Overview of Public Pension Issues and Trends

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Presentation Overview

- The size and scope of public pensions in the US and Connecticut
- Public pension funding conditions
- Perspective on retirement plan design
- Trends and changes in public pension plan design
- Risk-sharing in public pension plan design

Public pensions in the U.S.

- ~$4 trillion in assets
- 14.5 million active (working) participants—employees of states and local government
  - Nearly 10 percent of the nation's workforce
- 10.7 million public pension retirees and their survivors receive ~$300 billion annually in benefits
- Annual contributions = $200 billion
  - $145 billion from employers; $55 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

US Census Bureau, Public Fund Survey

Public pensions in Connecticut

- ~$44 billion in assets
- 127,000 active (working) participants—employees of states and local government
- 122,000 public pension retirees and their survivors receive ~$5 billion annually in benefits
- Annual contributions = $4.0 billion
  - $3.4 billion from employers; $600 million from employees
  - Approximately 6.8 percent of all state and local government spending goes to public pensions (FY 15)
- Of 212 public retirement systems, TRB and SERS account for 70+ percent of assets and members
- Slightly fewer than one-half of public employees in CT do not participate in Social Security

US Census Bureau

Comparison of Retirement Benefits in the U.S.

Private Sector

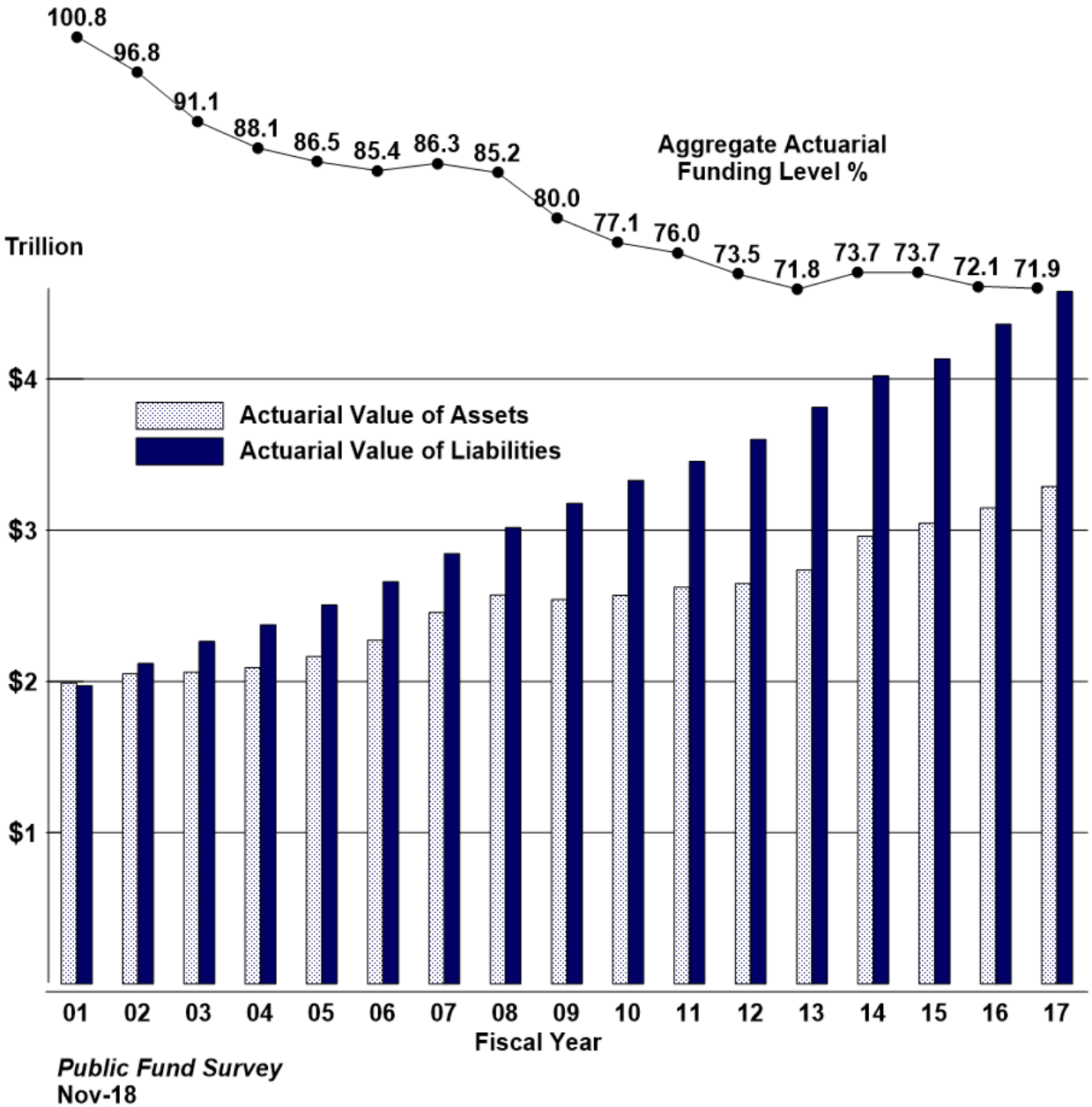
- 60% of full-time private sector workers participate in an employer-sponsored retirement plan; 21% of part-time workers participate
- In total, 49% of all private sector workers participate in an employer-sponsored retirement plan
- Fewer than one in five have a traditional pension (DB) plan
- Social Security coverage is universal

Public Sector

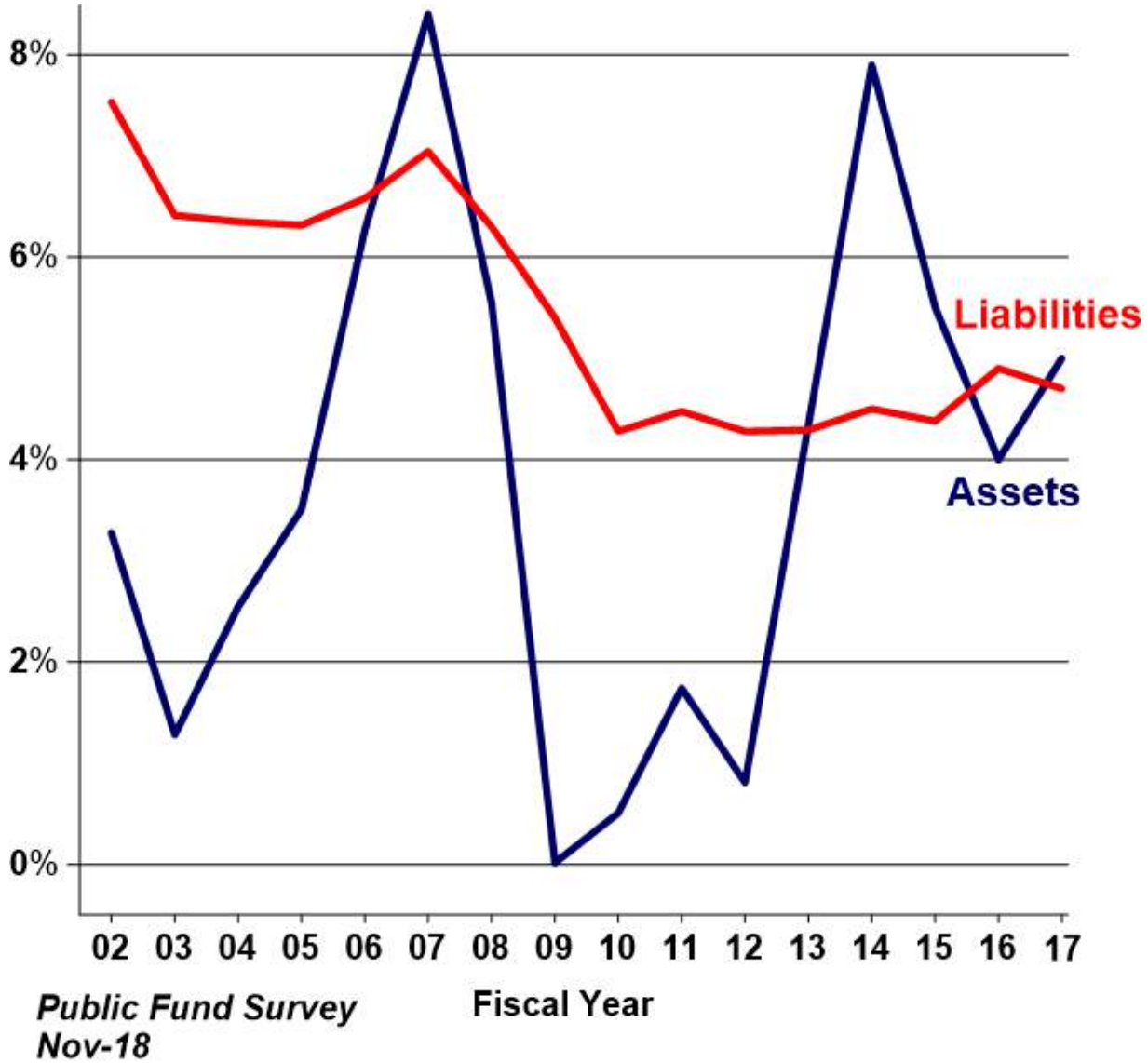
- Nearly all full-time workers have access to an employer-sponsored retirement benefit; most have access to a traditional pension (DB plan)
- 87% of full-time employees participate in a pension plan
- 80% of all employees, including part-time workers
- Virtually all others are in a DC plan
- Three-fourths participate in Social Security

