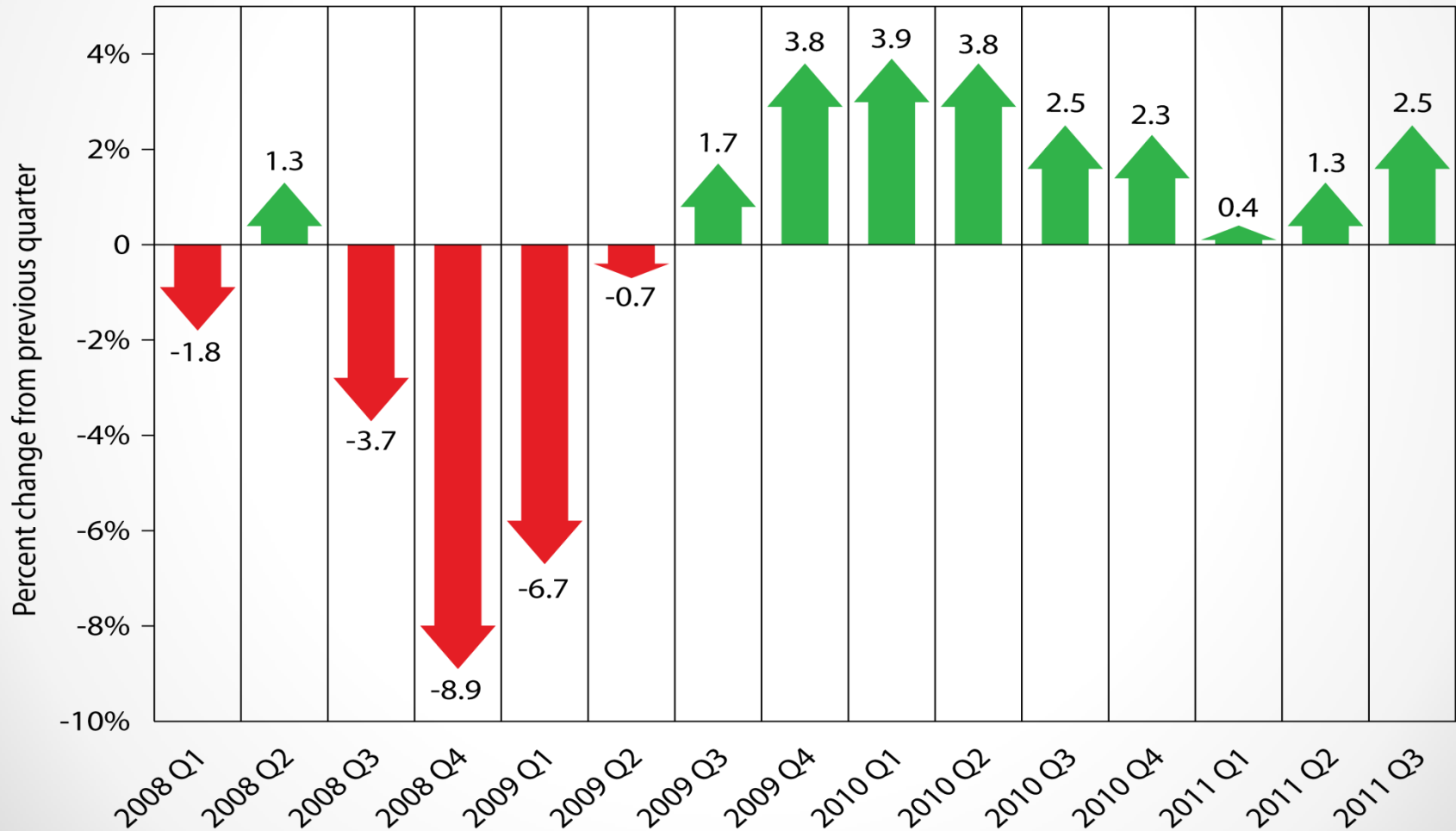
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Pension Plans?

