

Pennsylvania Association of Public Employee Retirement Systems, Spring Forum

A Discussion Regarding Public Pension Plans

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The Pew Charitable Trusts**

The Pew Charitable Trusts

- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

Pew's Public Sector Retirement Systems Project

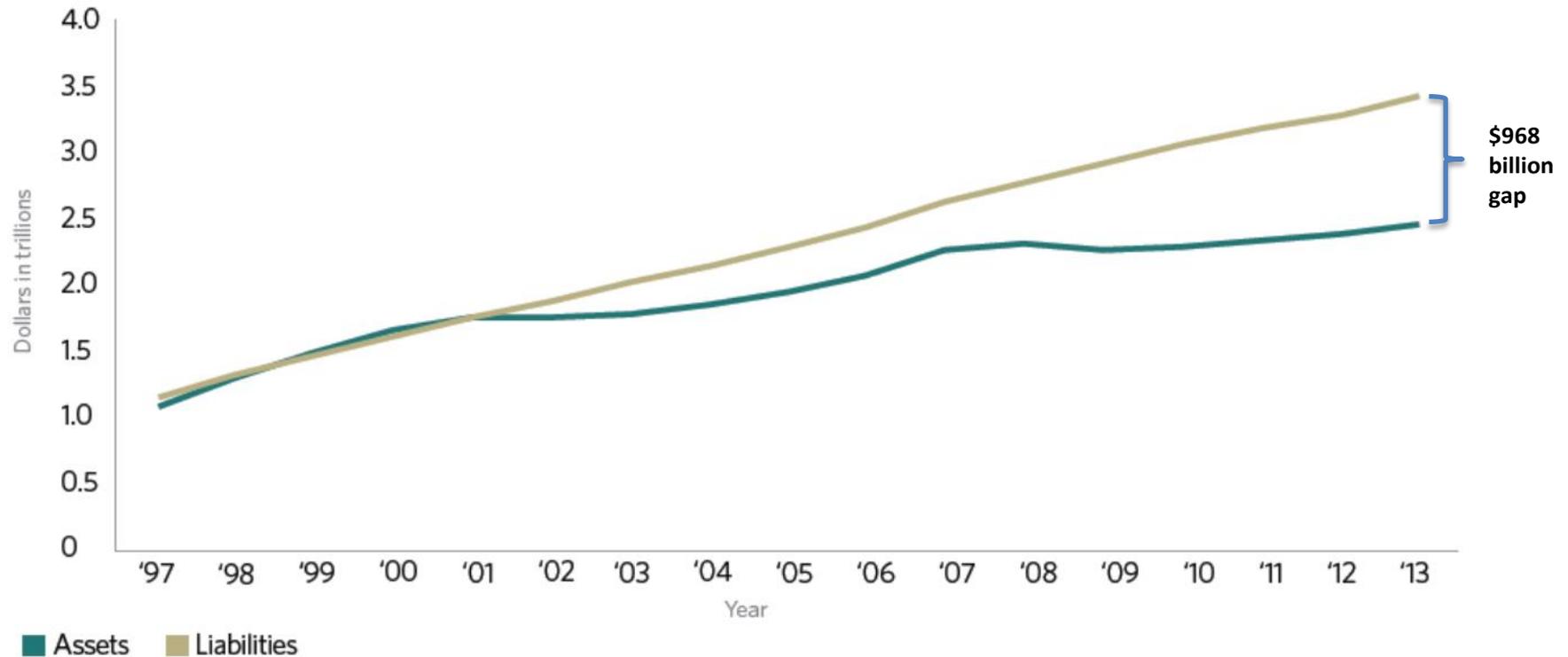
- Research since 2007 includes 50-state trends on public pensions and retiree benefits relating to funding, investments, governance, and employee preferences
- Technical assistance for states and cities since 2011; PA since 2012

Overview

- Research
 - Pension funding and new reporting requirements
 - Investments and governance
- Policy/Reform Updates
 - National
 - Pennsylvania

Pension Funding and New Reporting Requirements

State Pension Funding Gap (Aggregate of 50 States)