US Bureau of Labor Statistics

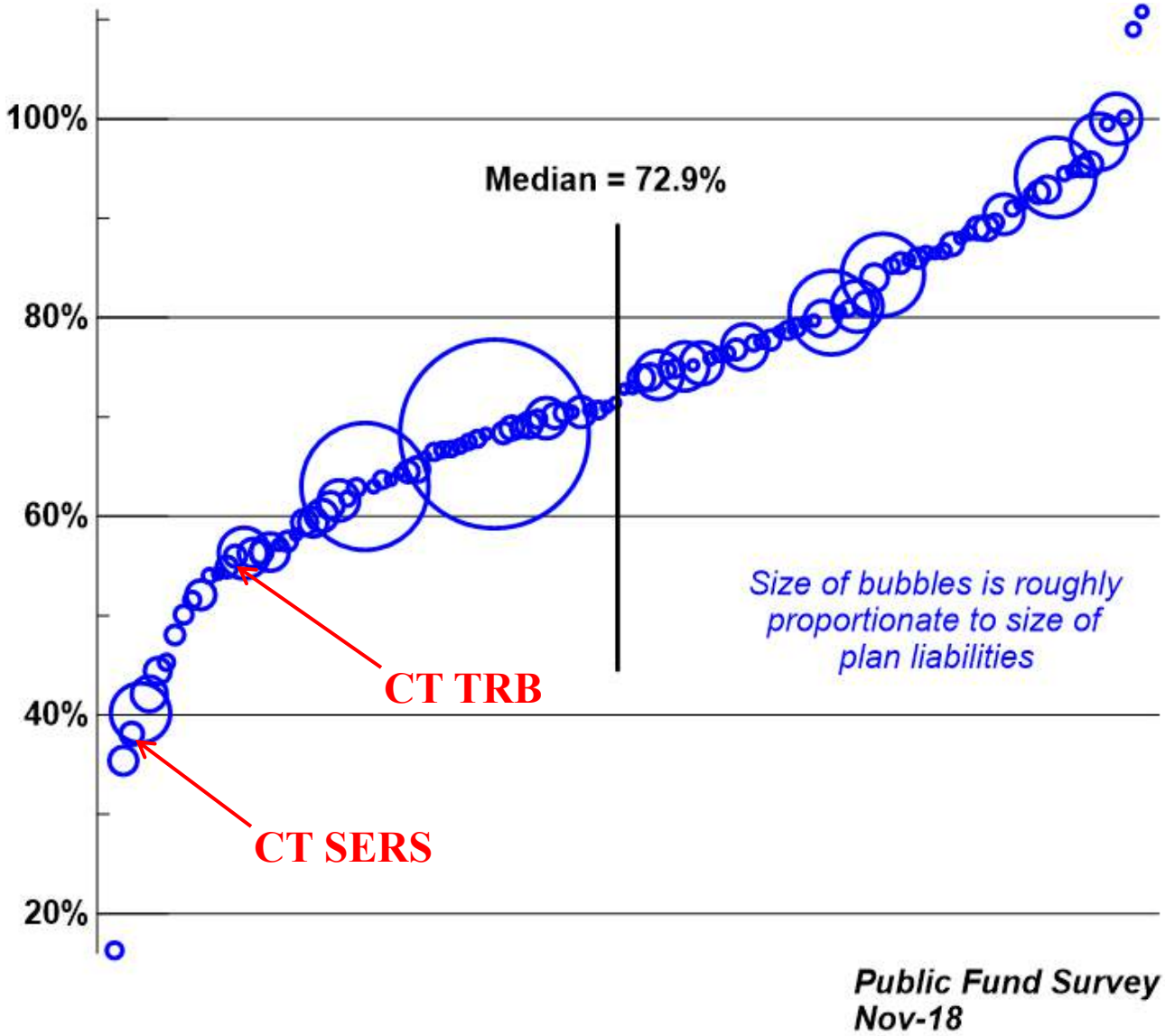
Change in Aggregate Public Pension Funding Level, FY 01 to FY 17



Median Change From Prior Year in Actuarial Value of Assets and Liabilities



Distribution of Public Pension Funding Levels, FY 17



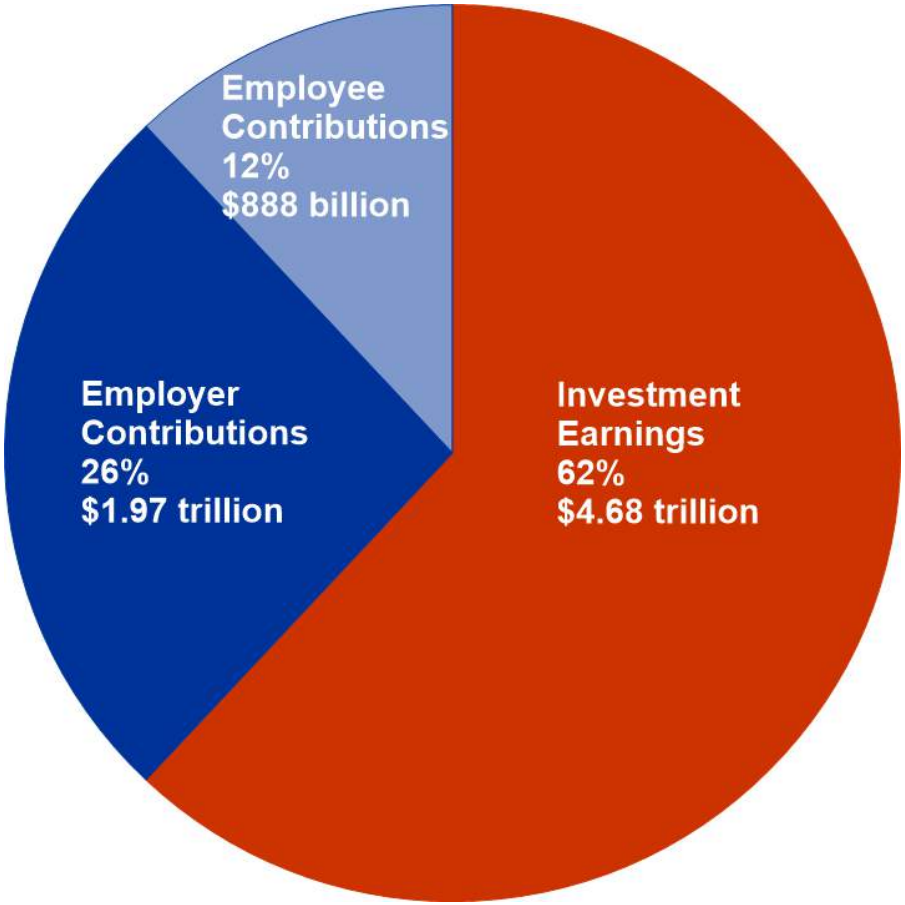
Headwinds Facing Public Pension Plans

- Declining investment return assumptions
- Slow payroll growth as a result of
  - Sluggish hiring rates
  - Tepid salary growth
- Higher required pension plan costs
- Updated mortality assumptions to reflect longer life expectations
- Negative cash flow

Tailwinds Supporting Public Pension Plans

- Stronger employer efforts to pay contributions
- More aggressive liability amortization strategies:
  - More closed periods
  - Shorter periods
- Lower benefit levels = lower long-term costs
- Improving economy
- Slow improvement in hiring and salary growth

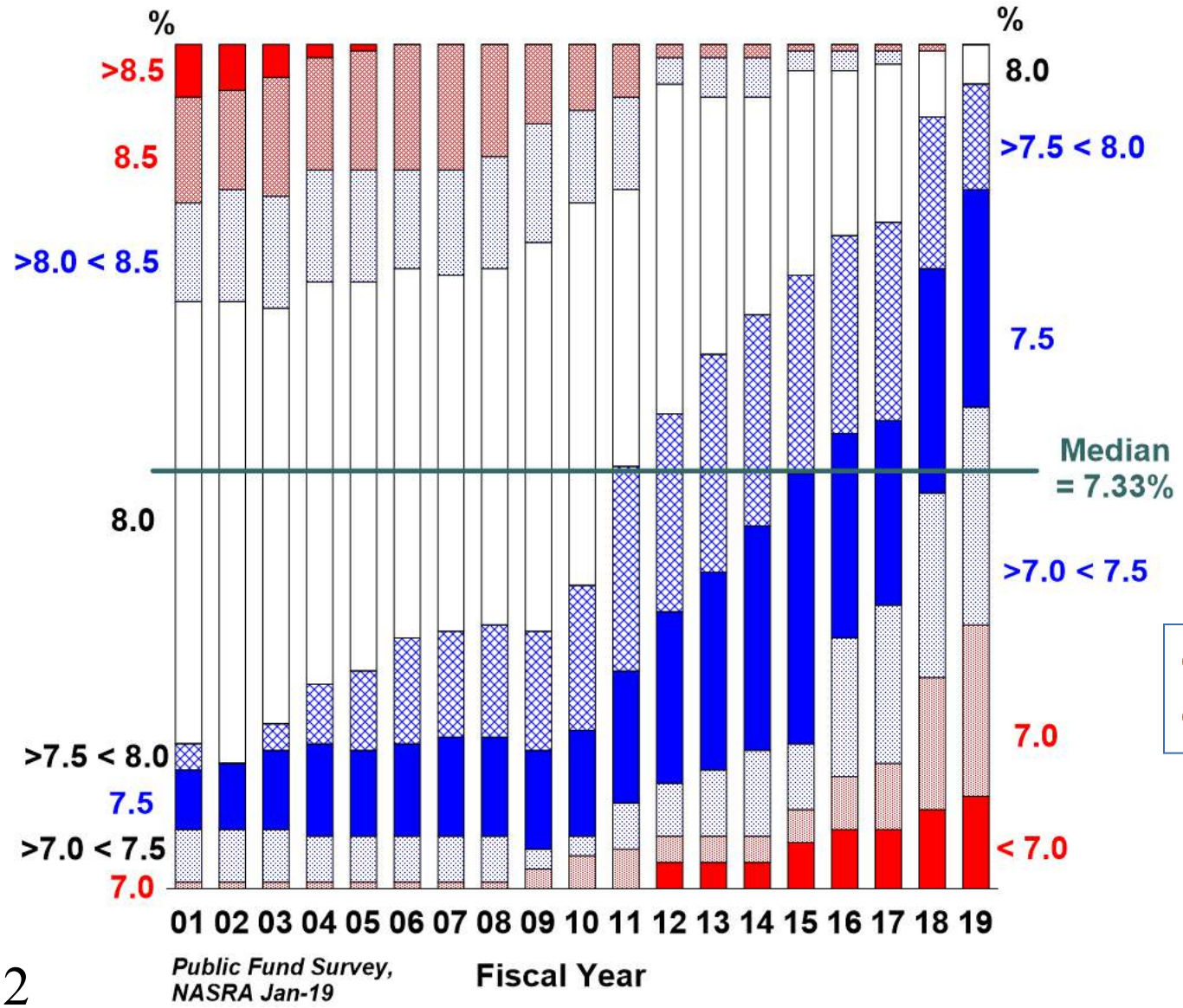
Public Pension Fund Sources of Revenue, 1988 to 2017