U.S. Gross domestic product (GDP): 2008 (1st quarter) - 2011 (3rd quarter)



Source: United States Department of Commerce, Bureau of Economic Analysis

1. How State Finances Impact State



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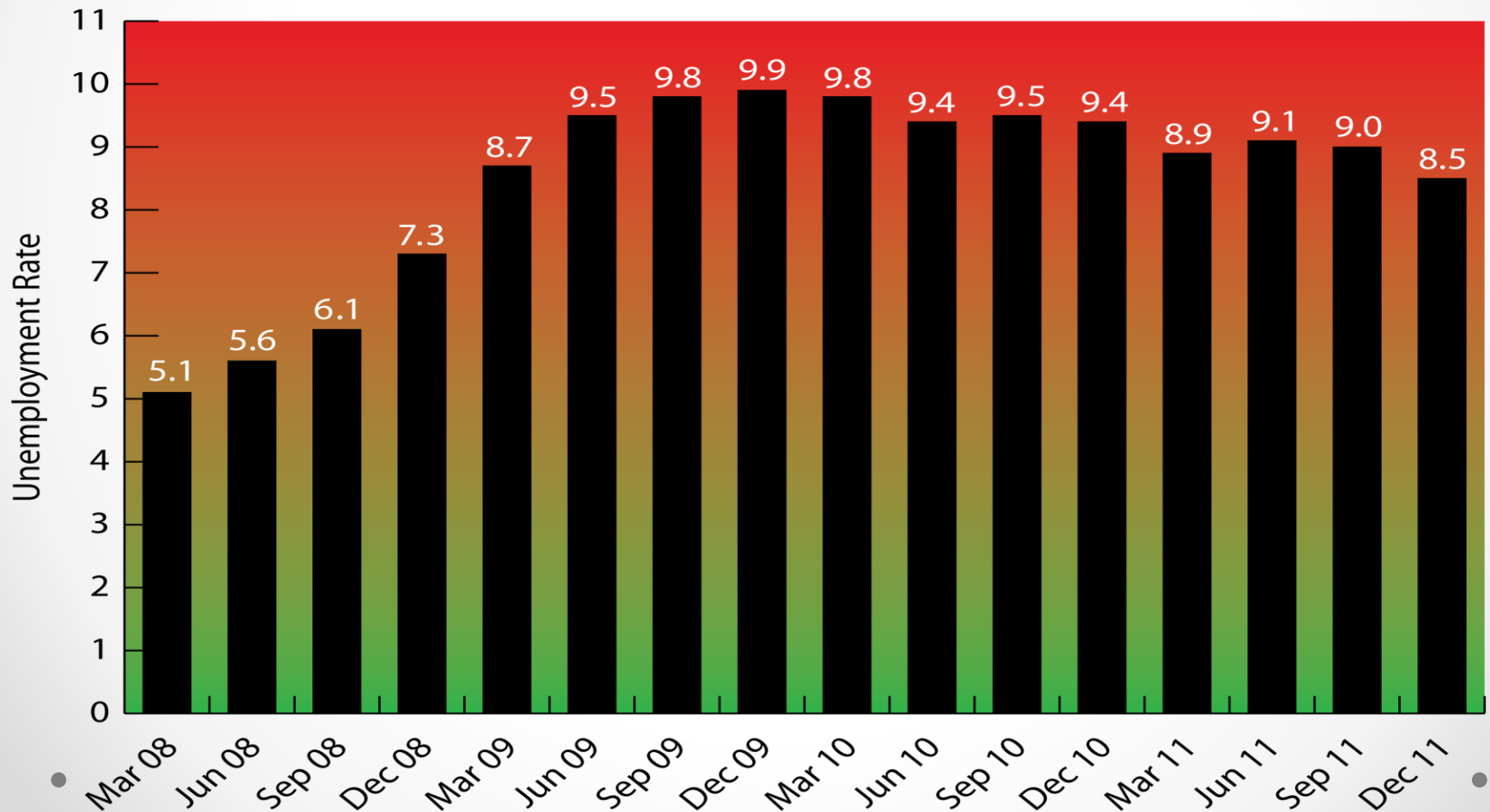


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Pension Plans?

