A National Perspective of State and Local Pensions

Keith Brainard
Research Director
National Association of State Retirement Administrators

New Mexico Educational Retirement Board
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Comparison of Retirement Benefits in the U.S.

<table>
<thead>
<tr>
<th>Private Sector</th>
<th>Public Sector</th>
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<tbody>
<tr>
<td>60% of full-time private sector workers participate in an employer-sponsored retirement plan; 21% of part-time workers participate</td>
<td>Nearly all full-time workers have access to an employer-sponsored retirement benefit; most have access to a traditional pension (DB plan)</td>
</tr>
<tr>
<td>In total, 49% of all private sector workers participate in an employer-sponsored retirement plan</td>
<td>87% of full-time employees participate in a pension plan, as do 80% of all, including part-time workers; virtually all others are in a DC plan</td>
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<tr>
<td>Fewer than one in five have a traditional pension (DB) plan</td>
<td>Three-fourths participate in Social Security</td>
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<tr>
<td>Social Security coverage is universal</td>
<td></td>
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</table>
Public pensions in the U.S.

- ~$4.33 trillion in assets
- ~14 million active (working) participants
  - 10 percent of the nation’s workforce
- 10.3 million retirees and their survivors receive ~$280 billion annually in benefits
- Annual contributions = $192 billion
  - $141 billion from employers; $51 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 = ~72%

US Census Bureau, Public Fund Survey
Public pensions in New Mexico

- ~ $28 billion in assets
- ~ 117,000 active (working) participants
- ~ 85,000 retirees and their survivors receive around $2.2 billion annually in benefits
- Annual contributions = $1.3 billion
  - $734 million from employers; $560 million from employees
- Spending on pensions as a percentage of all state and local government spending: 3.41%
- Two public retirement systems: ERB and PERA

US Census Bureau, 2016
Comparing Public Pensions

The purpose for providing a retirement benefit is to meet stakeholder objectives, and a retirement plan should be measured in the context of how well it meets these objectives.

Primary public retirement plan stakeholders are employers, employees, and taxpayers.

Employers seek to attract and retain qualified workers needed to perform essential public services.

Employees seek competitive compensation, including a good retirement benefit.

Taxpayers and recipients of public services want public services provided in a cost-effective manner.
## Comparison of Selected Features of Teacher Retirement Plans

<table>
<thead>
<tr>
<th>ARIZONA SRS</th>
<th>MONTANA TRS</th>
<th>IDAHO PERS</th>
<th>NEW MEXICO ERB</th>
<th>NORTH DAKOTA TEACHERS</th>
<th>OKLAHOMA TRS</th>
<th>SOUTH DAKOTA RETIREMENT SYSTEM</th>
<th>WYOMING RETIREMENT SYSTEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit formula(^1)</td>
<td>2.1% for up to 20 years, 2.15% for 20 to 25 years, 2.2% for 25 to 30 years, and 2.3% for 30 or more years</td>
<td>1.67%</td>
<td>2.00%</td>
<td>2.35%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>1.80%</td>
</tr>
<tr>
<td>% income replaced at 10 and 25 years</td>
<td>21% @10 yrs; 54% @25 yrs, plus SS</td>
<td>16.7% @10 yrs; 41.8% @25 yrs, plus SS</td>
<td>20% @10 yrs; 59% @25 yrs, plus SS</td>
<td>23.5% @10 yrs; 59% @25 yrs, plus SS</td>
<td>20% @10 yrs; 50% @25 yrs, plus SS</td>
<td>20% @10 yrs; 50% @25 yrs, plus SS</td>
<td>18% @10 yrs; 45% @25 yrs, plus SS</td>
</tr>
<tr>
<td>Retirement eligibility (age/yrs of service)(^1)</td>
<td>65/any, 62/10, 60/25, or 55/30</td>
<td>60/5 or 55/30</td>
<td>65/5</td>
<td>67/5, any/30 or sum of age + years of service = 80 at age 65</td>
<td>65/any or sum of age + years of service = 90</td>
<td>65/5 or sum of age + years of service = 90</td>
<td>67/3</td>
</tr>
<tr>
<td>Employee contribution rate</td>
<td>11.35%</td>
<td>8.15%</td>
<td>6.79%</td>
<td>10.7%</td>
<td>11.75%</td>
<td>7.00%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Employer contribution rate</td>
<td>10.85%</td>
<td>8.67%</td>
<td>11.59%</td>
<td>13.9%</td>
<td>12.75%</td>
<td>17.25%</td>
<td>6.0%</td>
</tr>
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</table>
| COLA | Automatic, from 0.5% to a max of 1.5%, depending on the plan’s funded status, beginning 36 months after retirement, for those hired on or after 7/1/13; 1.5% for those hired before 7/1/13. Auto 1.5% beginning 3 years after retirement | Automatic 1.0% plus discretionary COLA for all others. Once the CPI is greater than 1%, Total COLA (mandatory plus discretionary) cannot exceed 6%. | Automatic 1.0% plus discretionary COLA for all others. Once the plan reaches a funding level of 90%, COLA levels will become 1.9% for retirees with 25 years of service and 1.8% for all others. | Automatic 1.8% for retirees with 25 years | Automatic 1.8% for retirees with 25 years | Automatic 1.8% for retirees with 25 years | Ad hoc as approved by the legislature | Ad hoc as approved by the legislature; statute requires funding the cost of a COLA upon legislative approval. Based on plan's funding level and rate of inflation, with a minimum of 0.5% and a maximum of 3.5%.