Sources: State and pension plan CAFRs and pension plan actuarial valuations

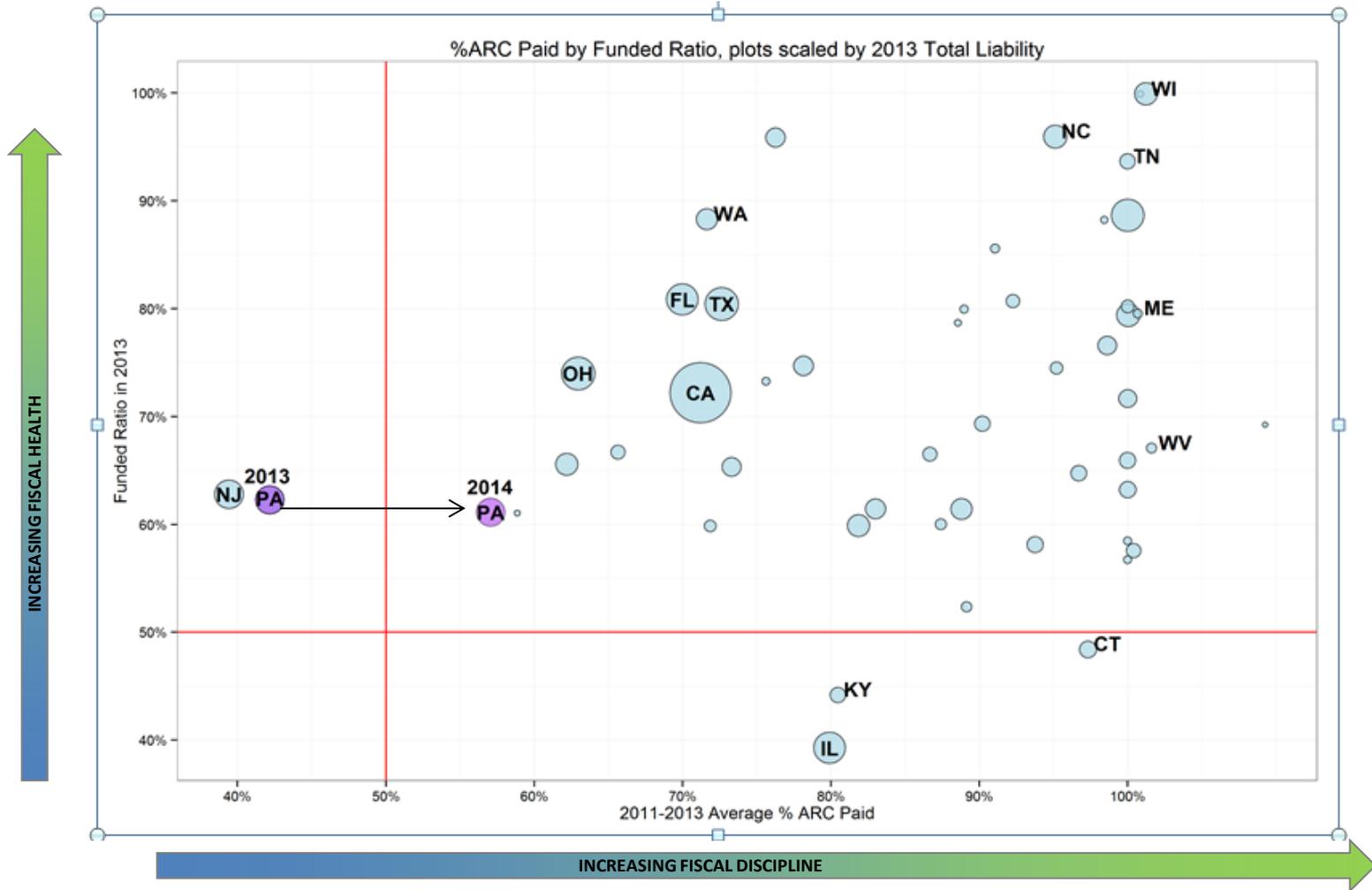
State and Local Pension Debt as a Share of Gross Domestic Product



Sources: *The Federal Reserve and U.S. Department of Commerce Bureau of Economic Analysis*