National Unemployment Rate March 2008 - December 2011

Source:
U.S. Department of Labor,
Bureau of Labor Statistics



1. How State Finances Impact State



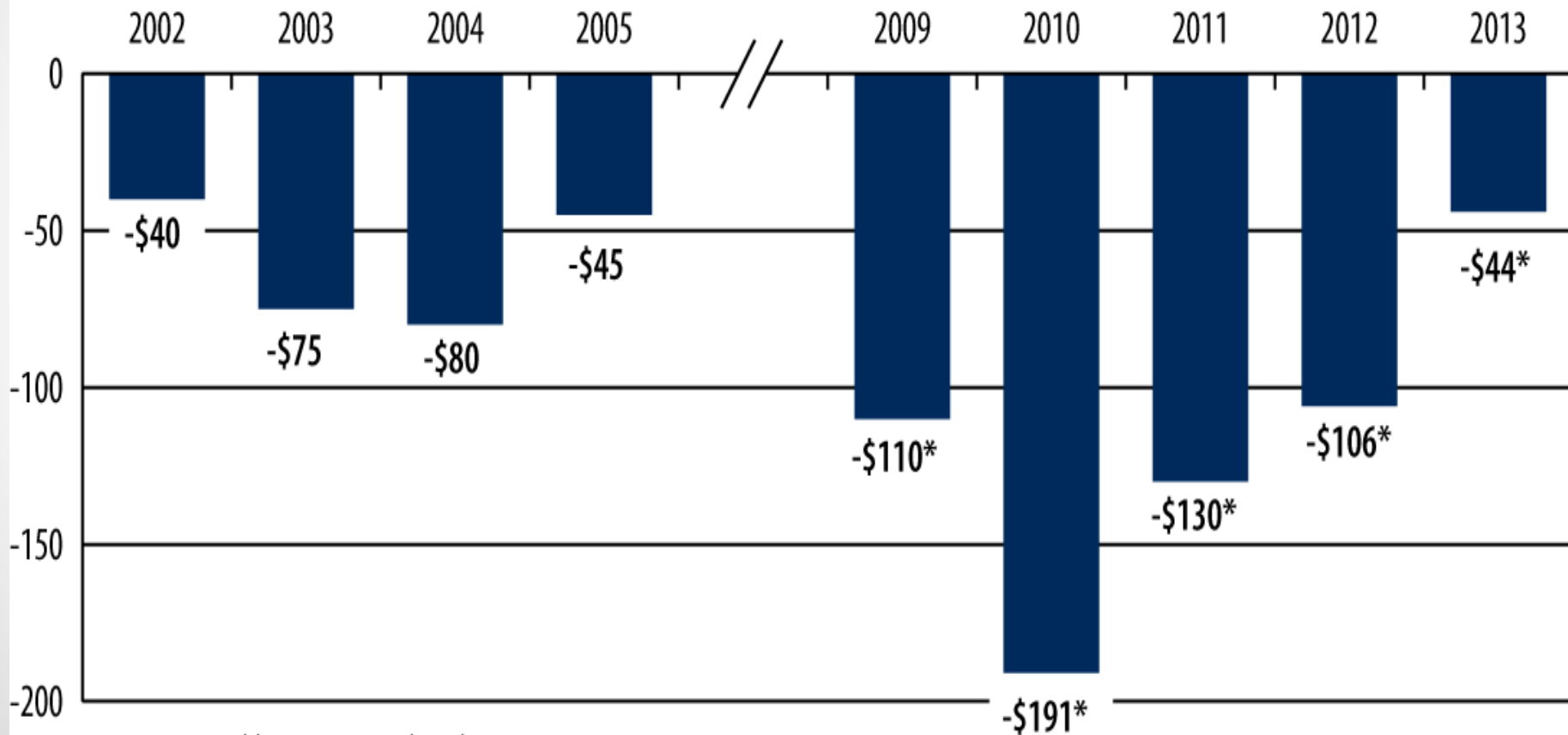
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Pension Plans?

Total State Budget Shortfalls, Fiscal Years 2002-2013 (in \$ billions)



