Public Pension Issues and Trends

Texas Municipal Retirement System

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Comparison of retirement benefits in the U.S.

Private Sector

- 65% of full-time private sector workers participate in an employer-sponsored retirement plan
- When part-time workers are counted, less than half of the private sector workforce participates 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
- 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
- Targeted income replacement
- Assets that are pooled and professionally invested
- A benefit that cannot be outlived

A 50,000-foot view 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 = ~72%

US Census Bureau,
Public Fund Survey

Key public pension trends

- From 2009 to 2014, there was an unprecedented
  - number of reductions in public pension benefit levels
  - number of increases to employee contribution rates
  - number of legal challenges—and rulings—in response to pension changes
  - reduction in state and local government employment
- New pension accounting standards are changing the way pensions are calculated and reported
- Investment return assumptions are under scrutiny and challenge, and are being reduced
- Public pension funding levels are improving in most places
- Some states have yet to resolve their pension problems

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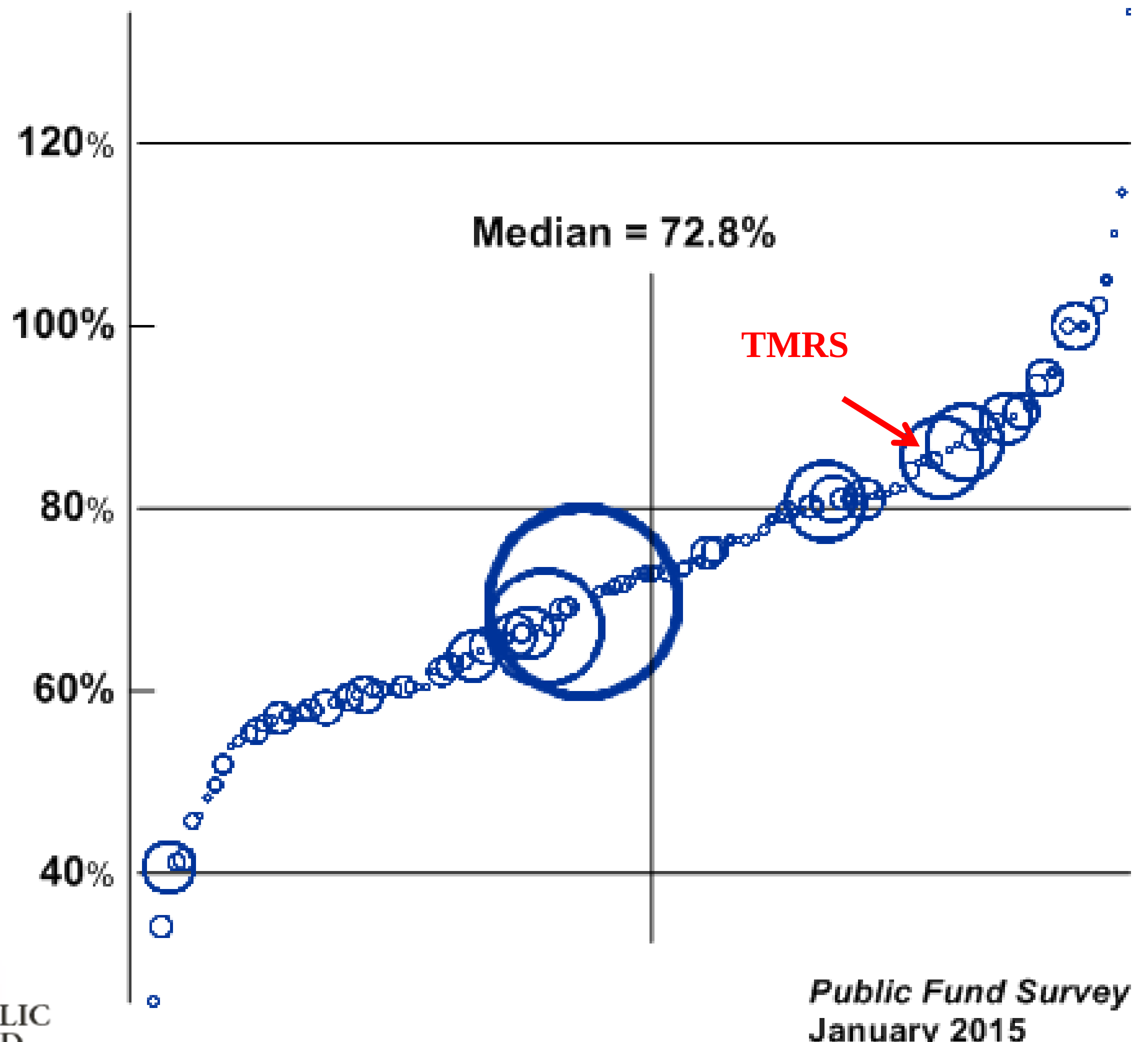
Distribution of public pension actuarial funding levels and relative size



Bubbles are roughly proportionate to size of plan liabilities

PUBLIC FUND SURVEY

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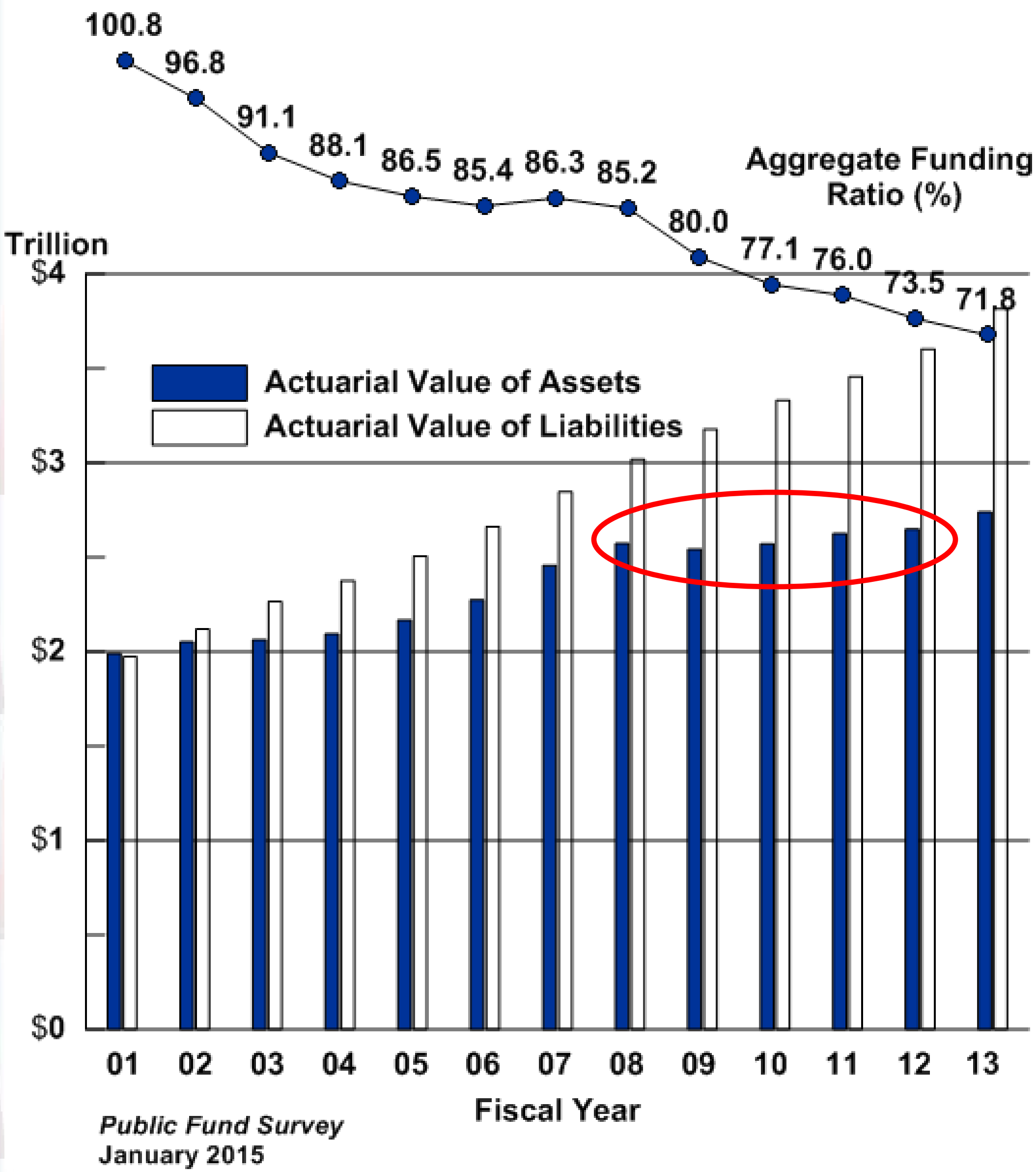
Actuarial value of assets and liabilities, and funding level, FY 01 to FY 13