US Census Bureau

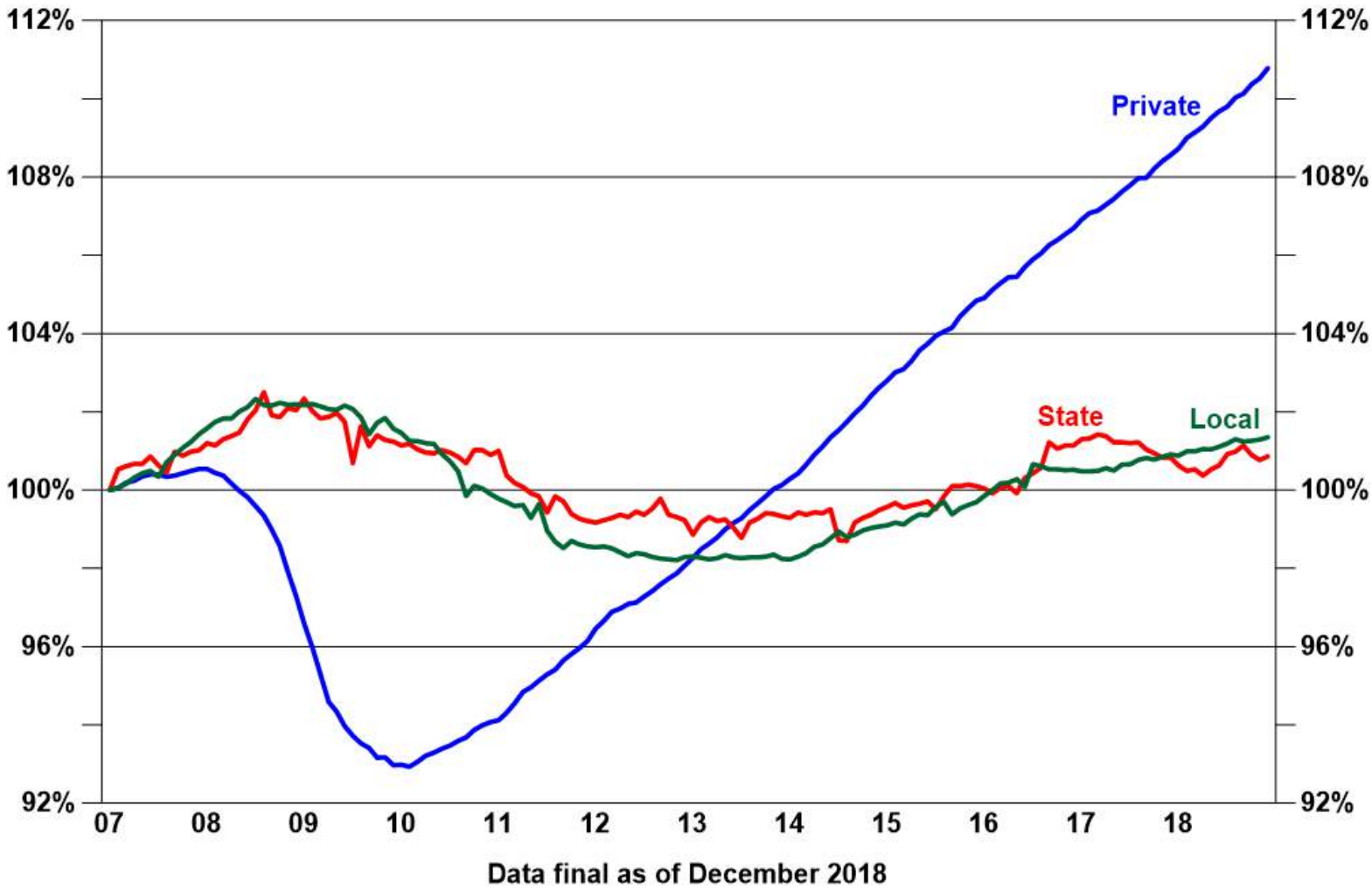
The typical public pension funding model is highly reliant on investment earnings.