Source: <http://www.cbpp.org/cms/index.cfm?fa=view&id=711>

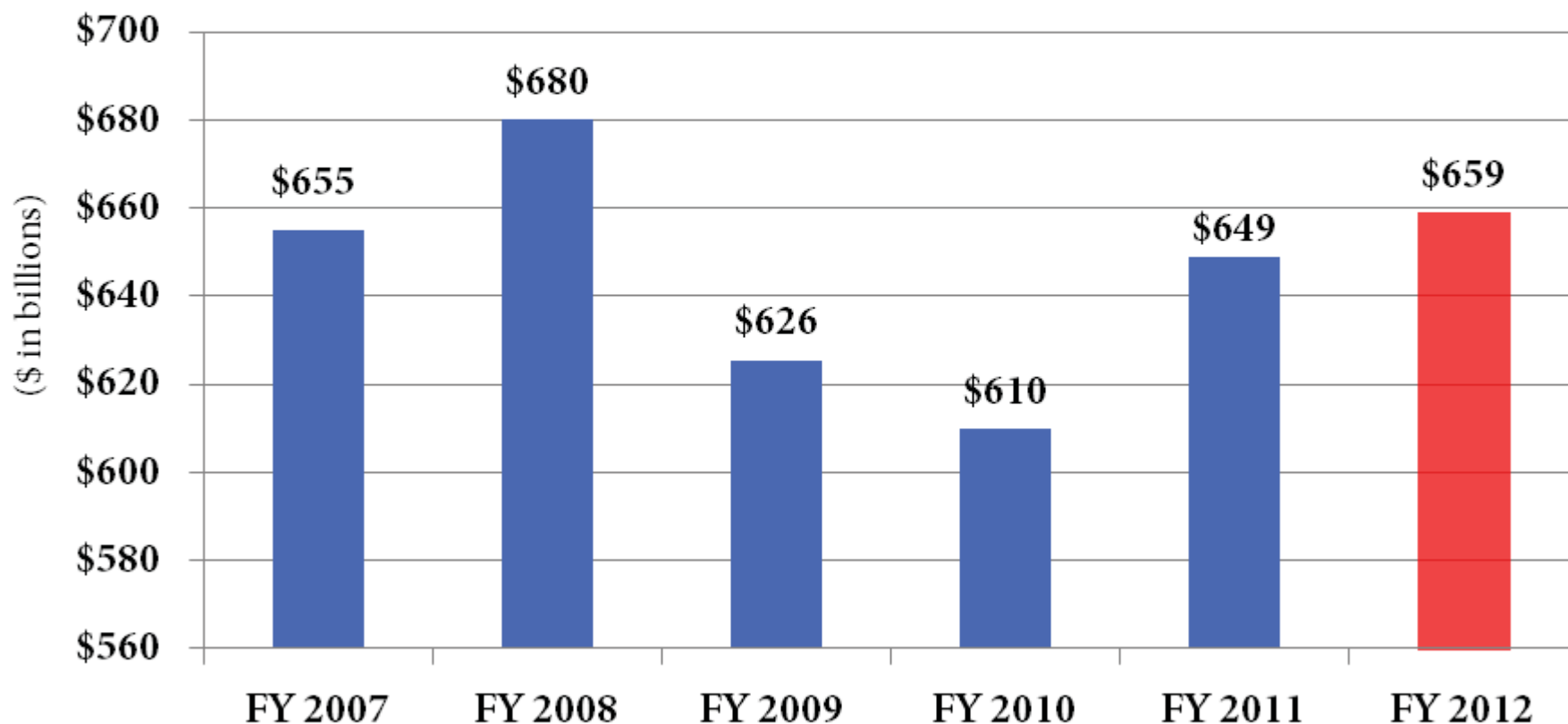
Note: * = Current as of December 2011

1. How State Finances Impact State

Pension Plans?