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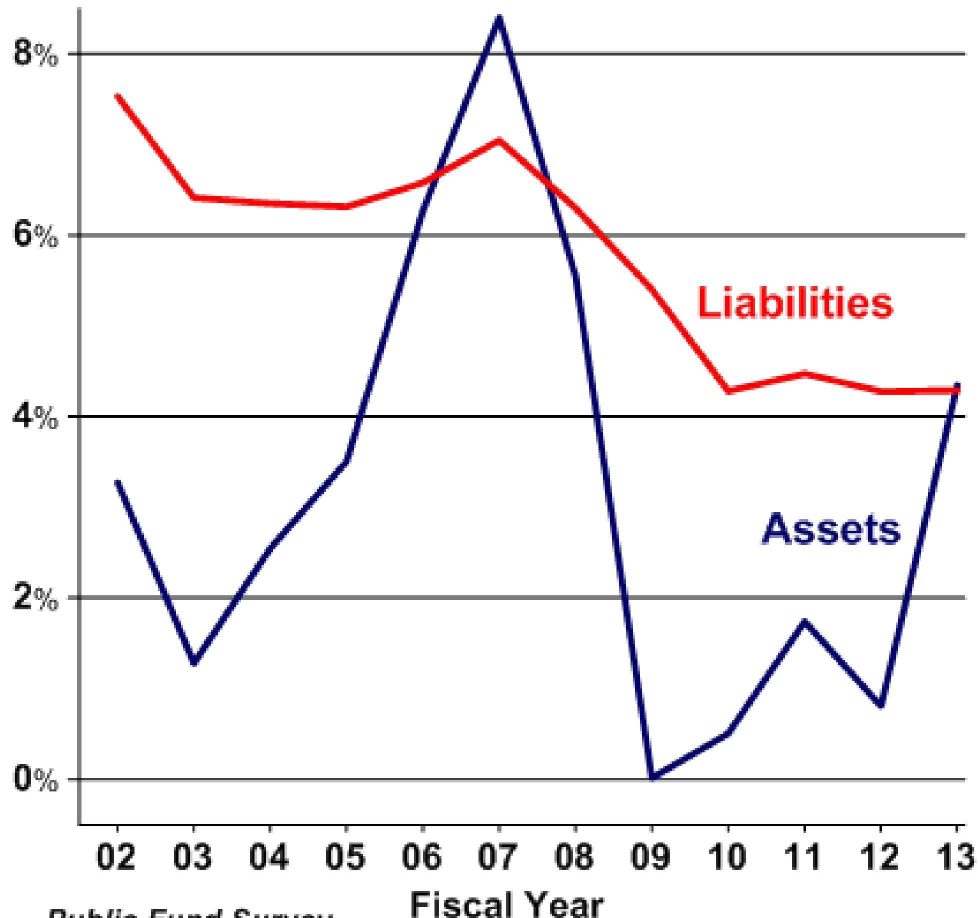
Median change in actuarial value of assets and liabilities, FY 02 to FY 13



Public Fund Survey
January 2015

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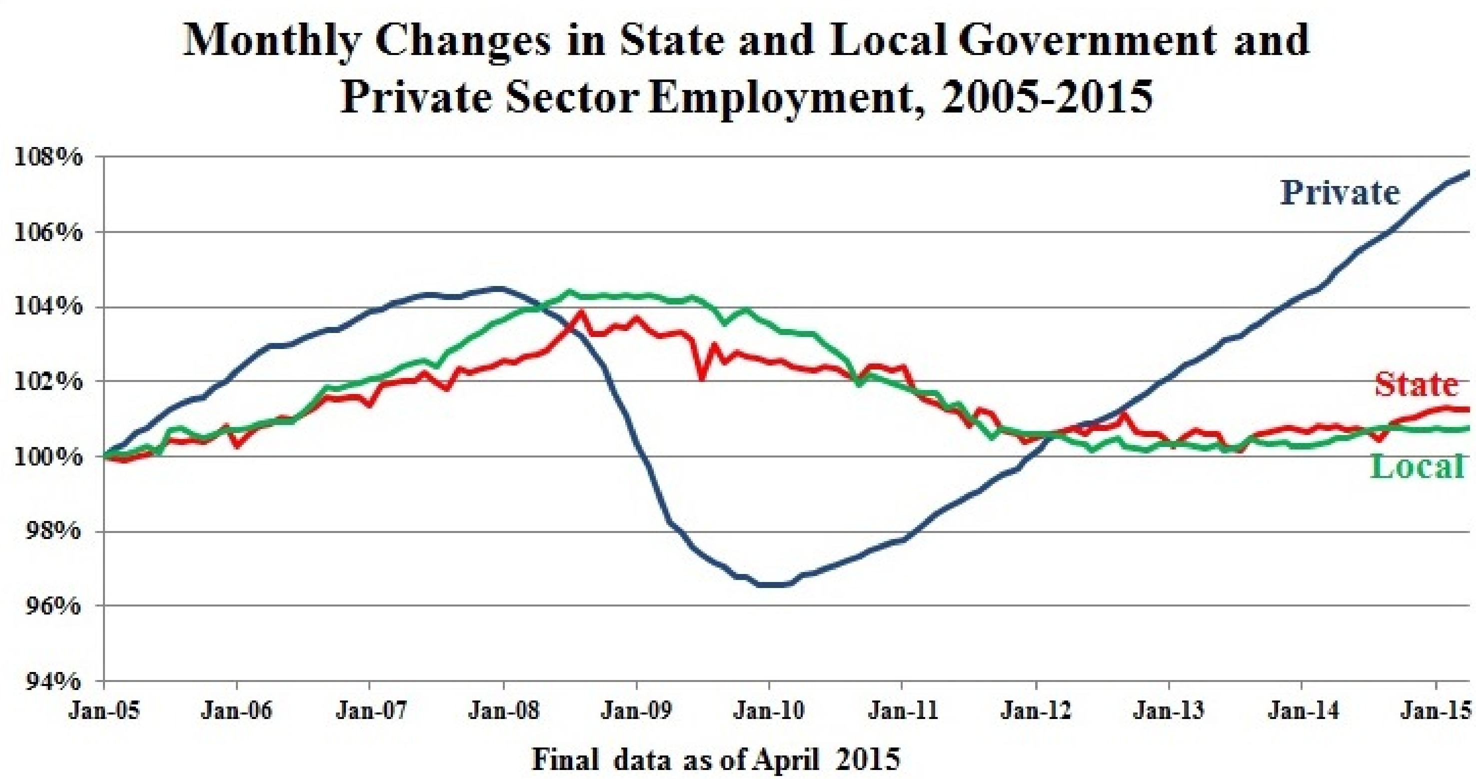
State & local government employment remains sluggish