Pennsylvania is an outlier in pension underfunding

2013 data



Sources: State and pension plan CAFRs and pension plan actuarial valuations

Funding Policy

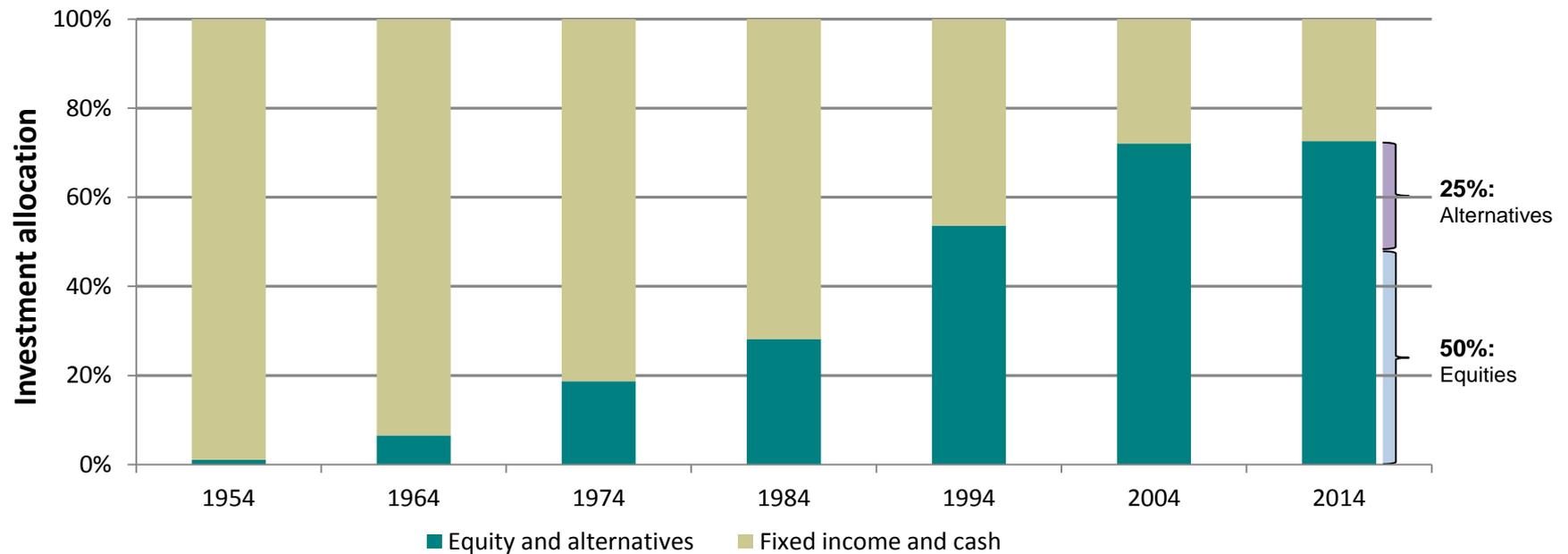
- New GASB Requirements
 - Net pension liability reported on the balance sheet
 - ARC no longer a required disclosure
 - Additional data (service cost)
 - Standardized actuarial requirements for disclosure
- Looking Forward
 - Unfunded liabilities are already accounted for but market value reporting make results more volatile
 - New metrics to measure contribution adequacy
 - Additional use of stress testing

Pension Investments & Governance

Investments – Key Trends: More in Stocks and Less in Bonds

Public Pension Investments, 1954-2014

Allocations to equities and alternative investments have increased, while those to fixed-income investments have declined