Revenue Remains Below Pre-Recession Levels

General Fund Revenue: FY 2007-FY 2012



1. How State Finances Impact State



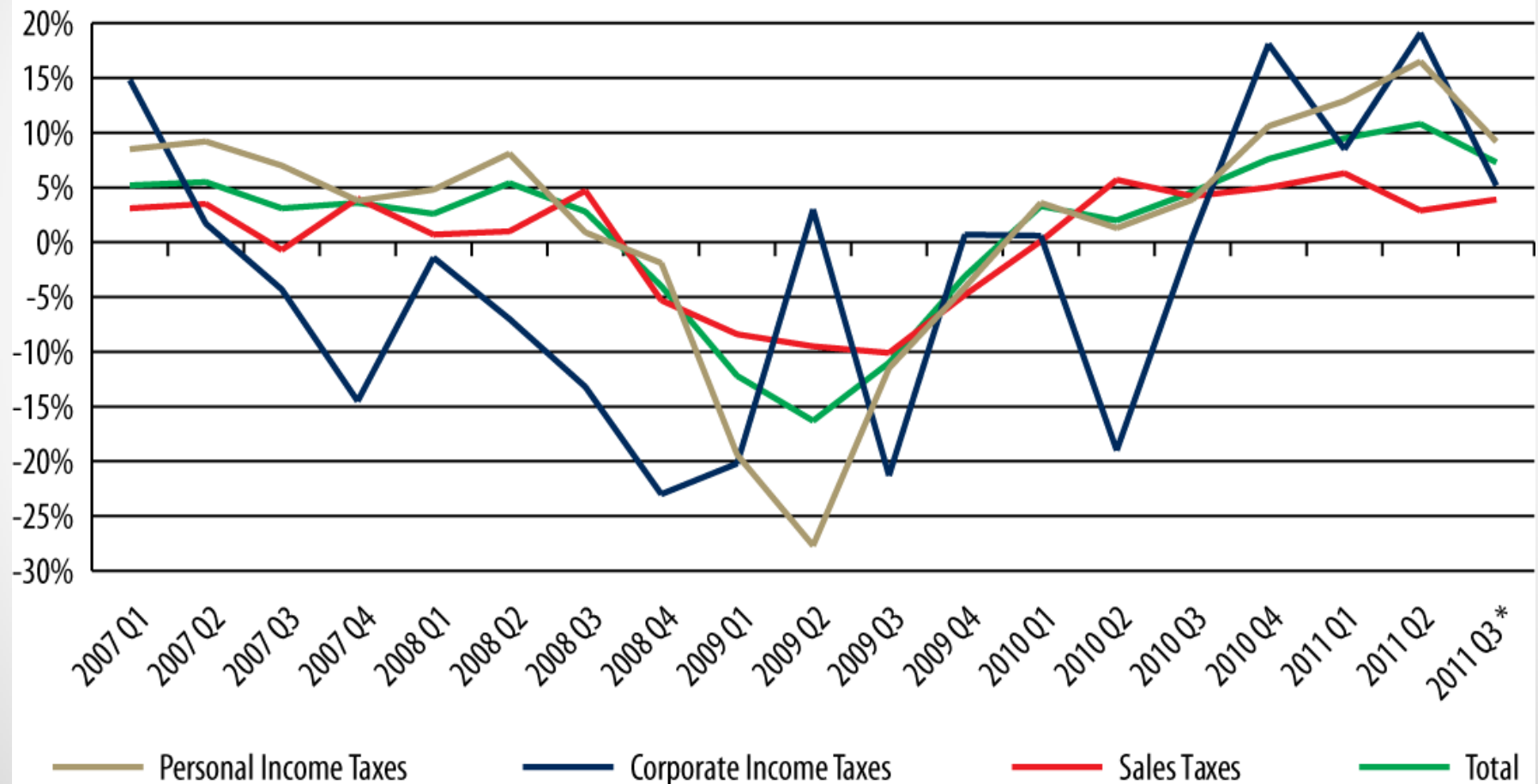
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Pension Plans?

Percent Change in State Tax Collections, 2007 Q1 - 2011 Q3



Source: Rockefeller Institute, December 8, 2011, http://www.rockinst.org/newsroom/data_alerts/2011/12-08.aspx

1. How State Finances Impact State



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Pension Plans?

- Many states did not make their full annual required contribution (ARC) to their pension systems because of enormous budgetary pressures in the last decade;
- Included in this list were Alaska, Indiana, Louisiana, Massachusetts, Michigan, New Jersey, Pennsylvania and Washington;

1. How State Finances Impact State



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Pension Plans?

- North Carolina reduced ARC in 2001 by nearly \$130 million but made catch-up payments;
- New Jersey faced credit downgrade because of failure to make ARC for years.

2. Why Focus on Pensions?

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

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

AND

- ■ Public Pensions

2. Why Focus on Pensions?

■ Social Security:

- ✓ According to 2011 Annual Report, Social Security expenditures exceeded program's non-interest income in 2010 for the first time since 1983;
- ✓ The projected exhaustion date for Social Security's Old-Age and Survivors Insurance (OASI) Trust Fund, which pays retirement and survivors benefits, is 2038;
- ✓ The projected exhaustion date for Social Security's Disability Insurance (DI) Trust Fund, which pays disability benefits, is 2018.

2. Why Focus on Pensions?

- Medicare:
 - ✓ In 2011, Medicare's Hospital Insurance (HI) Trust Fund began paying out more in hospital benefits and other expenditures than it receives in income, and will do so in all future years;
 - ✓ The projected date of the HI Trust Fund exhaustion is 2024, five years earlier than estimated in last year's report, at which time dedicated revenues would be sufficient to pay 90 percent of HI costs.