US Bureau of Labor Statistics

State and local employment is lower by 626,000, or 3.2% from its August 2008 peak

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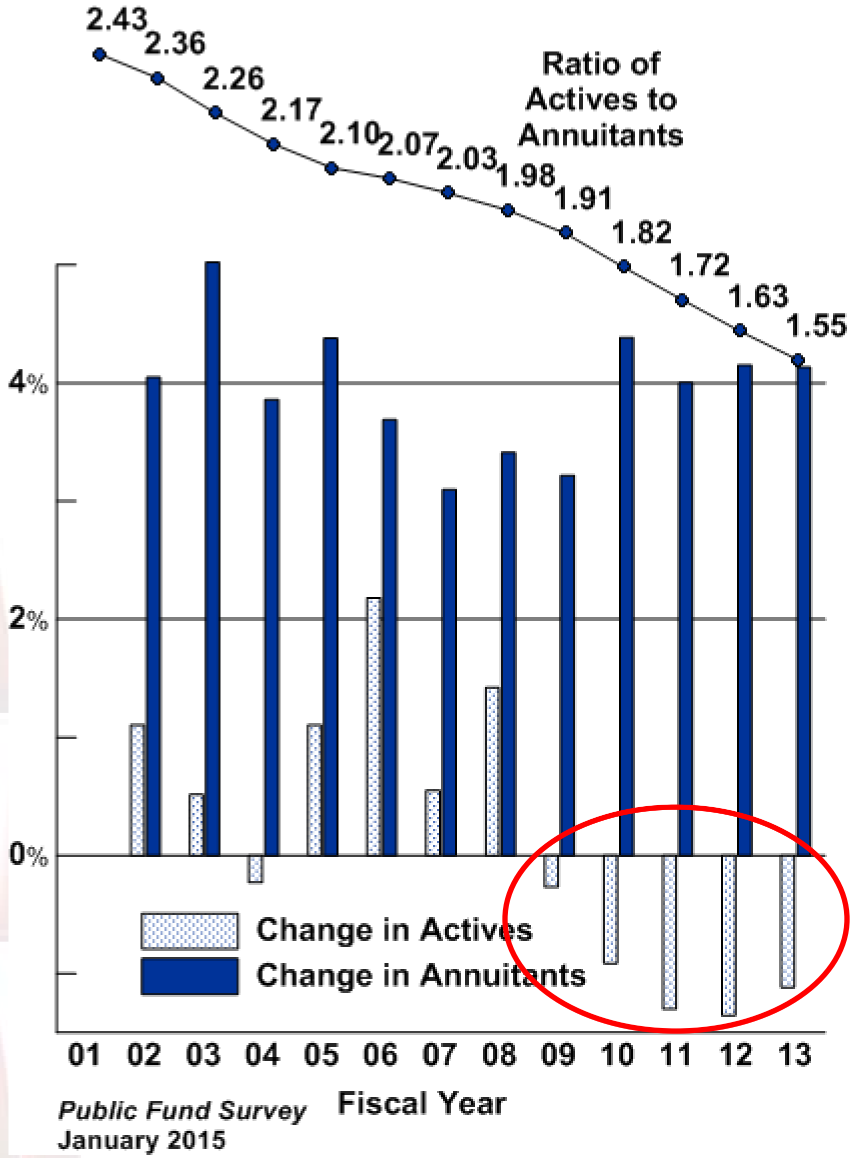
Change in Actives and Annuitants, and Active/Annuitant Ratio FY 01 – FY 13



TMRS ratio: 2.06 to 1

Wages and salaries appear to be improving

BLS, compiled by NASRA

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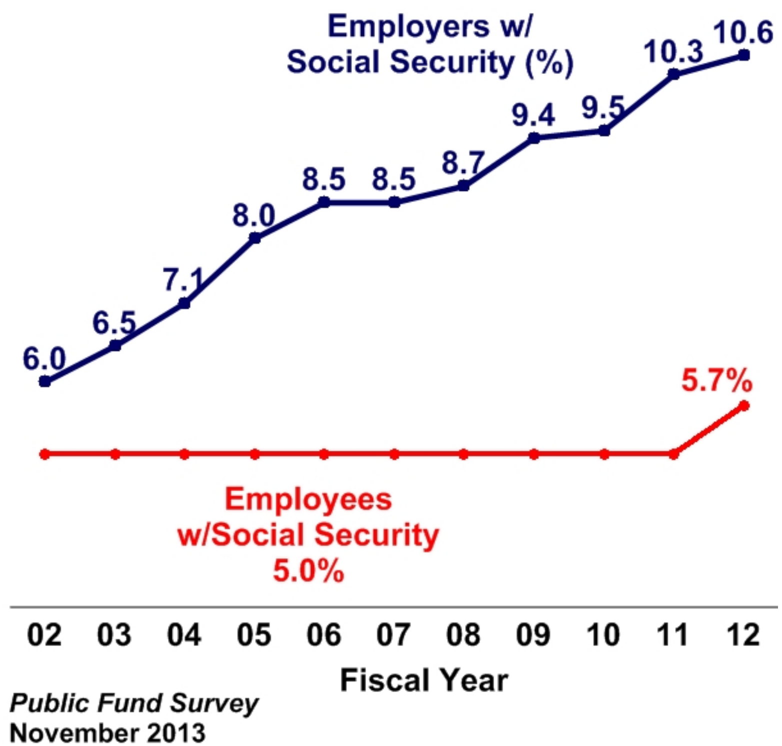
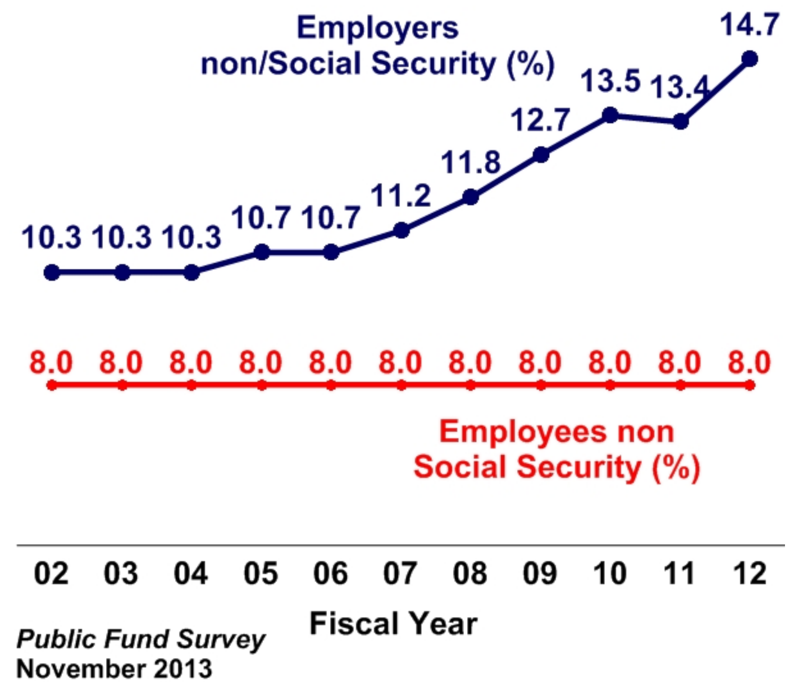
Median contribution rates, FY 02 to FY 12