Investment Return Assumptions, FY 01 to latest



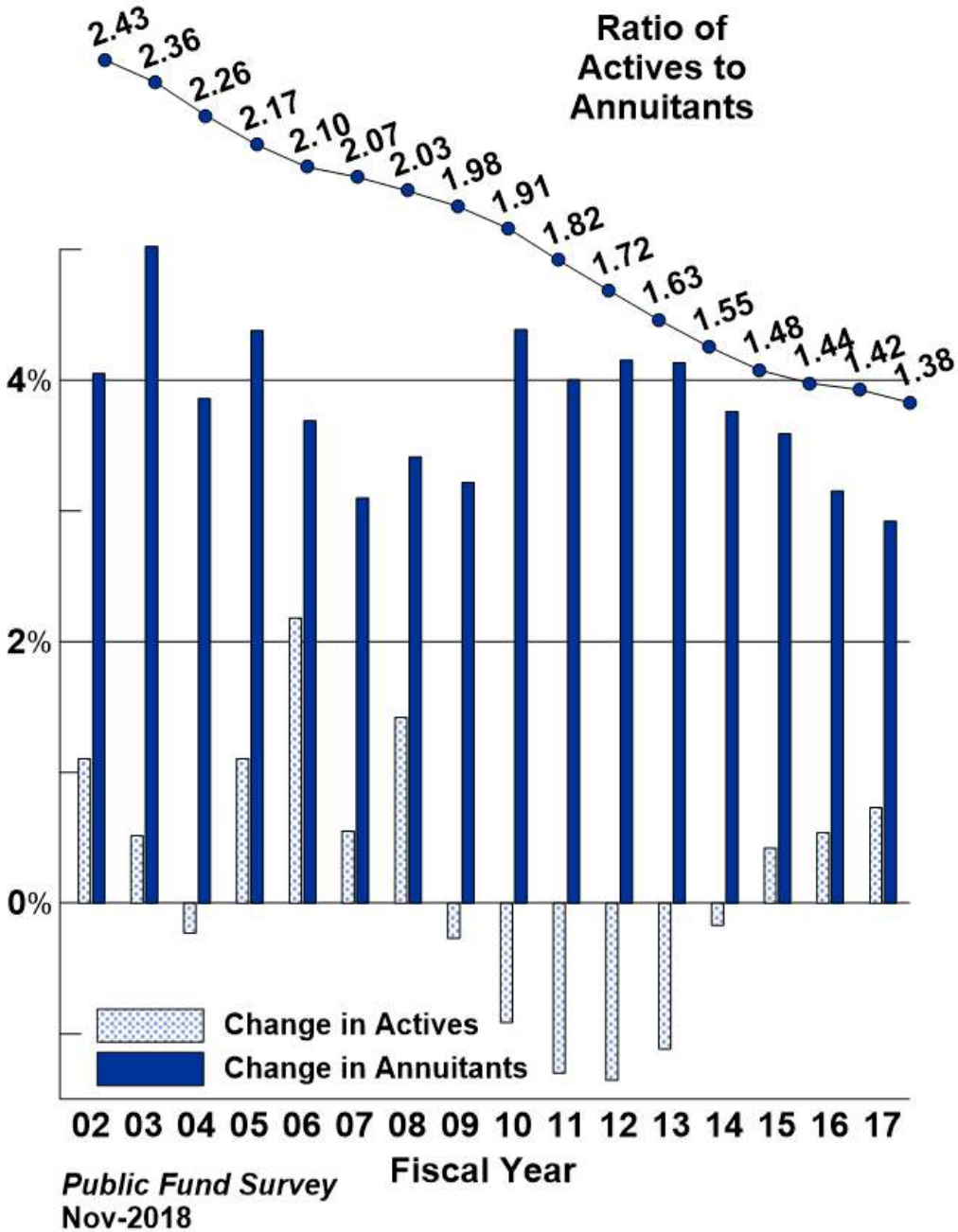
CT TRB: 8.0%
CT SERS: 6.9%

Relative Change in Employment in Private and Public Sectors, 2007 to present

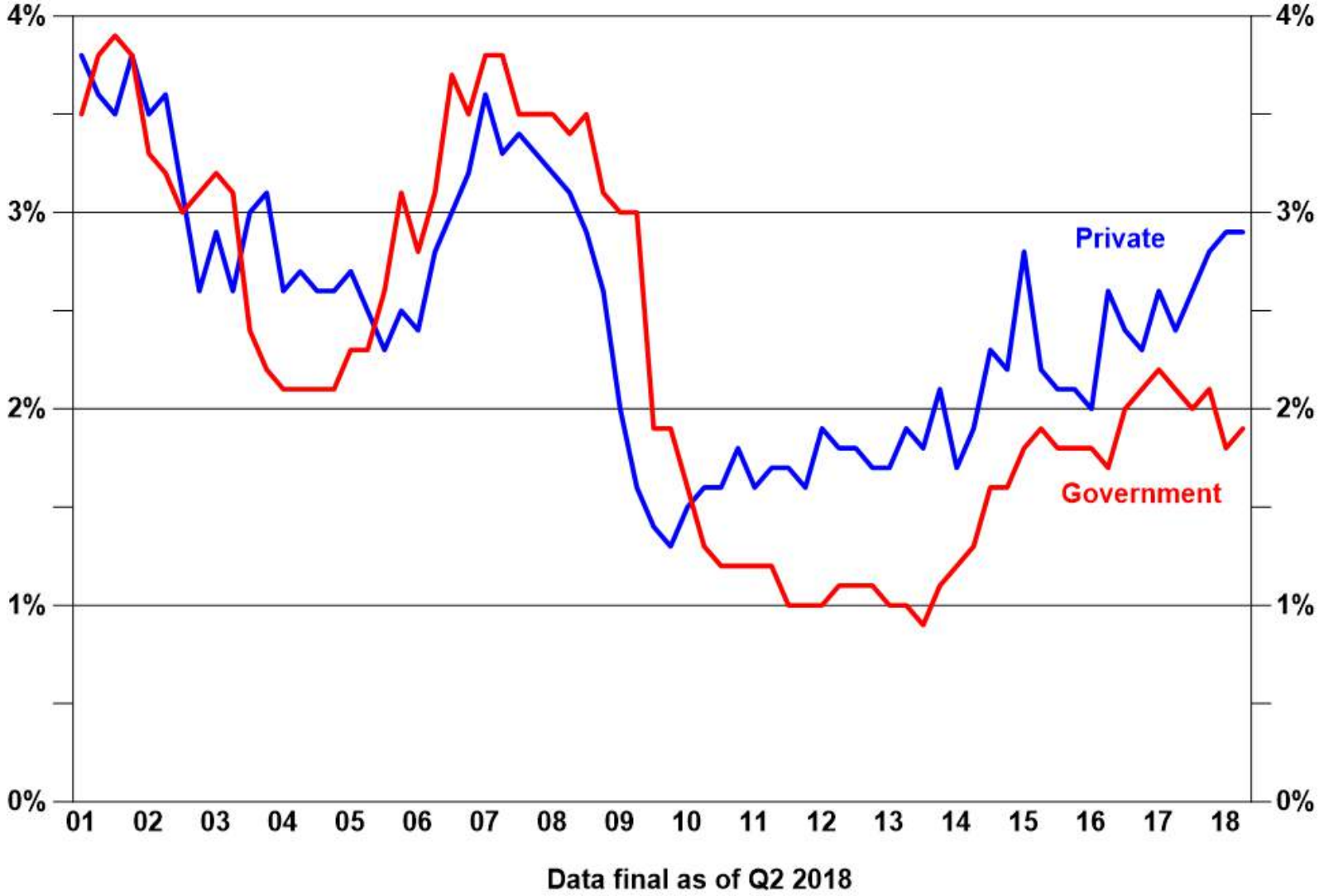


U.S. Bureau of Labor Statistics

Change in Actives and Annuitants FY 01 to FY 17

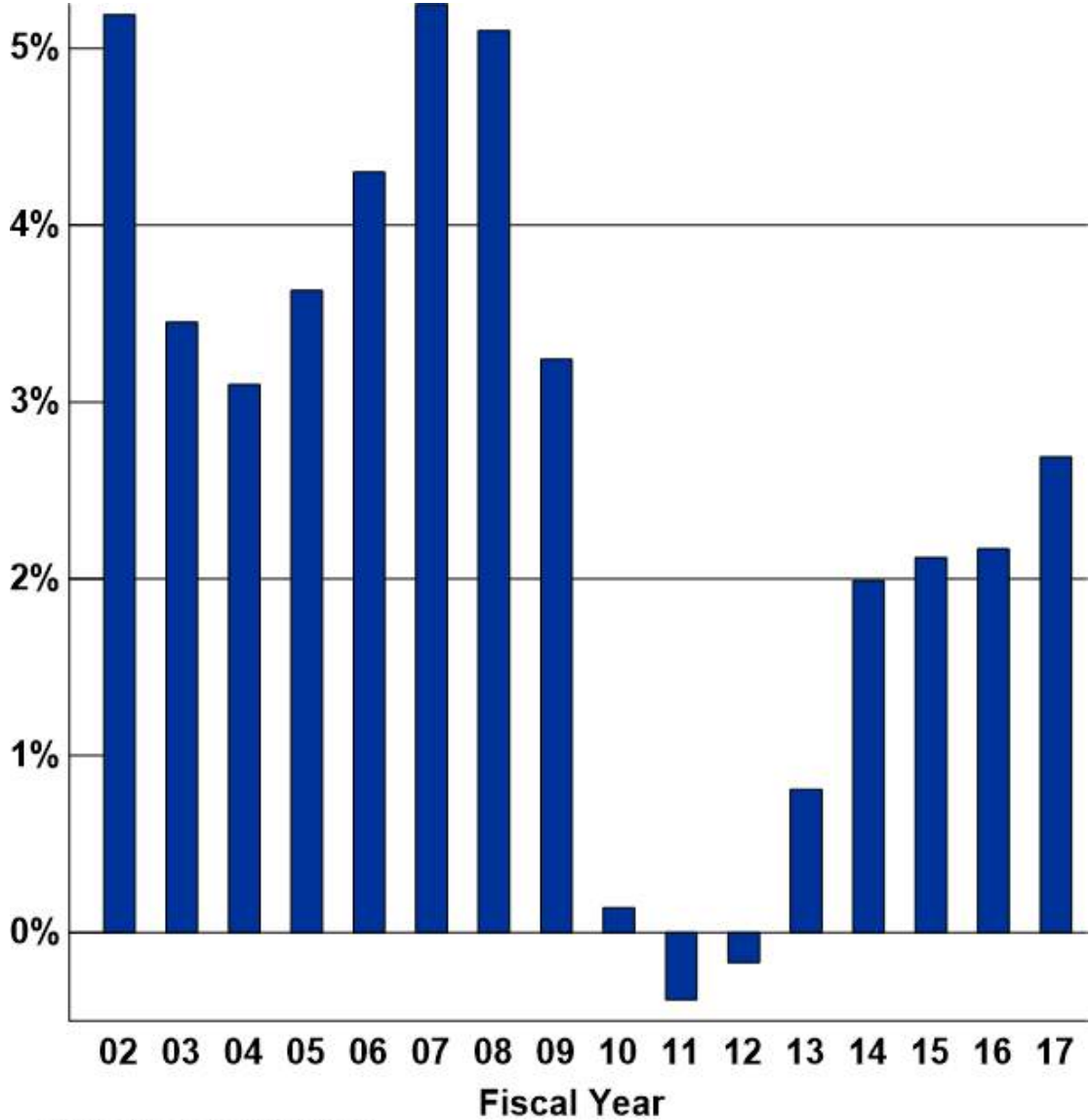


Annualized Quarterly Change in Wage and Salary Costs for Private and State & Local Government Employees, 01-18



U.S. Bureau of Labor Statistics

Median Annual Change in Public Pension Payrolls, FY 02 to FY 17



Public Fund Survey
Jul-18

NASRA's Position on Pension Plan Design

- Core elements of public pension plan design:
  - Mandatory participation
  - Employee-employer cost sharing
  - Assets that are pooled and professionally managed
  - Targeted income replacement
  - Annuitized benefits
  - Survivor and disability benefits
  - Access to a supplemental retirement savings plan

Perspective on Retirement Plan Design

- The purpose for providing a retirement plan is to meet stakeholder objectives
- Primary retirement plan stakeholders are public employers (school districts, police departments, state agencies, etc.), public employees, and taxpayers
- Stakeholder objectives:
  - Employers seek to attract and retain qualified workers needed to perform essential public services
  - Employees seek a competitive compensation package that includes a retirement benefit
  - Taxpayers seek public services delivered in a cost-effective manner

Perspective on Retirement Plan Design

Q. Why not switch to a defined contribution plan as the primary retirement benefit?

A. A DC plan provides cost certainty and shields taxpayers from certain risks, but introduces new and different types of risk. Sound retirement plan design balances risks and rewards.