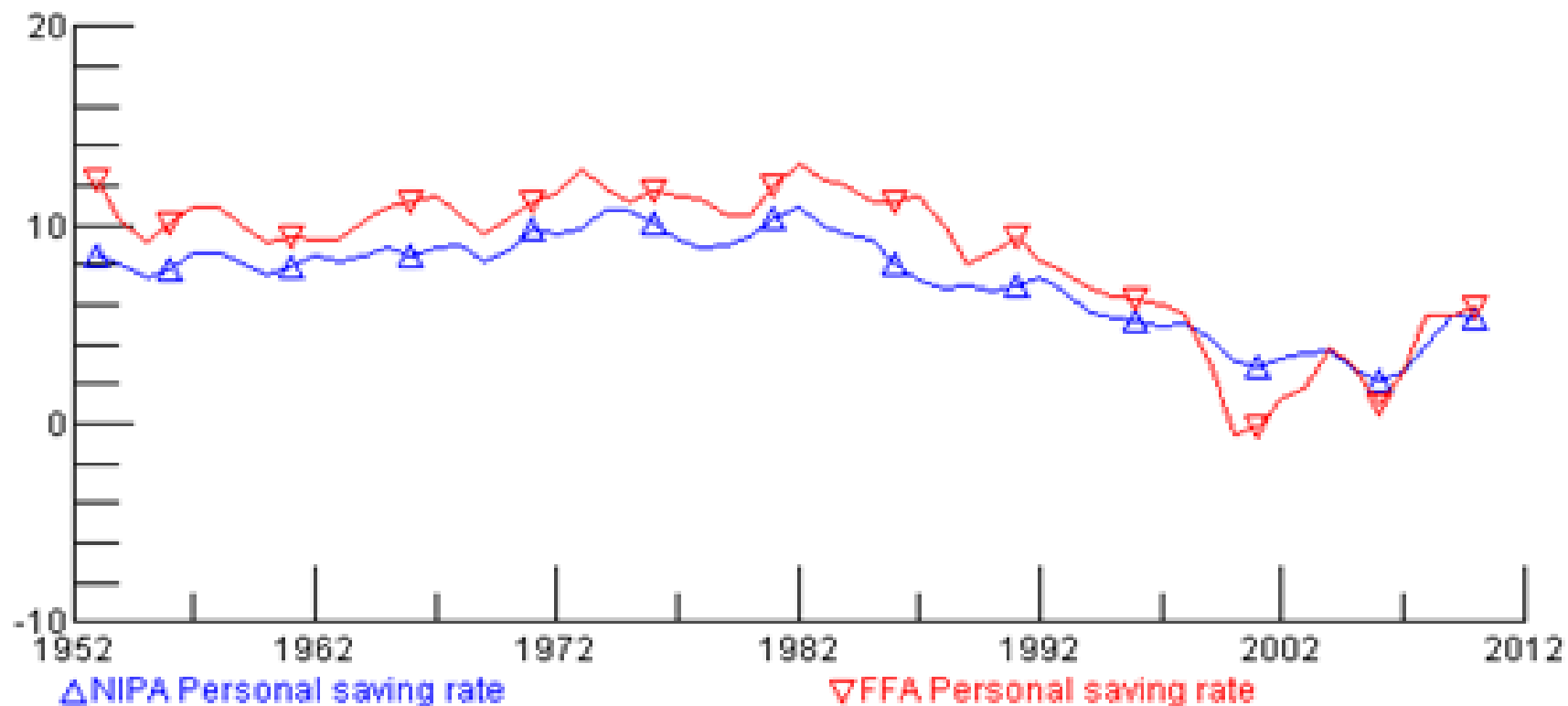
2. Why Focus on Pensions?

■ Corporate Pension Plans:

- ✓ Funding gap for U.S. Corporate Pension plans almost doubled in 2011;
- ✓ From a moderate surplus of at end of 2007, pension plan assets at S & P 500 Companies only cover 74 percent of estimated liabilities, a deficit of \$450 billion;
- ✓ The federal Pension Benefit Guaranty Corporation (PBGC), the entity that insures the pension benefits of private pension plans covering 44 million Americans, showed a deficit of \$26 billion in fiscal year 2011, an increase of \$3 billion from fiscal year 2010. •