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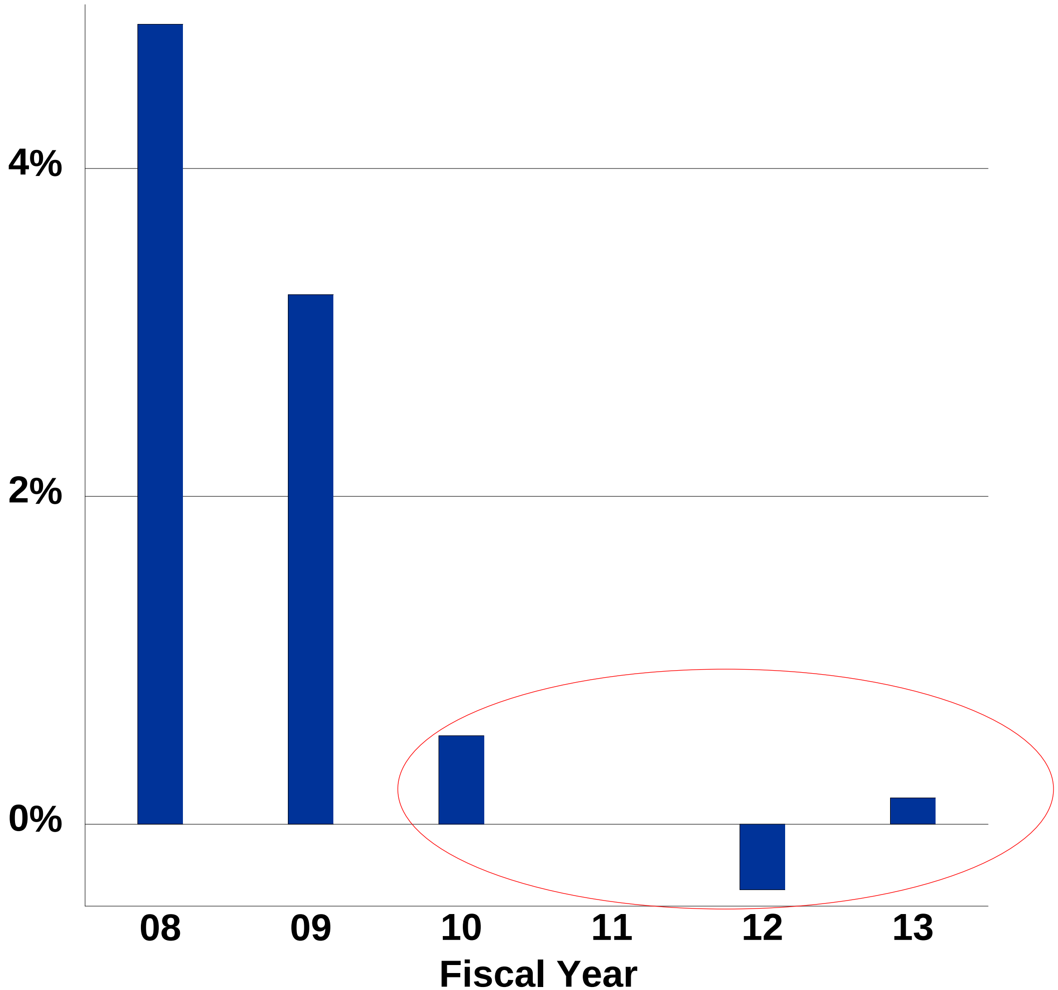
Median annual change in covered payroll, FY 08 to FY 13



Public Fund Survey

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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: Key Findings

- Policies (statutes, constitutional provisions, retirement board requirements) that require payment of the ARC generally produced better pension funding outcomes than polices that do not.
- 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.
- Policy constraints that limit payment of the actuarially determined contribution were more likely to negatively affect the ability of employers to fund the pension plan.

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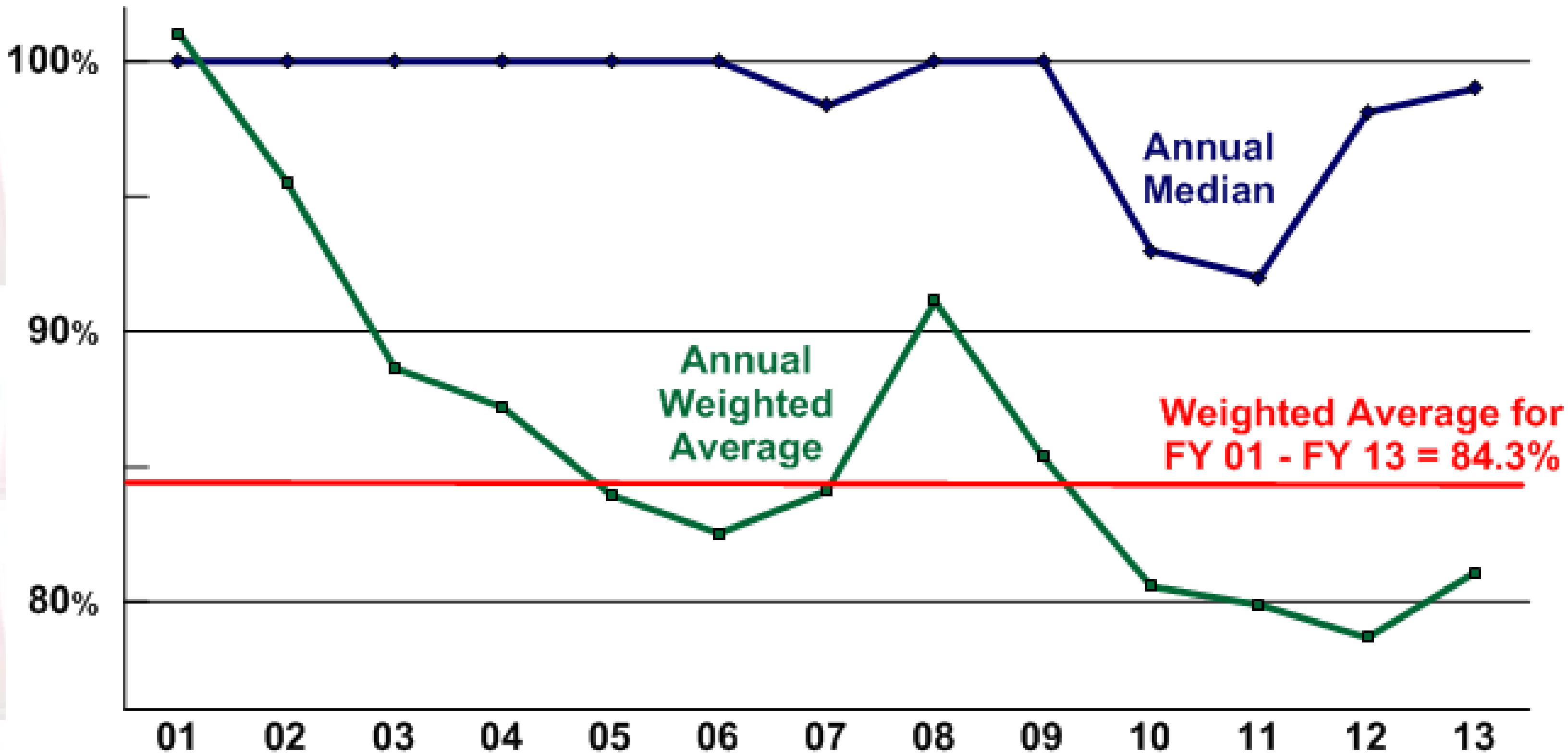
ARC Experience Summary