Q. What type of risks would a typical DC plan introduce?

- Among others:
- A DC plan can impair the ability of employers to retain workers, especially those who are older and experienced.
- A DC plan can impede the ability of workers to retire in a timely and orderly manner.
- A DC plan will result in some employees having no source of assured retirement income, which could mean they will rely on public assistance in their old age.

Perspective on Retirement Plan Design

- Multiple studies have concluded that a traditional pension benefit will deliver the same level of retirement income at a lower cost relative to alternative plan types.
- Generally, this is due to three factors:
  - Pooled assets avoid "over-saving" by saving for the group rather than on an individual basis
  - Lower investment and administrative costs
  - Higher investment returns enabled by assets that are professionally managed and by maintaining a longer investment horizon
- *See also*
  - "Still a Better Bang for the Buck," National Institute on Retirement Security, 2014
  - "Pension Benefit Design Study, TRS of Texas," 2018
  - "Study of Colorado PERA Hybrid DB Plan," 2015
  - Plan Design@NASRA.org

Trends in Plan Design

- Reforms to pension plans since the 2008-09 market decline and the Great Recession are unprecedented in scope and magnitude
- Nearly every state has made changes to pension benefit levels, financing arrangements, or both
- Many states have enacted changes more than once
- Nearly all states have retained access to a traditional pension plan as employees' primary retirement benefit

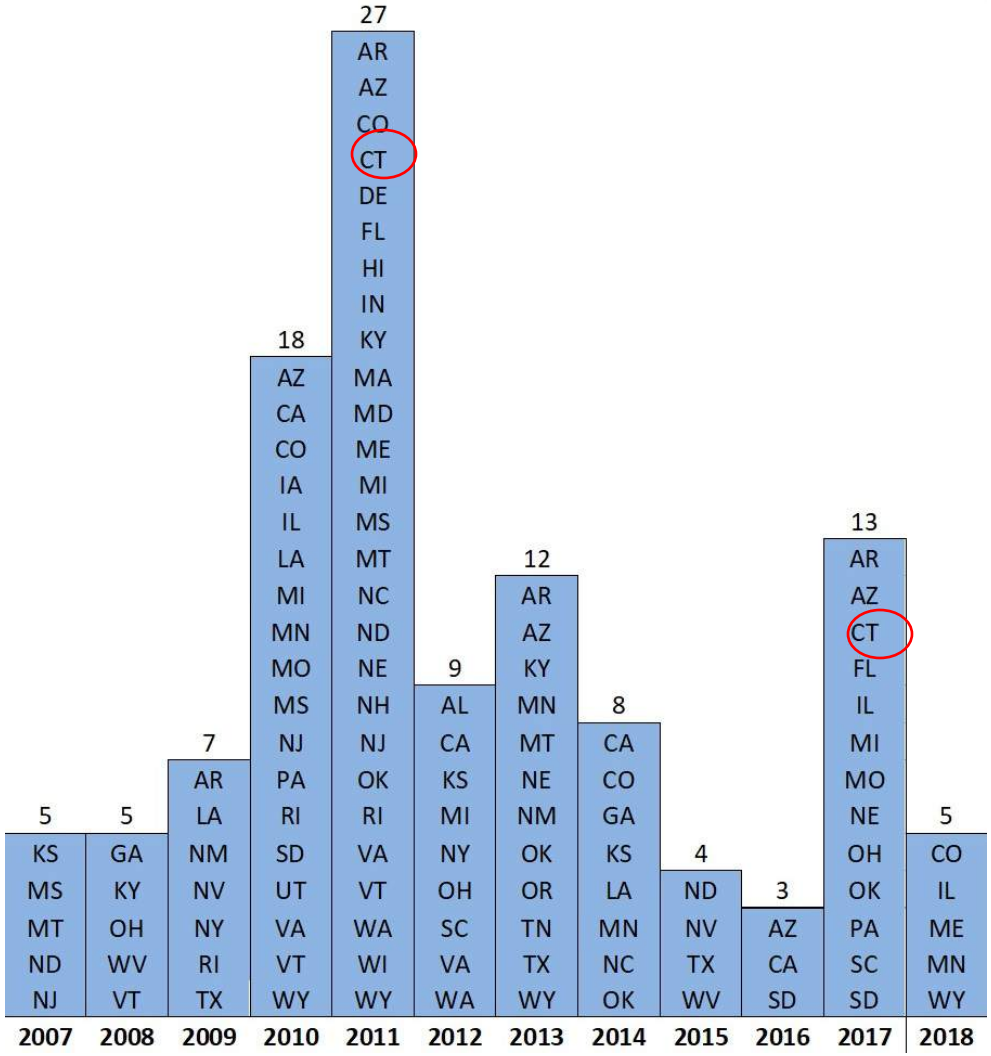
Trends in Plan Design

- Changes to plan design typically are intended to accomplish one or more of the following objectives:
  - Lower employer costs
  - Reduce liabilities
  - Reduce employer risk
- The types of change, the degree of change, and who is affected vary widely among states and plans
- The effect on costs of changes in a pension plan design is heavily reliant on the groups that are affected by the changes

Trends in Plan Design

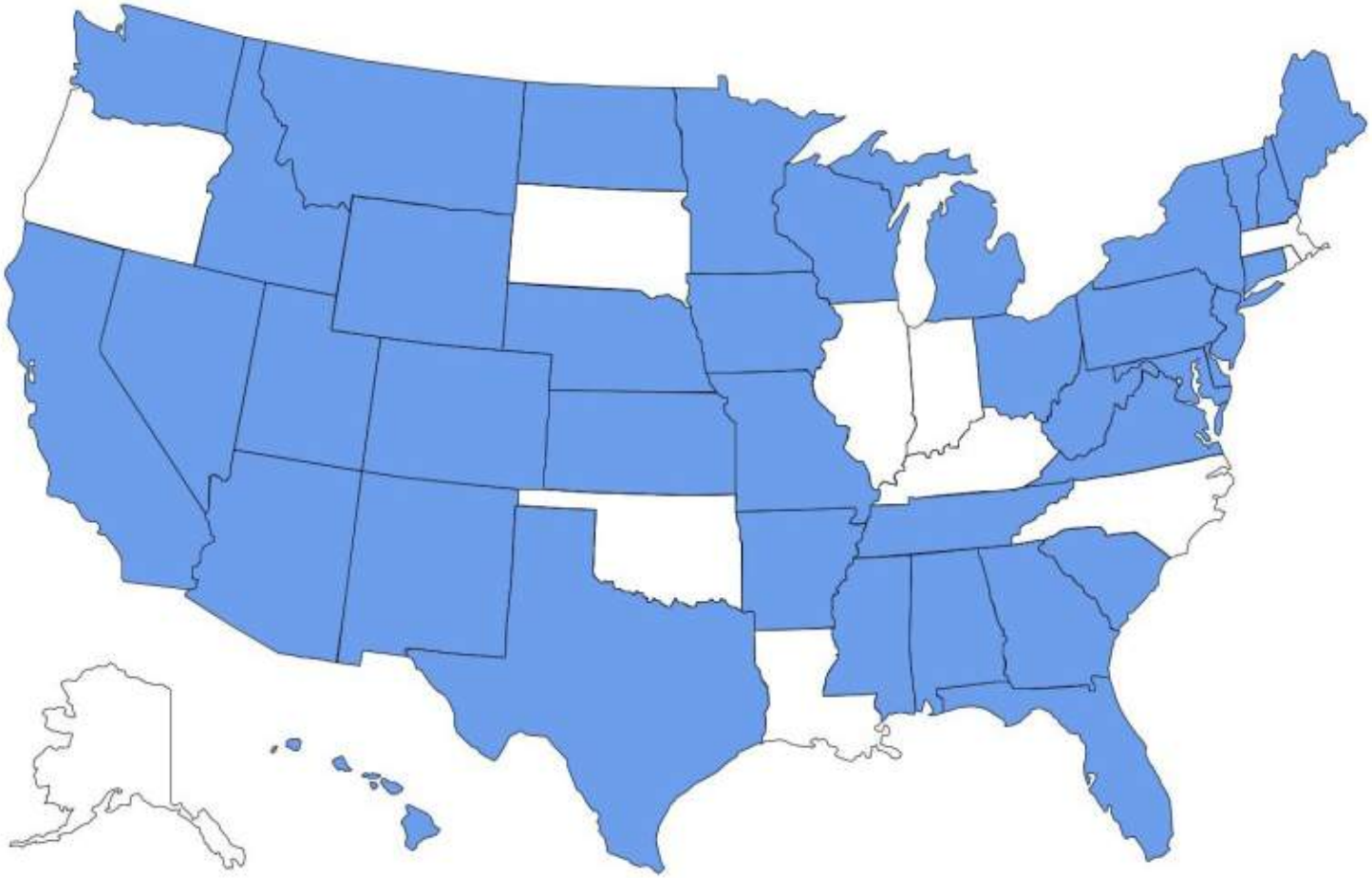
- Reforms may affect new hires only, current active members, those already retired, or all three
- Changes that affect new hires only tend to have limited effects on costs and liabilities
- Changes that affect those already retired can have a significant effect on plan costs and liabilities
- Public pension legal protections are a primary factor when considering changes to a pension plan
- Legal protections run a wide range and are not always clearly known