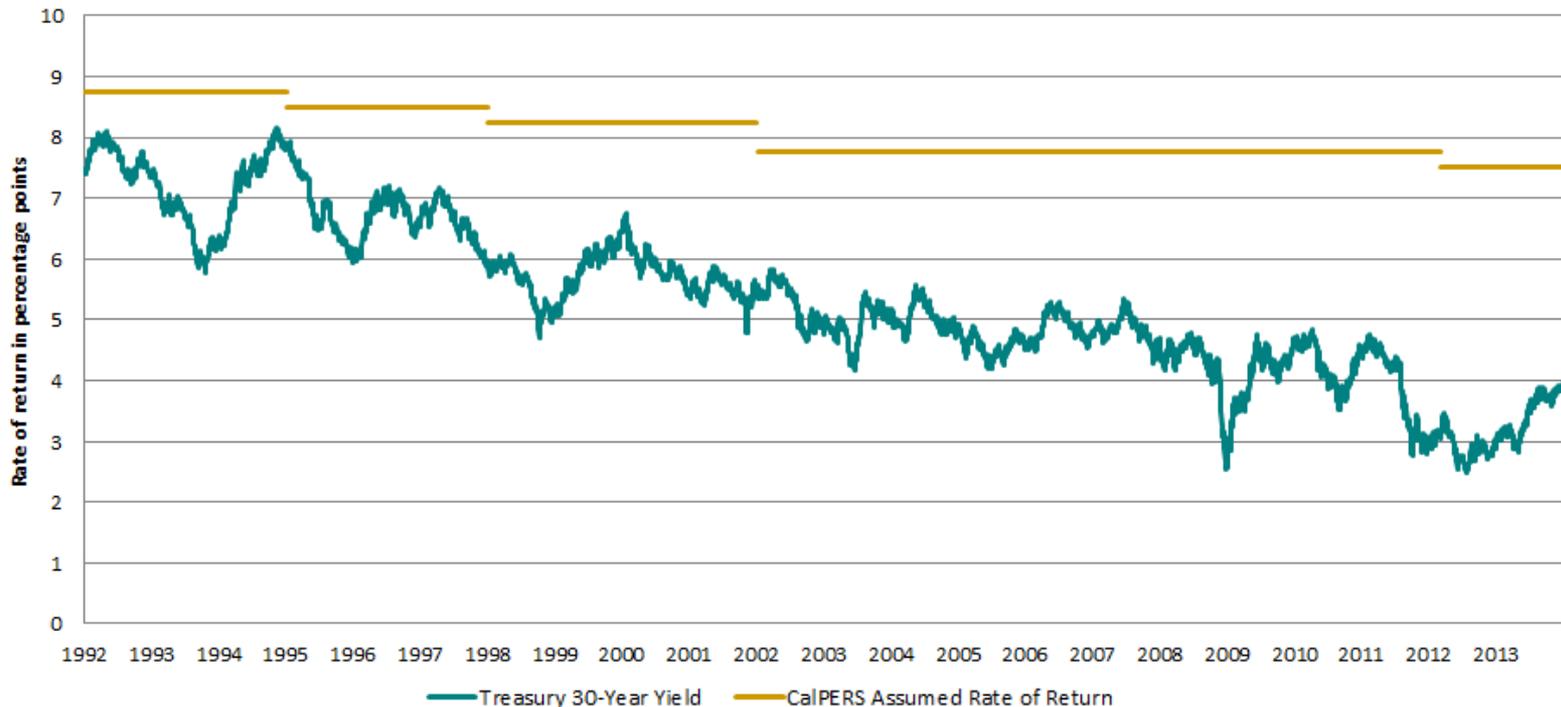


Source: U.S. Board Of Governors of the Federal Reserve System, *Financial Accounts of the United States, 1954 to 2014*; *Pew Analysis of State Financial Reports ©2014 The Pew Charitable Trusts*

Investments – Key Trends: Increased Risk Premium

CalPERS' Increasing Risk Premium

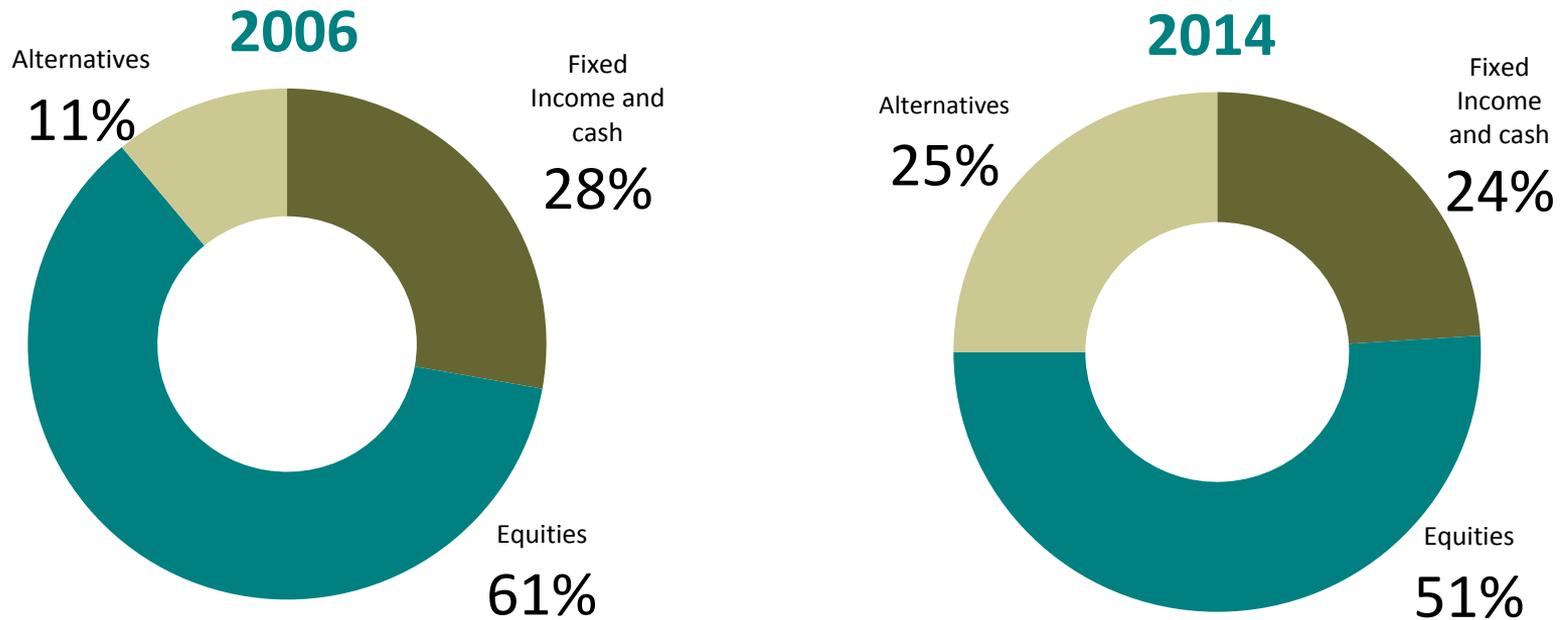
Plan's assumed rate of return remains relatively stable, while bond yields have declined