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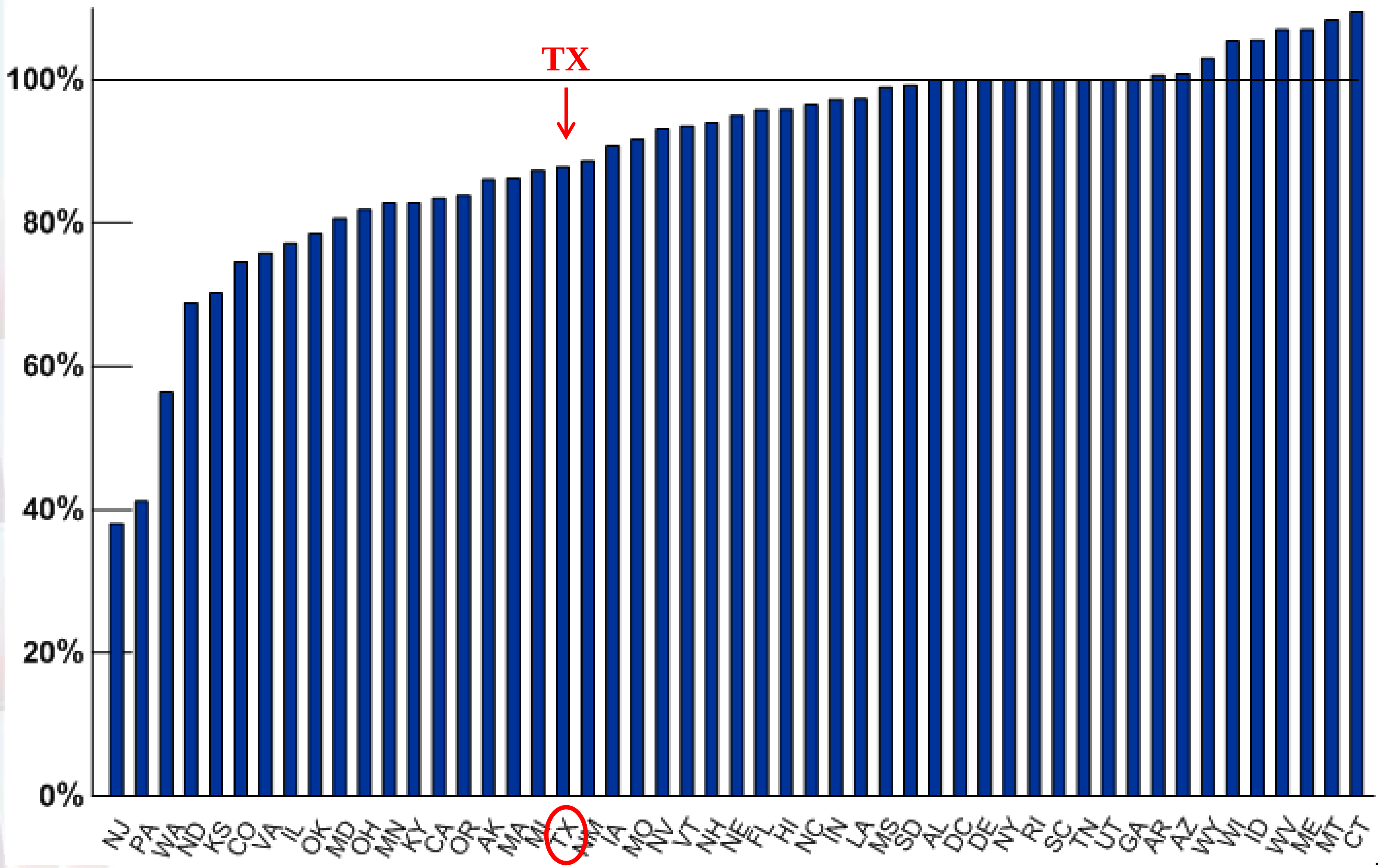
Weighted average ARC experience by state



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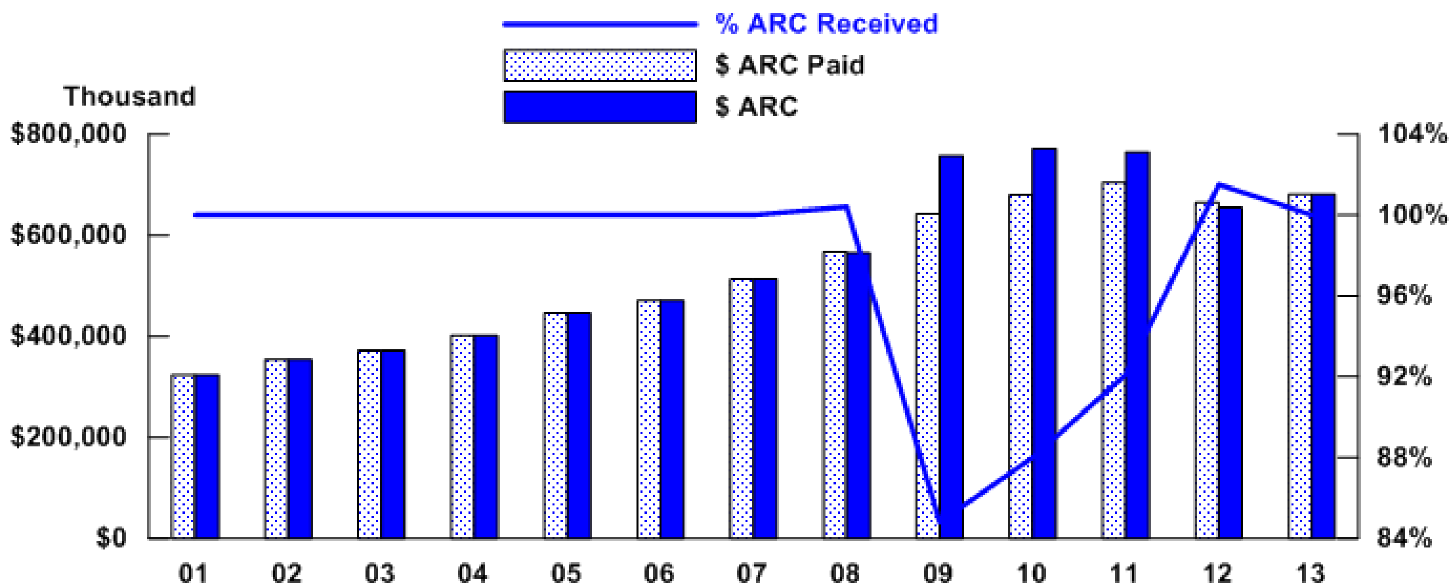
TMRS ARC experience