States Enacting Pension Reforms 2007 to 2018

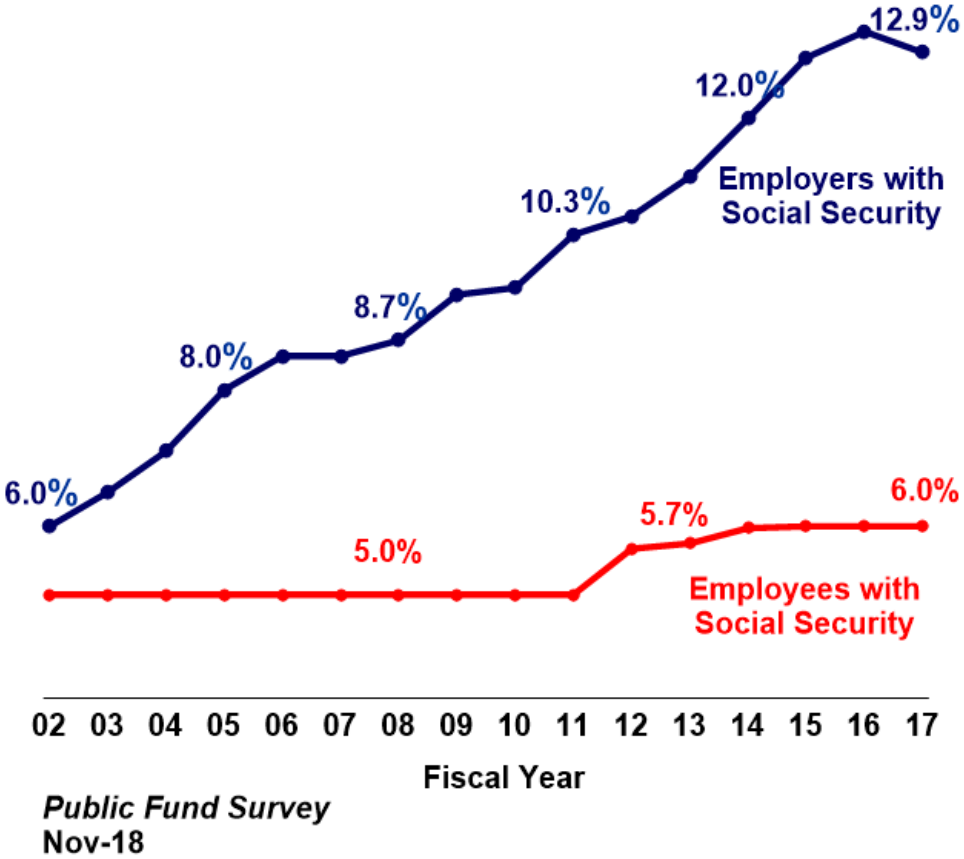


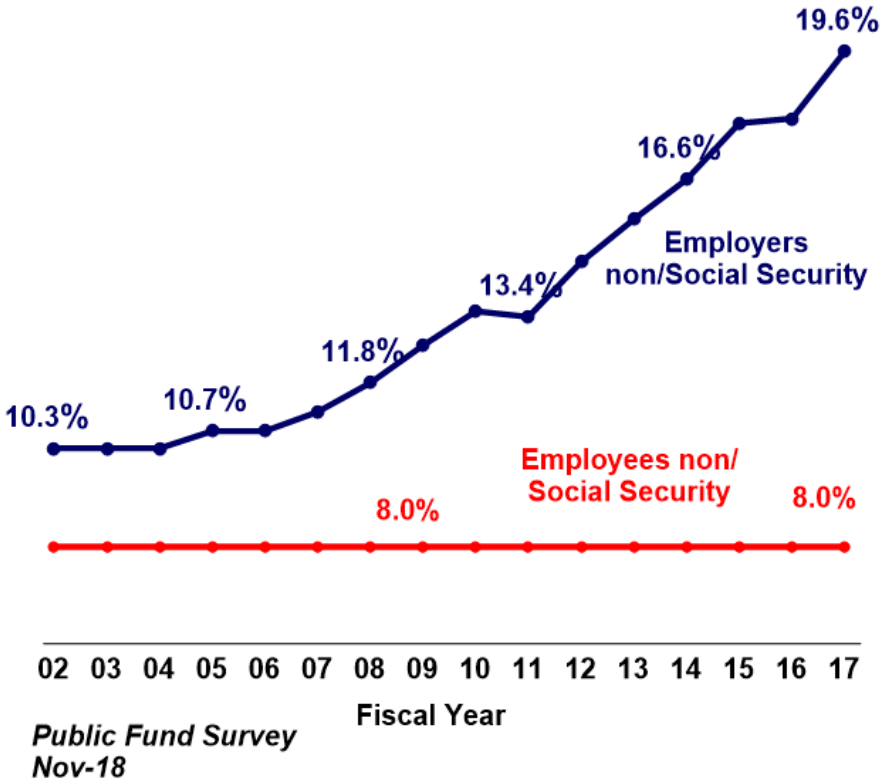
Significant Reforms to State Retirement Systems, NASRA

States That Have Increased Employee Contribution Rates



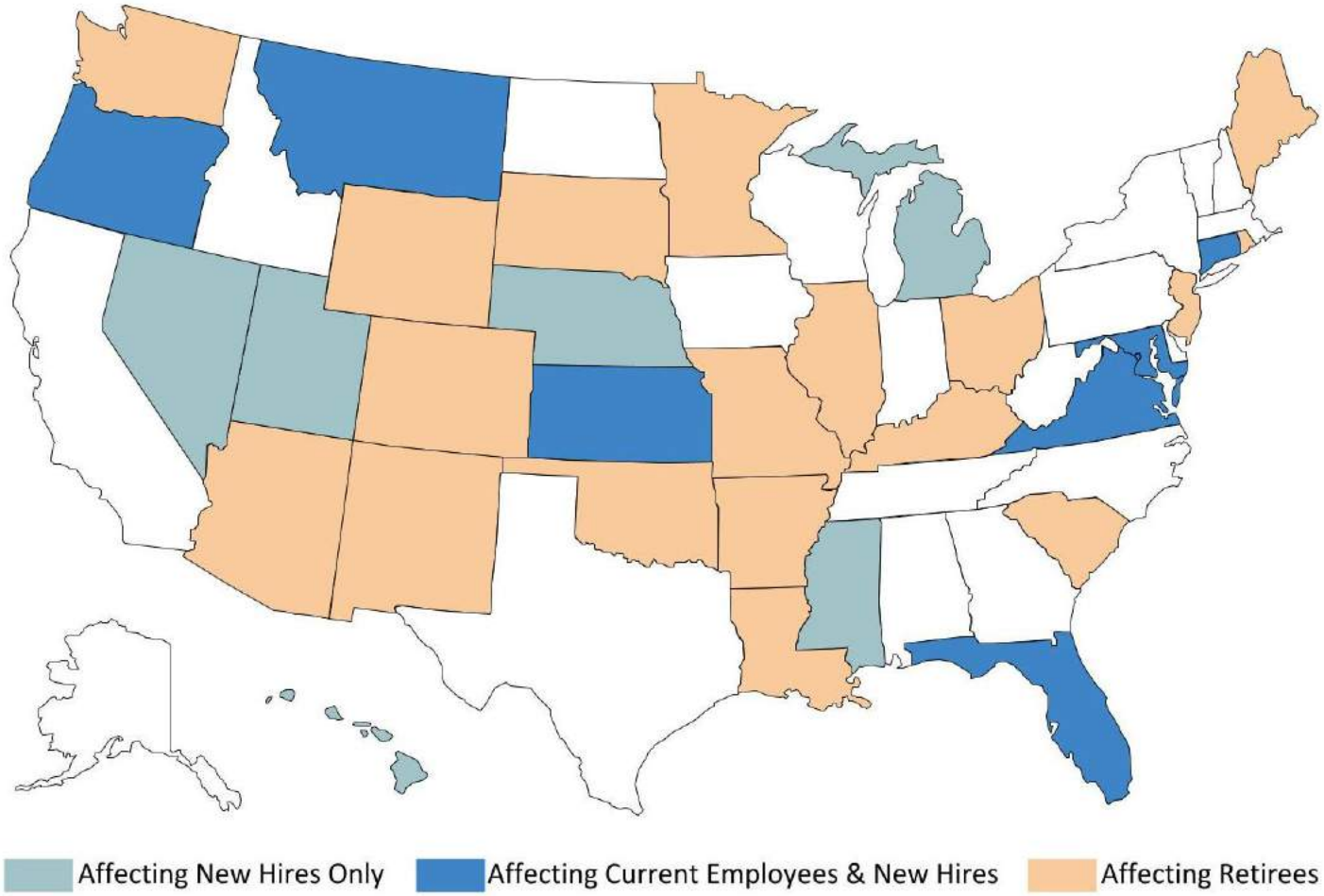
Median Employee and Employer Contribution Rates, FY 02 to FY 17