\(^1\) Plan design reflects provisions in place for employees hired currently. Plan design features for employees hired previously may differ.
Distribution of public pension funding levels, FY 16

Median = 73.1%

Size of bubbles is roughly proportionate to size of plan liabilities

Public Plan Database, Public Fund Survey
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(s)
- 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 length of time needed to amortize any unfunded liabilities
- The plan’s demographics
Public pension reforms in recent years

- Nearly 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

- Higher contributions
  - often from employees
  - usually from employers

- Increased use of hybrid retirement plans

- Limited use of defined contribution plans

- Many municipal plans also have been reformed
“Significant Reforms to State Retirement Systems,” NASRA 2016
States that increased employee contributions

“Significant Reforms to State Retirement Systems,” NASRA 2016
States that reduced pension benefits

“Significant Reforms to State Retirement Systems,” NASRA 2016
States that reduced automatic COLAs

― Affecting New Hires Only  ― Affecting Current Employees & New Hires  ― Affecting Retirees

“Significant Reforms to State Retirement Systems,” NASRA 2016
Recent Reforms to the New Mexico ERB Plan

In 2009, for new hires as of 7/1/10:
- Increased age and service requirements for normal (unreduced) retirement. Members may retire at age 67 with 5 years of service, any age with 30 years, or when age and service adds up to 80.
- Previously they could retire at age 65 with 5 years of service, any age with 25 years, or Rule of 75

In 2013:
- For current and future retirees: reduced COLA until the plan’s funding level reaches designated levels
- For current active members: increased employee contribution rates
- For new hires as of 7/1/13: Established a minimum normal retirement age, and moved back the onset of the COLA until age 67
New hybrid plans are being created by legislatures nearly every year.

Mostly DB-DC, some cash balance plans.

Usually apply to new hires only.

DB-DC plans maintain a DB component, with a lower benefit accrual rate.

Cash balance plans contain key features of DB plans, but also transfer some investment risk to workers.
Statewide Hybrid Plans, 2017
Statewide Defined Contribution Plans, 2017

For broad employee groups: teachers, general employees, and public safety personnel
West Virginia Teachers’ Retirement System was funded primarily on a pay-as-you-go basis throughout the 20th century.

Funding level in 2001: below 20%

Funding level today: 67%

The state’s political leadership committed itself to strengthening the plan’s funding level.

In addition to fully funding the plan, the state committed budget surplus and tobacco settlement monies to reduce the plan’s unfunded liability.

The plan altered its actuarial methods and assumptions to more aggressively pay down its unfunded liability.
Maine PERS Funding Level Improvement

A constitutional amendment approved by Maine voters in 1995 requires amortization of the state pension plan’s unfunded liability within 30 years from 6/1/97.

The amendment also prohibits creation of new unfunded liabilities except those incurred by experience losses, which must be amortized within 10 years.

Plan’s funding level in 1995 was 46%.

Funding level in 2017: 81%.

The state and its school districts consistently pay at least the full actuarially determined contribution.

The legacy unfunded liability is on track to be amortized in 2028.

Following the market decline of 2008-09, the state suspended its COLA for 3 years, then re-started it at a lower level: CPI only up to 3% (rather than 4%) and only on the first $20k of benefit.
Maine PERS Projected Employer Contribution Rate

Cheiron
Oklahoma TRS Funding Level Improvement

After decades of inadequate contributions, the OK TRS plan had a funding level below 40% in the mid-1990s.

In 1999, the legislature dedicated a portion of state income, sales, and use taxes, and lottery revenue, to pay down the unfunded pension liability, without a required legislative appropriation.

The amount was later increased to 5% of these revenue sources.

The plan has consistently received more than 100% of its required contribution.

Amortization period is capped at 20 years, and may go lower.

In 2011, retirement age was increased to 67 and COLAs were eliminated until the plan reaches 100% funding level.

Restriction on legislative enactment of benefit enhancements.

TRS of OK has an excellent investment record.