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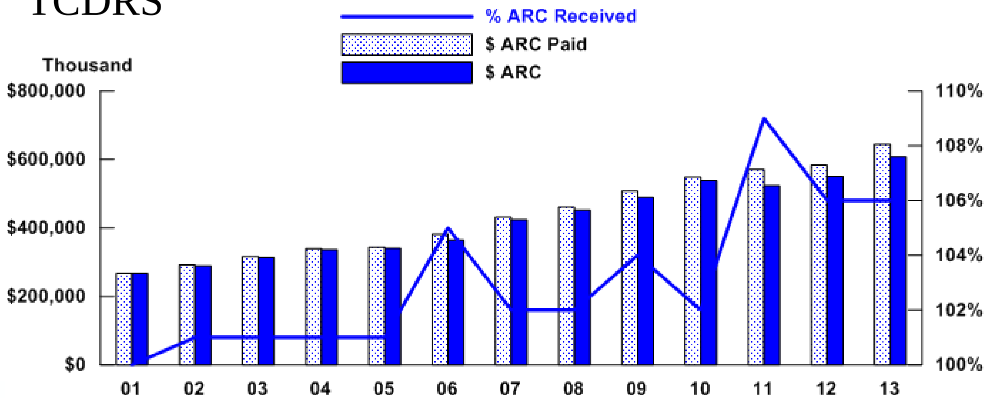
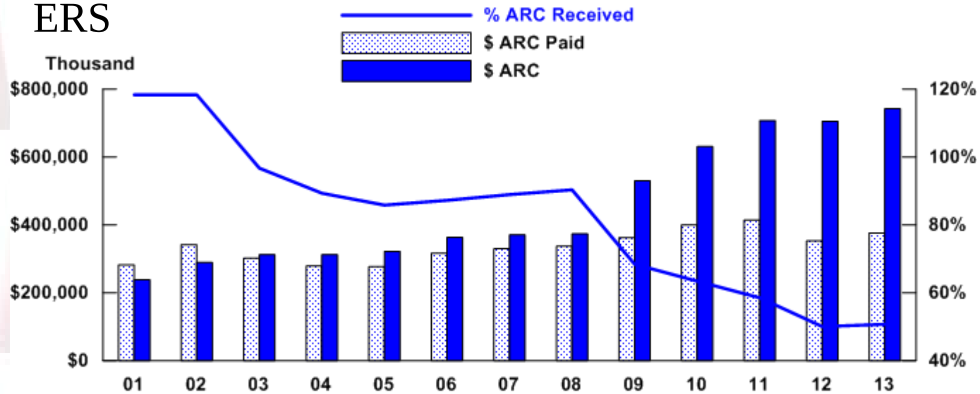
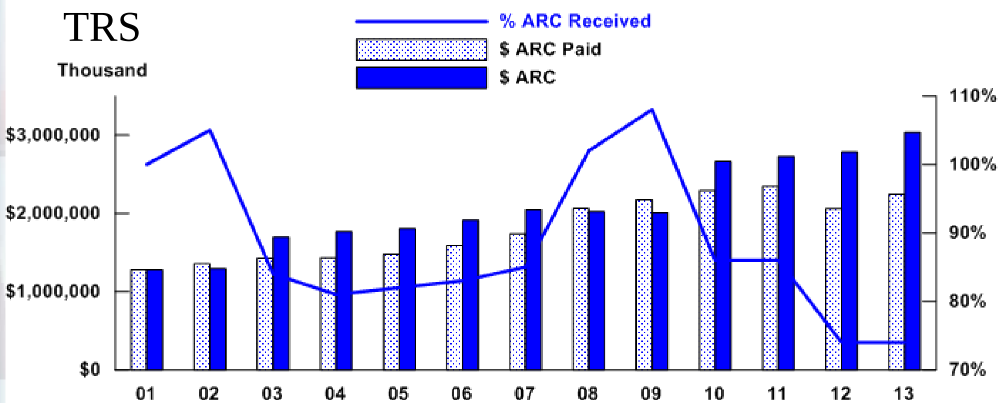
TCDRS