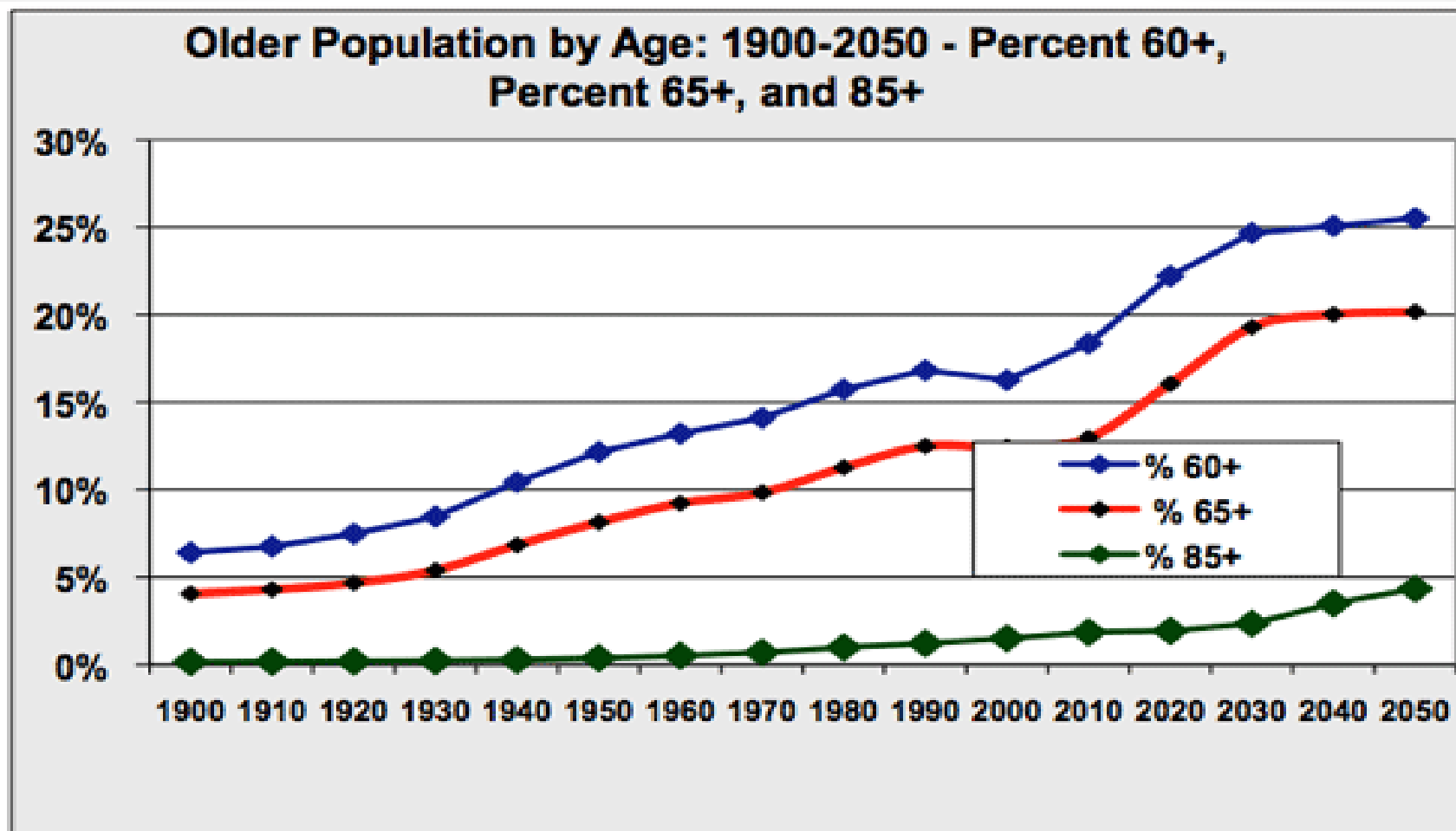
2. Why Focus on Pensions?

U.S. Personal Savings Rate, 1952 - 2012
As presented in the National Income and Product Account (NIPA)
and Flow of Funds Account (FFA)



2. Why Focus on Pensions?

- Source: U.S. Bureau of the Census



2. Why Focus on Pensions?

- By 2030, the population aged 60 and over in Utah and Alaska will be 17.1 percent and 18.2 percent of total population; in 2000, these two percentages were 11.3 percent and 8.5 percent;
- By 2030, 39 states will have between 20.2 percent and 28.4 percent of total population aged 60 and over;
- By 2030, Alabama will have 27.2 percent of its population aged 60 and over; in 2000, this percent was 17.3 percent;
- By 2030, 9 states will have between 30 percent and 33.9 percent of their populations aged 60 and over with Florida being the highest.

2. Why Focus on Pensions?

Year	Covered Workers (Thousands)	Beneficiaries (Thousands)	Ratio
1950	48,280	2,930	16.5
2000	155,295	45,166	3.4
2005	159,081	48,133	3.3
2010	156,725	53,398	2.9
2035	-	-	1.9

3. Where Public Pension Plans Stand?



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- Pew Center on the States Report (February 2010) – \$1 trillion gap between what states have set aside and price tag;
- Wilshire Consulting (February 2011) – 69 percent actuarial funding ratio in 2010, an improvement from the 65 percent in prior year;
- Standard & Poor's (March 2011) – 75 percent mean funded ratio for state pension plans in 2009, down from 80 percent in the previous year;
- Latest NASRA Report – average funding level at 77.1 percent with a cumulative unfunded liability of \$768 billion.