See also NASRA issue briefs on employee and employer contributions

States That Have Made Changes to Cost-of-Living Adjustment Provisions 2009-2018

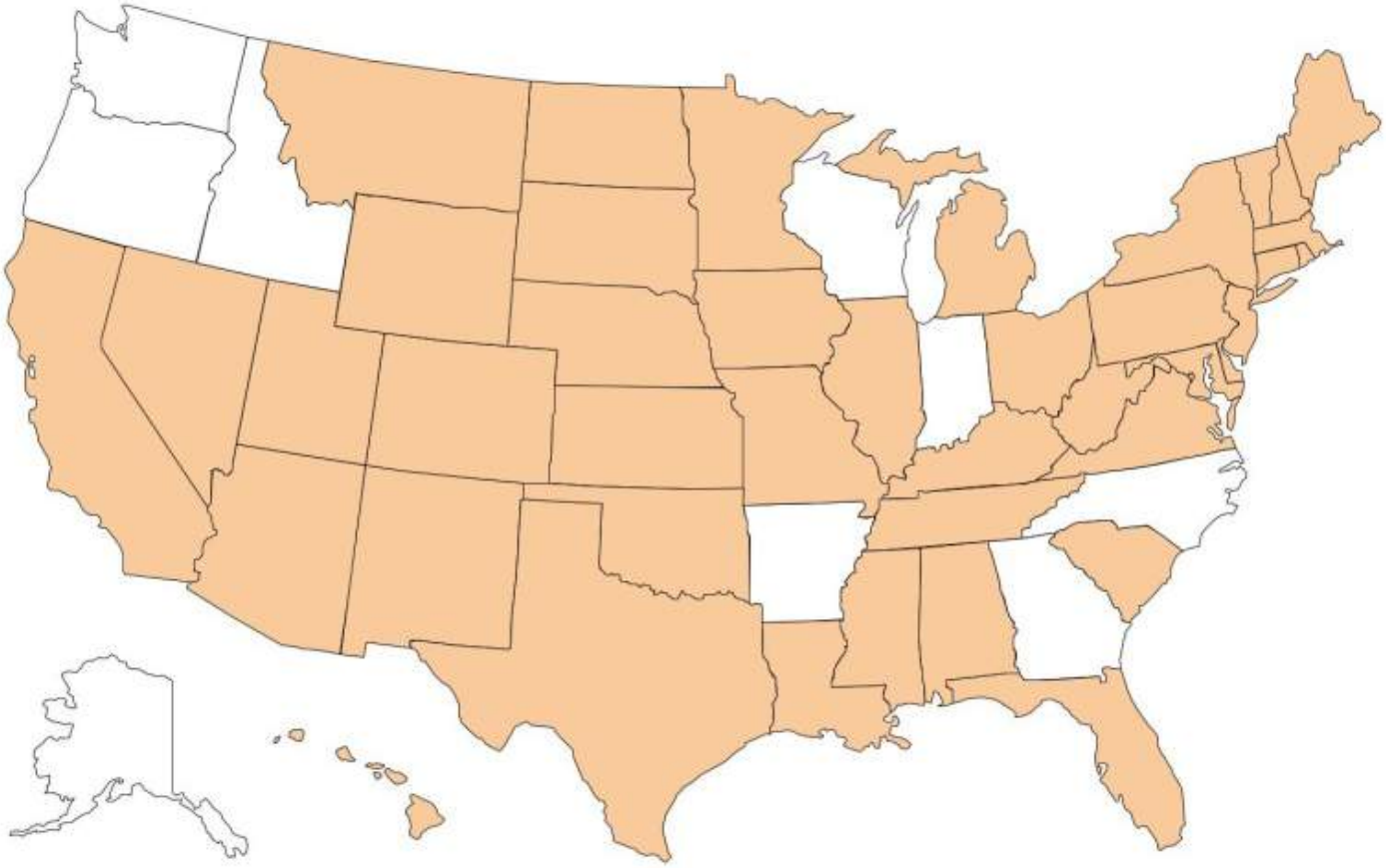


Significant Reforms to State Retirement Systems, NASRA

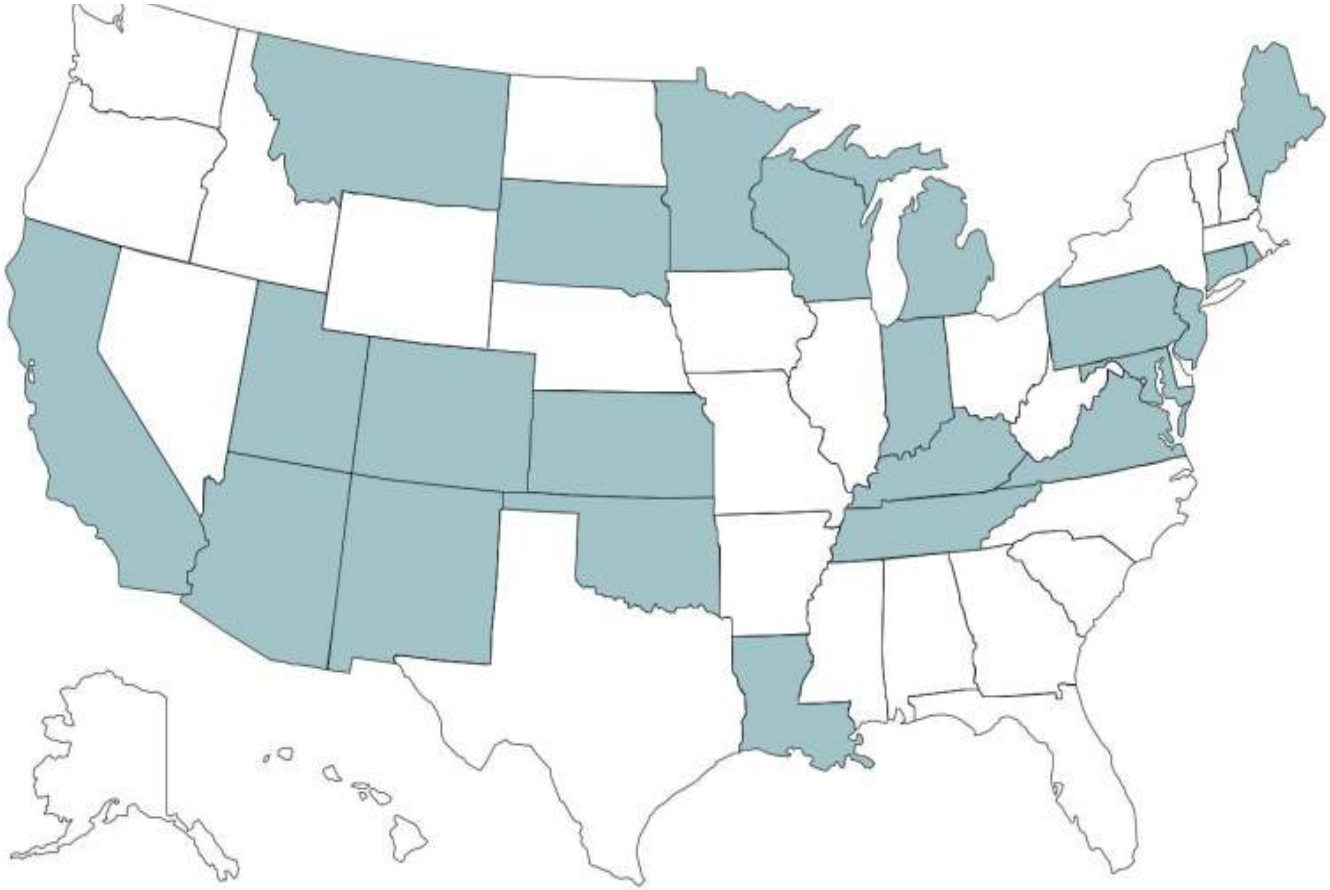
Ways Pension Benefit Levels Have Been Reduced

- Lower retirement multiplier
- Longer period for calculating pensionable salary
- Higher required age to qualify for a full retirement benefit
- More required years of service to qualify for a full retirement benefit
- Lower rate of interest accrual on contribution account balances

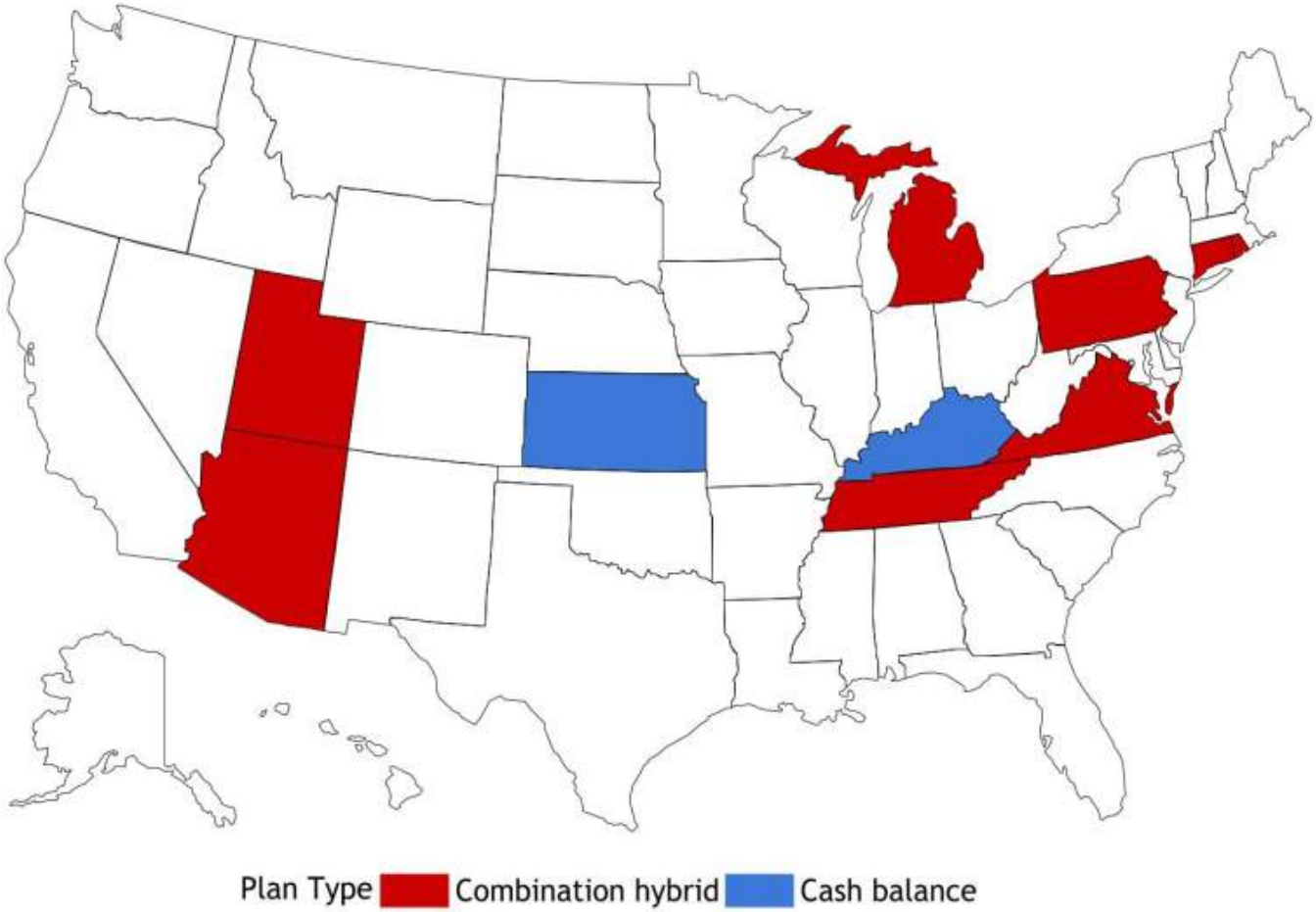
States That Reduced Pension Benefits, 2009-2018