ERS



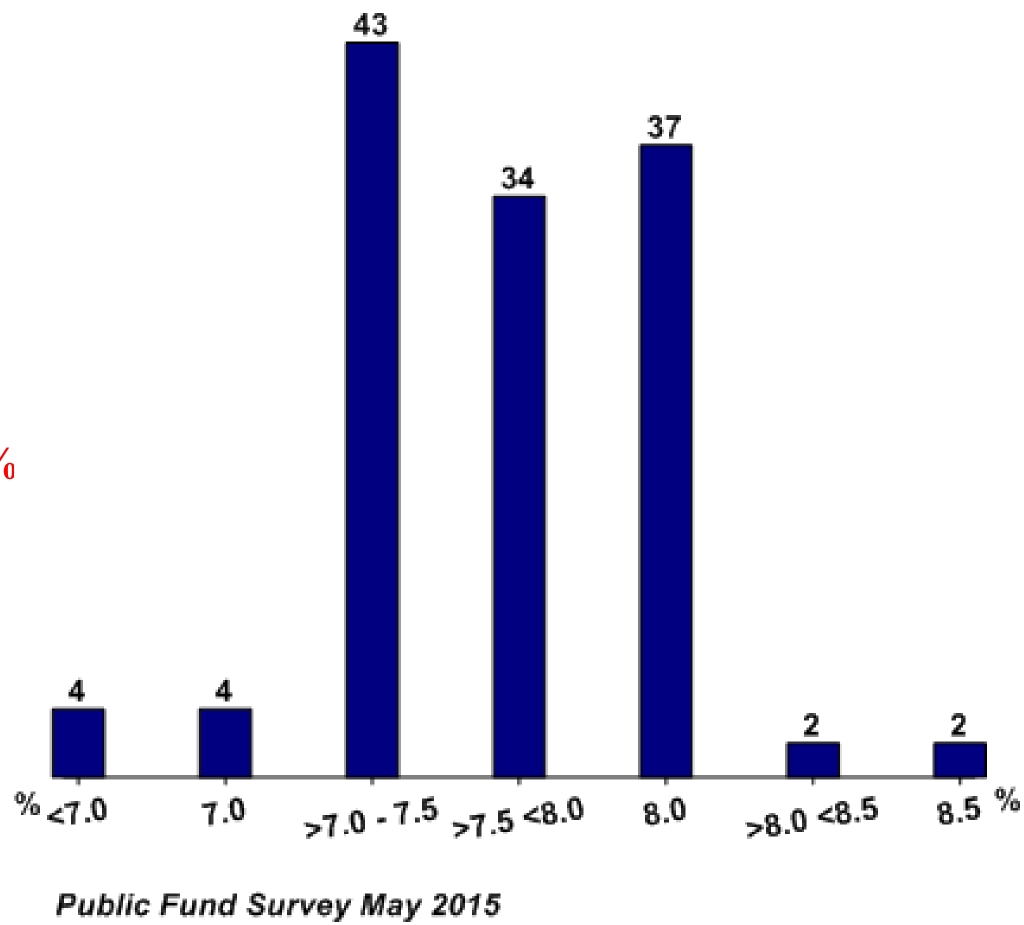
TRS



ARC experience of other Texas statewide plans

Distribution of current investment return assumptions

TMRS: 7.0%



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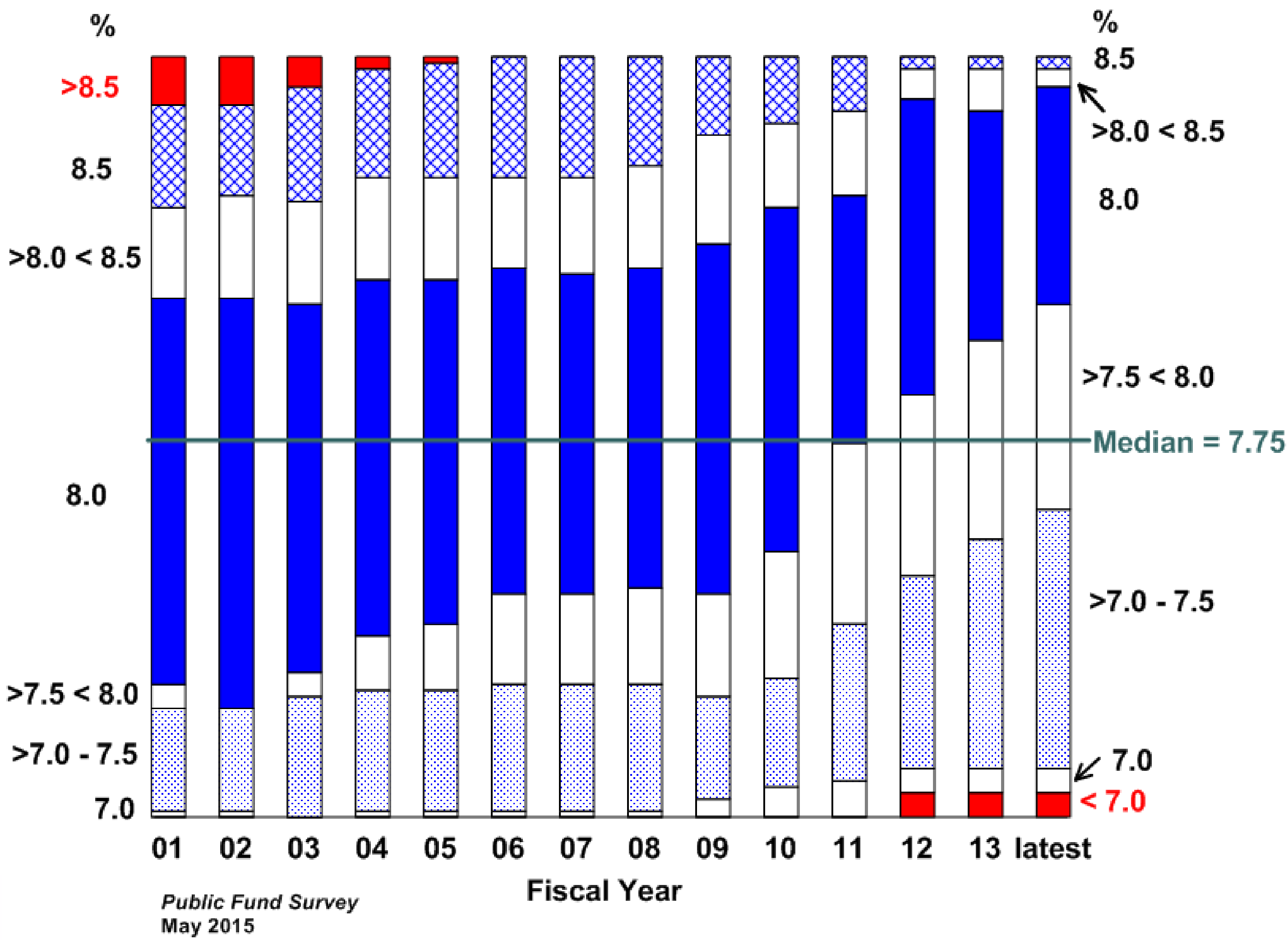
Change in distribution of investment return assumptions, FY 01 to present



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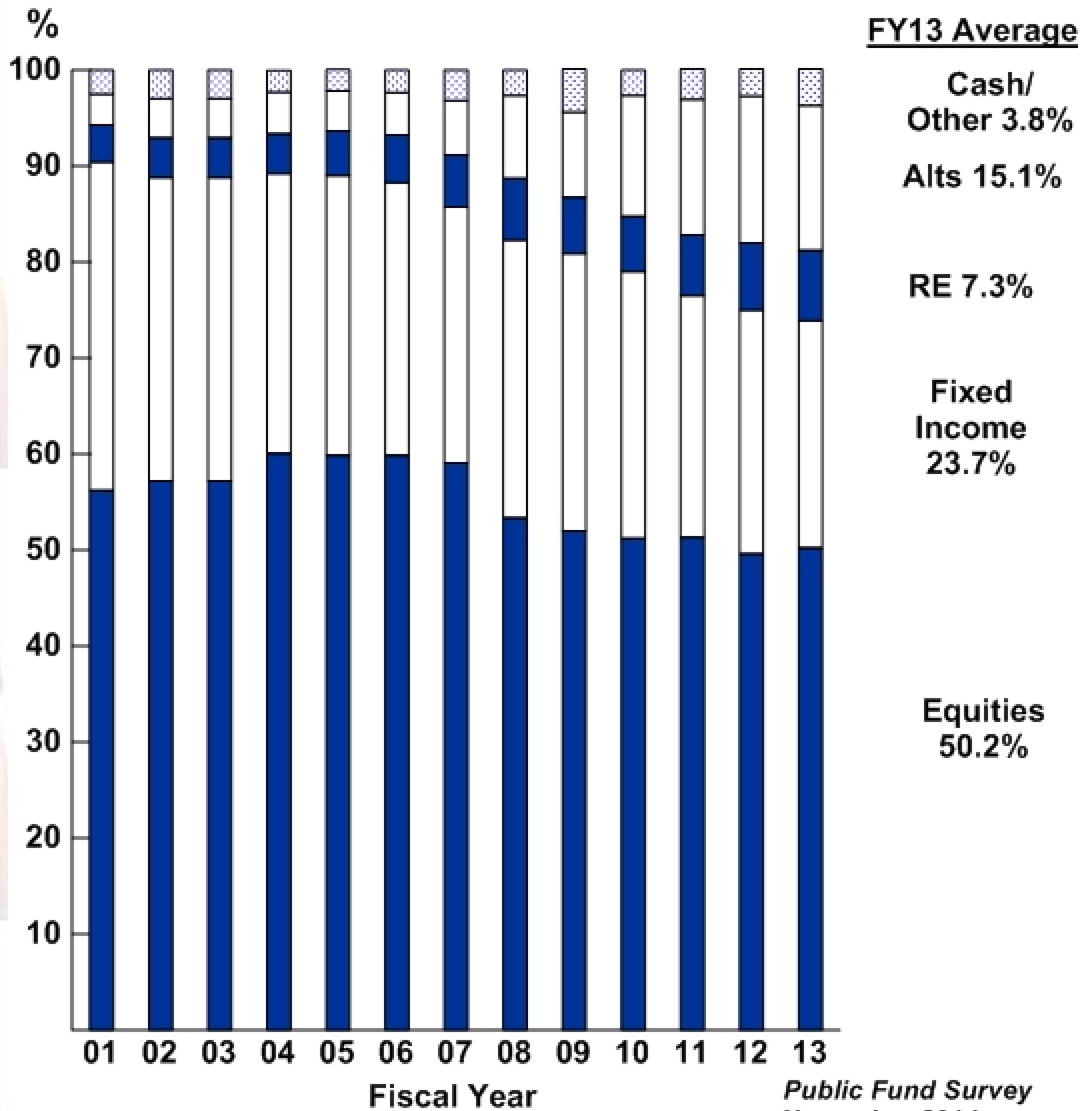
Average asset allocation, FY 01 to FY 13