The plan is now funded at 70.4%.
Common Elements Among WV, ME, and OK

- Payment of the full required contribution
- COLA benefits are modest to non-existent
- Actuarial methods that expedite amortization of the unfunded liability
- Relatively low investment return assumptions
- New Mexico’s fixed rate employer contribution policy is a major impediment to improving the plan’s funding level
## Sample Effects of COLA Changes

<table>
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<tr>
<th>Plan</th>
<th>Action</th>
<th>Effect on UAL</th>
<th>Effect on Funding Level</th>
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<tr>
<td>Oklahoma PERS, 2011</td>
<td>Eliminated assumed 2% annual COLA</td>
<td>Reduced UAL from $3.3 billion to $1.6 billion</td>
<td>From 66.0% to 80.7%</td>
</tr>
<tr>
<td>Maine PERS, 2011</td>
<td>Suspended COLA from CPI up to 4% for 3 years, then restored it at CPI up to 3% only on first $20k in benefit</td>
<td>Reduced UAL from $4.4 billion to $2.7 billion</td>
<td>From 70.4% to 80.2%</td>
</tr>
<tr>
<td>Minnesota PERA, 2010</td>
<td>Reduced COLA from 2.5% to 1.0% until system funding ratio = 90%</td>
<td>Reduced UAL from $5.6 billion to $4.0 billion</td>
<td>From 70.0% to 76.4%</td>
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National Institute on Retirement Security: Lessons From Well Funded Pension Plans

- Payment of the full required contribution
- Employee contributions to help share in the cost of the plan
- Benefit improvements, such as multiplier increases, that are actuarially valued before adoption and properly funded upon adoption
- Cost-of-living adjustments (COLAs) that are granted responsibly, such as through an ad hoc COLA that is amortized quickly, or an automatic COLA that is capped at a modest level
- “Anti-spiking” measures that ensure actuarial integrity and transparency in pension benefit determination
- Actuarial assumptions, including both the discount rate and inflation rate, that can reasonably be expected to be achieved over the long term.
Change in use of amortization methods

Public Plan Database, Public Fund Survey
Change in average amortization period and plans using closed amortization

Public Plan Database, Public Fund Survey
Graduated Multipliers

Some plans employ retirement multipliers that increase upon attainment of certain levels of service, creating an incentive for employees.

Four such examples that include teacher members:

- Arizona State Retirement System: 2.1% for first 20 years, 2.15% for 20 to 25 years, 2.2% for 25 to 30 years, and 2.3% for 30 or more years

- Mississippi PERS: 2.0% for first 25 years, and 2.5% for each year thereafter

- New York State TRS: 1.75% for 1st 20 years and 2.0% for years above 20

- Ohio STRS: 2.2% up to 30 years; for each year above 30, formula rises by 0.1% per year, beginning with 2.5% for year 31, up to 100% of final average salary (no Social Security)
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
  - A larger percentage of municipal employees are serve as public safety officers, whose retirement benefits are more expensive due to shorter careers
Employer (taxpayer) spending on public pensions, 1987 to 2016

"State and Local Government Spending on Public Employee Retirement Systems," NASRA 2018
NM ERB Contribution Experience, FY 01 to FY 17

From NM ERB annual financial reports
Methods states are using to amortize unfunded pension liabilities

- Pay the actuarially determined contribution
- Commit a portion of the budget surplus to the unfunded liability, either ad hoc or in statute (AK, HI, RI)
- Issue pension obligation bonds
- Establish a dedicated funding stream, such as revenue from tobacco, liquor, gambling, or severance taxes (KS, MT, OK)
- Dedicate a portion of sales, use, and/or corporate income tax revenues (OK)
- Reduce the funding amortization period/change the method
- Transfer ownership of the state lottery to the pension fund (NJ)

Funding Policies@NASRA.org  http://www.nasra.org/funding
Change in distribution of nominal investment return assumptions, FY 01 to FY 18

NM ERB: 7.25%
Pension Obligation Bonds

An employer-issued financial security used to reduce an unfunded liability or to make contributions to a pension plan.

A POB is a form of arbitrage: borrowing money at a rate that (hopefully) can be invested at a higher rate.

POBs are not tax-exempt.

Advantages: produces an immediate source of funding for the plan; lowers near-term costs by reducing the unfunded liability; and may reduce long-term costs through higher investment earnings.

Disadvantages: risk, of investments not exceeding borrowing rate; potential effect on plan sponsor’s credit rating; trading of “soft” pension obligations for “hard” debt.

Timing of issuance is critical: determines borrowing rate and affects subsequent returns on invested proceeds.
Who Has Issued POBs?

Pension obligation bonds issued from 1985 to 2013, in 2013 dollars

Center for Retirement Research, from Bloomberg Online and Thomson Reuters