3. Where Public Pension Plans Stand?



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- In April 2011, Pew Center on the States released a report focusing on funded ratios in 16 states;
- Six of these states had funded ratios that exceeded 80 percent;
- Delaware, Tennessee, Texas, Florida, Iowa and Minnesota.

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 74 percent of their total cash and investment holdings in Non-Governmental Securities;
- In 2009, this percentage had ballooned to 90 percent.

4. Key Trends – Public Pension Plans



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The CHRISTIAN SCIENCE
MONITOR

Retirement funds in Kentucky lose big with hedge fund failure

Retirement funds for Kentucky state and local workers see \$100 million loss after hedge fund fails. Official expects to recoup the retirement funds lost.

By Associated Press / January 8, 2012

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;
- NY State Comptroller Hevesi, who oversees state pension plan, convicted of “pay-to-play”;
- IA and ND 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



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Funded and Unfunded Actuarial Accrued OPEB Liabilities:

- AZ and OR – 69% and 68% funded
 - AL - \$14.9 billion unfunded liability (5% funded)
 - GA - \$20.3 billion unfunded liability (4% funded)
 - NC - \$33.8 billion unfunded liability (3% funded)
 - VA - \$5.8 billion unfunded liability (26% funded)
 - LA - \$11.5 billion unfunded liability (0% funded)
- Source: Pew Center on the States, 2011

4. Key Trends – Public Pension Plans

- Over 550,000 state and local government jobs have been slashed since the onset of the Great Recession;
- State employment fell 1.2 percent in 2011, the largest percentage for any year since counting began in 1955;
- Local government jobs fell 3.5 percent between 2009 and 2011;
- These unprecedented declines in state and local government payrolls have the effect of lowering pension costs and liabilities.

5. Strategies Adopted:

Pension Obligation Bonds

- 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, OR, IL, NJ, CT, WI;
- KS lawmakers will be deciding very shortly on a \$5 billion bond issue to bolster the state pension plan.

5. Strategies Adopted:

Pension Obligation Bonds

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

- 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;
- In June 2011, experts estimated that the state's pension and health systems were underfunded by more than \$120 billion.

5. Strategies Adopted:

Increasing Contributions

- 16 states increased employee contributions, including:
 - ✓ CO – State Trooper contributions will increase from 10% to 12.5%;
 - ✓ KS – Tier I members will see an increase from 4% to 6%;
 - ✓ LA – Firefighters and Police will see an increase from 8% to 10%;
 - ✓ MD – Employees and Teachers will see an
 - increase from 5% to 7%.

5. Strategies Adopted:

Limiting COLA Increases

- 10 states revised their automatic COLA increases, including:
 - ✓ CT - COLA increase now 2% instead of 2.5%;
 - ✓ HI - COLA increase for new members limited to 1.5% from 2.5%;
 - ✓ KS - Benefit multiplier for Tier II members reduced from 1.75% to 1.4%;
 - ✓ MN – Repealed guaranteed COLA for retirees;
 - ✓ CO – Capped COLA at 2% for retirees.

5. Strategies Adopted:

Increasing Age and Vesting Limits

- 15 states increased age and vesting levels, including:
 - ✓ DE – Need 65 years with 10 years service, 60 with 20 and at any age with 30 years;
 - ✓ ME – Have to be 65 years to retire with less than five years service;
 - ✓ MD – Vesting period for all employees except legislators and judges now 10 years.

5. Strategies Adopted:

Trimming Benefits

- 6 states lengthened period to determine final average salary for pension benefits, typically from highest 36 months to 60 months;
- HI prohibits any retirement benefit enhancements until the actuarial value of the system's assets reach 100% of actuarial funding liability.

5. Strategies Adopted:

Trimming Benefits

- RI – Switched most active members to a hybrid plan with lower DB combined with a mandatory participation in a DC plan;
- IN – Established a DC as an option for new members;
- MN – Consolidated pension boards to effect greater oversight and economies of scale.

State Retirement Systems: Recent Trends

Thank You

For more information, please contact

Sujit M. CanagaRetna

Senior Fiscal Analyst

404/633-1866

Or

scanagaretna@csg.org

- *www.slcatlanta.org*