Public Fund Survey
November 2014

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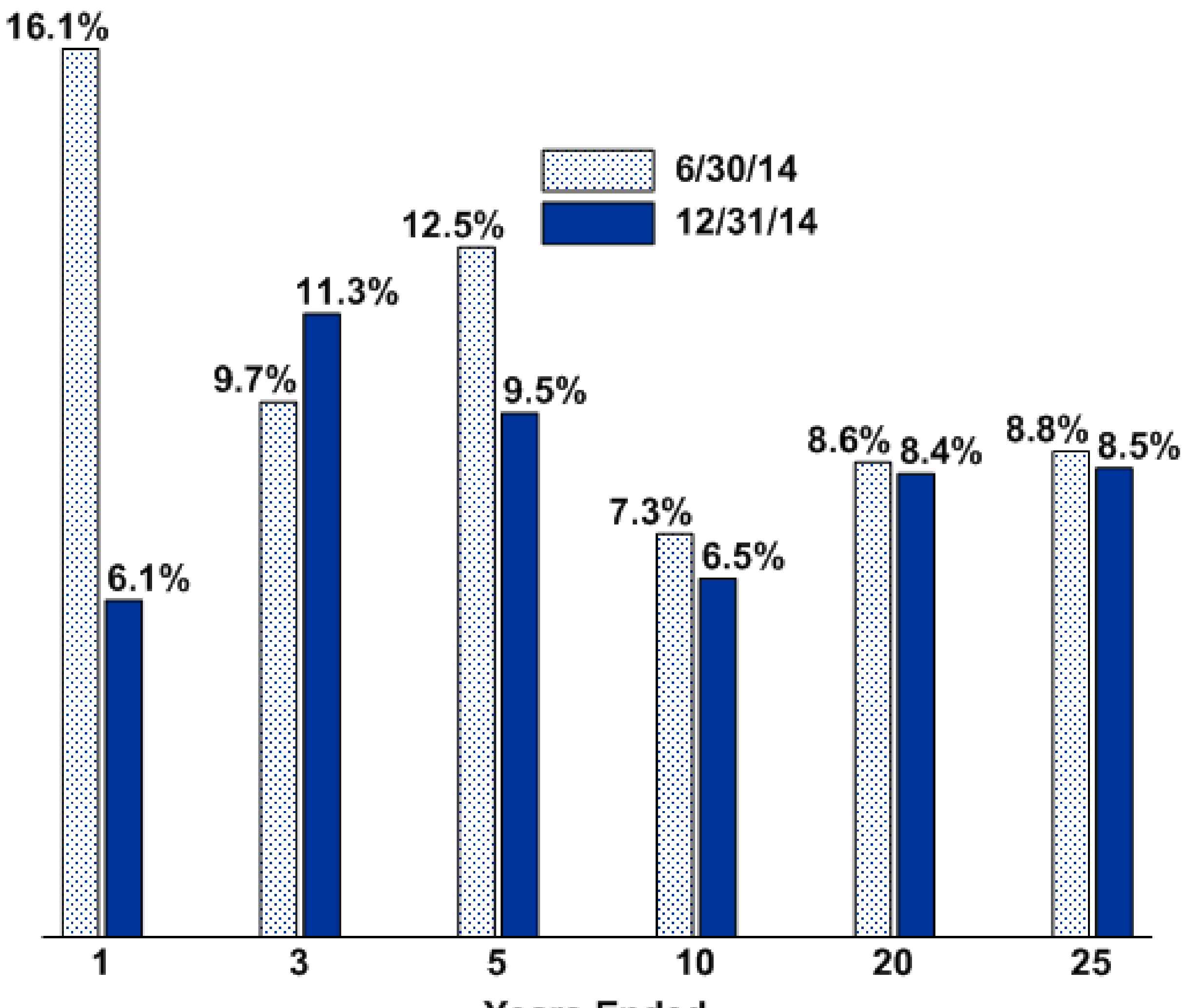
FY 14 median investment returns



Callan Associates

Legislative pension enactments in recent years

- Nearly every state has modified public pension benefits, raised employee contributions, or both, since 2009
- 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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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

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
  - Colorado, for most local public safety officers
  - Kentucky, for state and local workers (not teachers)
  - Kansas for all new hires since 1/1/15

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 = 8.22 percent (10.72 percent for public safety)
- Remaining 1.78 percent (1.28 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"

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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 efforts
- Notable rulings:
  - Colorado, Florida, Illinois
- Federal bankruptcy rulings in 2014 in Detroit and Stockton, CA permitted reductions in pension benefits despite strong legal protections in those states

Key GASB Changes

- Statement 67 changes affect pension plan reporting and take effect in FY 2014
- Statement 68 changes affect employers that sponsor pension plans and take effect in FY 2015
- Statement 67 eliminates the ARC and shifts the focus from the plan's funding position to its accounting position
- Statement 68 requires employers to place their proportionate share of the pension liability on their basic financial statements

Other trends and final thoughts

- The pace of pension reforms has slowed sharply
- Reform battles remain in some states (e.g. IL and PA)
- Pension costs are stabilizing for many plans
- Costs will rise for some plans, especially those that traditionally have not received their ARC
- Improving longevity may increase costs
- Investment return assumptions will remain under scrutiny and pressure
- Public pension issues are state- and plan-specific, not systemic
- New GASB measures will reveal new ways of looking at pension financial conditions

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