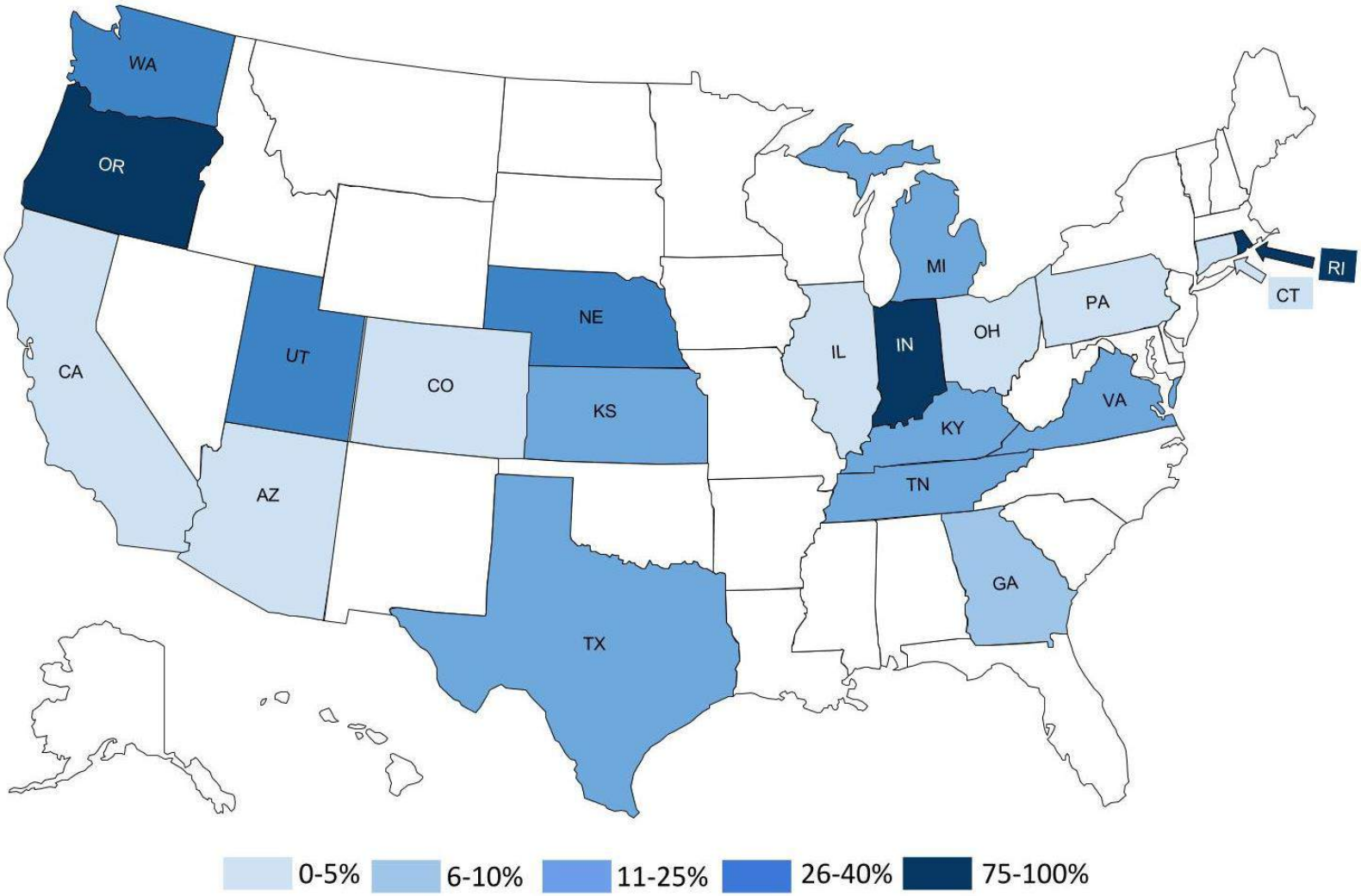
States That Implemented Automatic Risk-Sharing Features 2009-2018



States That Created New Hybrid Plans, 2009-2018



Statewide Hybrid Plans and Relative Participation Rates



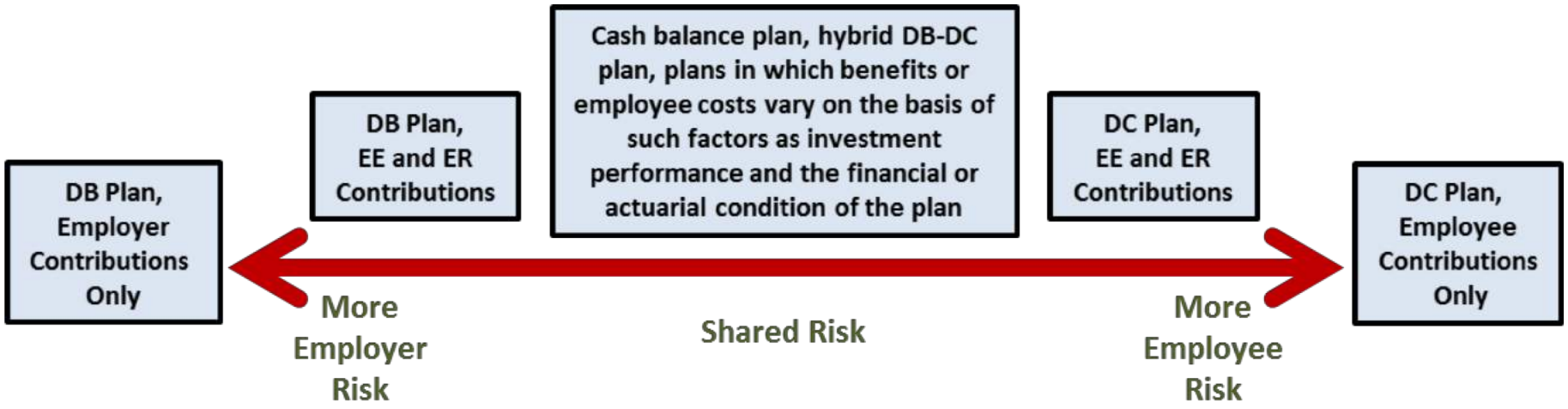
See also NASRA issue brief on state hybrid retirement plans

Risk-Sharing Conceptually

C + I = B + E

- Contributions plus Investment Earnings equals Benefits plus Expenses
- Over time, the revenue into a retirement plan must equal the plan's expenses
- In a traditional defined benefit plan, when revenues are insufficient to pay for benefits, employer contribution rates rise
- Risk-sharing introduces the possibility that employee contributions or benefit levels will be adjusted

Conceptual Illustration of Typical Risk Distribution, by Plan Type



NASRA

Examples of Risk-Sharing Features

- **Hybrid plans**
  - DB-DC: a traditional pension plan combined with a defined contribution plan
  - Cash balance: a retirement benefit like a pension plan except the benefit is affected by investment experience and the employee's retirement age
- **Variable employee contribution rates**, which can change based on the plan's actuarial condition
- **Contingent benefits**, in which the size of the basic retirement benefit may be affected by the plan's actuarial condition
- **Contingent COLAs**, the post-retirement benefit adjustment depends on some external factor, such as investment return or the plan's funding level

Final Thoughts

- Public pension funding conditions range from strong and healthy to distressed
- In terms of scope and magnitude, an unprecedented number of changes to public pension plans have been enacted in the last decade
- Sound retirement plan design reflects the objectives of all stakeholder groups:
  - Taxpayers, public employers, and public employees
- Most states have retained core features of sound retirement plan design while shifting some risk to employees

Thank you for listening !

With questions or to discuss public pension issues:

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