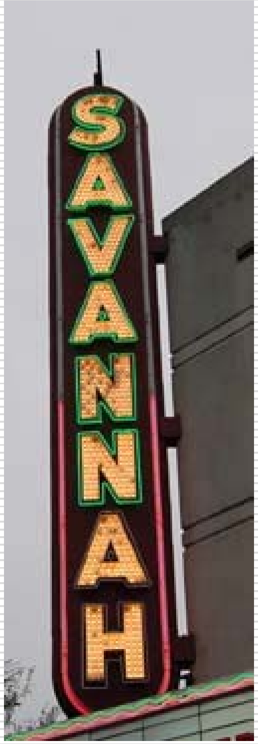
State Retirement Systems: Recent Trends



Sujit M. CanagaRetna
The Council of State Governments' Southern Office
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Southern Legislative Conference

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Four Main Parts

1. Why Focus on State Retirement Plans?
2. Where Public Pension Plan Finances Stand?
3. What Are Some Key Recent Trends in Public Pension Plans?
4. How Are States Seeking to Bolster their Pension Plans?

1. Why Focus on Pensions?

- Huge demands on state finances expected in upcoming years

  - ✓ Recent revenue growth from a greatly depressed base.

  - ✓ Healthcare, education, retirement systems, corrections, transportation, emergency management and infrastructure needs will soar.

1. 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 currently on shaky ground

1. Why Focus on Public Pensions?

- Elderly population in every state will grow faster than the total population (3.5 times faster).
- Seniors will outnumber school-age children in 10 states in the next 25 years.
- 26 states will double their populations of people older than 65 by 2030.
- FL, PA, VT, WY, ND, DE, NM, MT, ME and WV will all have fewer children than elderly.

1. Why Focus on Public Pensions?

- Life expectancy rates inching up along with low birth rates

- Declining worker to beneficiary ratio:
  - ✓ 1950 = 16.5 to 1
  - ✓ Today = 3.3 to 1
  - ✓ In next 40 years = 2 to 1

- Declining 15-24 age cohort, the age cohort entering the workforce

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2. Where Public Pension Plans Stand?

- 2004 50-State SLC Report – 73 percent or 68 of the 93 plans unfunded
- 2006 Wilshire Report – actuarial funding ratio declined from 103 percent in 2000 to 87 percent in 2005
- 2006 NASRA Report – average funding level at 87 percent with a cumulative unfunded liability of $337 billion

2. Where Public Pension Plans Stand?

- According to a February 2006 Standard & Poor's Report

  - ✓ Five Best Funded Public Plans were FL, NC, GA, NY and SD

  - ✓ Five Worst Funded Public Plans were WV, OK, RI, CT and IL

3. Key Trends – Public Pension Plans

- Shift to Non-Governmental Securities (corporate stocks, corporate bonds, foreign stocks).
- In 1993, public pension plans had only 62 percent of their total cash and investment holdings in Non-Governmental Securities.
- In 2005, this percentage had ballooned to nearly 80 percent.

3. Key Trends – Public Pension Plans

- Payments have clearly surpassed receipts, led by healthcare expenditures.
- Given the flurry of corporate scandals and the steep drop in asset values, greater activism by boards, controlling authorities and legislatures.

3. 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.

3. Key Trends – Public Pension Plans

- Statement 45 is effective in three phases:
  - ✓ Governments with revenue > $100 Million = December 15, 2006
  - ✓ Governments with revenue between $10 Million and $100 Million = December 15, 2007
  - ✓ Governments with revenue < $10 Million = December 15, 2008

3. Key Trends – Public Pension Plans OPEB Estimates

❑AL = $10B	❑NJ = $20B
❑AK = $500M	❑NY = $47B-$54B
❑CA = $40B-$70B	❑NC = $14B
❑CO = $925M	❑NV = $1.75B-$4.4B
❑DE = $3B	❑RI = $550M
❑MD = $20B	❑UT = $540M
❑MA = $13B	❑VA = $5B
❑MI = $30B	❑VT = $2.59B

3. Key Trends – Public Pension Plans

- June 2006 50-state SLC report on Pension Portability among Public Health Officials noted:
  - ✓ 36 of the 50 states permit intrastate pension portability between eligible plans within their states.
  - ✓ At the interstate level, only four states (Connecticut, Indiana, New Hampshire and West Virginia) permit the purchase of credits for out-of-state service.

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4. Strategies Adopted: Pension Obligation Bonds

- Racking up debt to bridge budget shortfalls has been a popular strategy among states recently.
- According to latest (2006) Moody's report, state net-tax supported debt rose 6% in 2005, down from the record 17% in 2003 and 12% in 2004.
- 2005 growth, is lower, but is relative to a larger base.
- Total state net-tax supported debt in 2005=$360.3 billion.
- Recent pension bond issues have been very successful (CA, KS, OR, IL, WI).

4. 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).

4. Strategies Adopted: Pension Obligation Bonds

- In 1997, New Jersey borrowed $2.8 billion to, among other goals, clear its unfunded liability.
- Investment earnings that exceeded 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. (Now, $72 billion)
- NJ's pensions currently have an unfunded liability of $18 billion.
- City of Pittsburgh suffered similar fate too.

4. 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).
- Linking annual increases to CPI (IL, RI, NH, CO, AZ).
- Preventing workers from securing pensions larger than their salaries (CA).
- Capping amount end-of-career raises adds to pension (IL).

4. Strategies Adopted: Trimming Benefits

- Adjusting age at which retirees paid full benefits (CO, KS, NY, IL, RI, TX, LA).
- Reducing percentage of pay retirees get each year (RI).
- Eliminating DROPs (LA).
- Ending practice of employees serving a short period in a position to boost overall pension (MO, LA).

4. Strategies Adopted: Trimming Benefits

- Cutting back and increasing health and life insurance costs (ID, MT).
- Placing salary caps on rehired retirees (NM)
- Debating and ending states offering lucrative health plans to retirees (NC, MI, IN)
- Eliminating “gain-sharing,” i.e., increasing pension checks when investments expand (WA)

5. Strategies Adopted: Other

- Increasing the costs to workers, counties and cities (MN, AK, OH, TX, KY, NV, AR, SC).
- Consolidating retirement boards (WV, LA, MN, VT).
- Matching, i.e., deliberately aiming for low, but guaranteed, investment income from conservative bonds (ME).
- Unorthodox investments (AL, MA, NJ).

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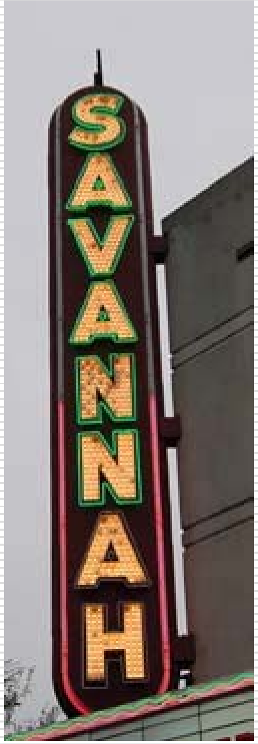
Recent Trends



Thank You

For more information, please contact
Sujit M. CanagaRetna
Senior Fiscal Analyst
404/633-1866
Or
scanagaretna@csg.org
www.slcatlanta.org