Source: Analysis by the Pew Charitable Trusts of U.S. Treasury data and CalPERS' Comprehensive Annual Financial Reports
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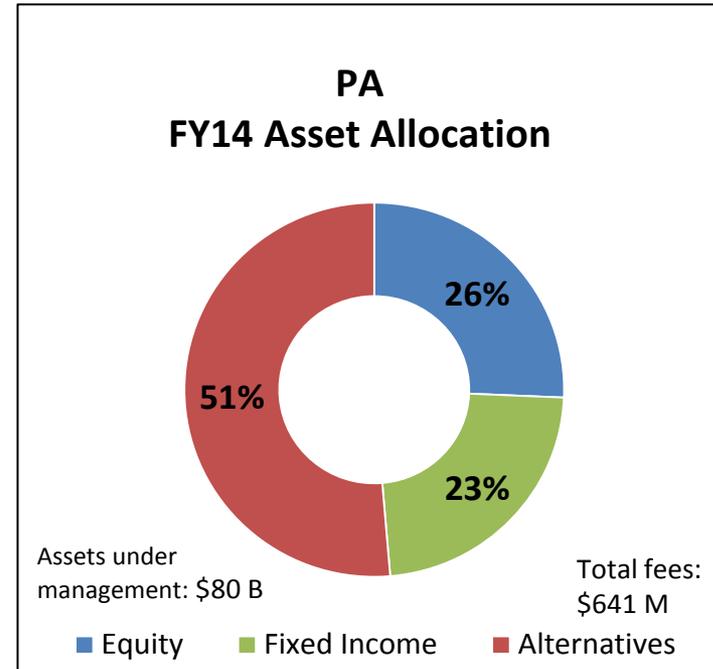
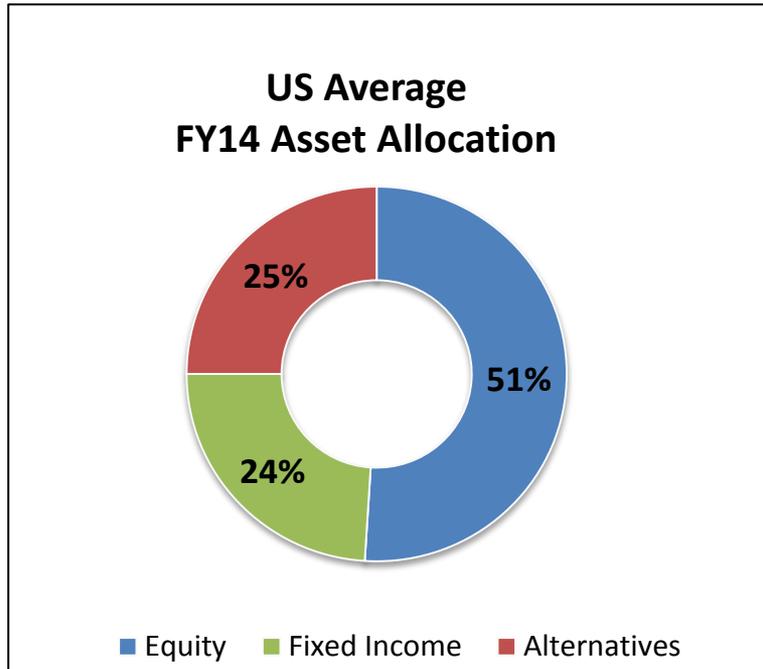
Investments – Key Trends: Increased Use of Alternatives

Public Pensions Include More Alternative Investments
Share of pension assets in alternatives has more than doubled



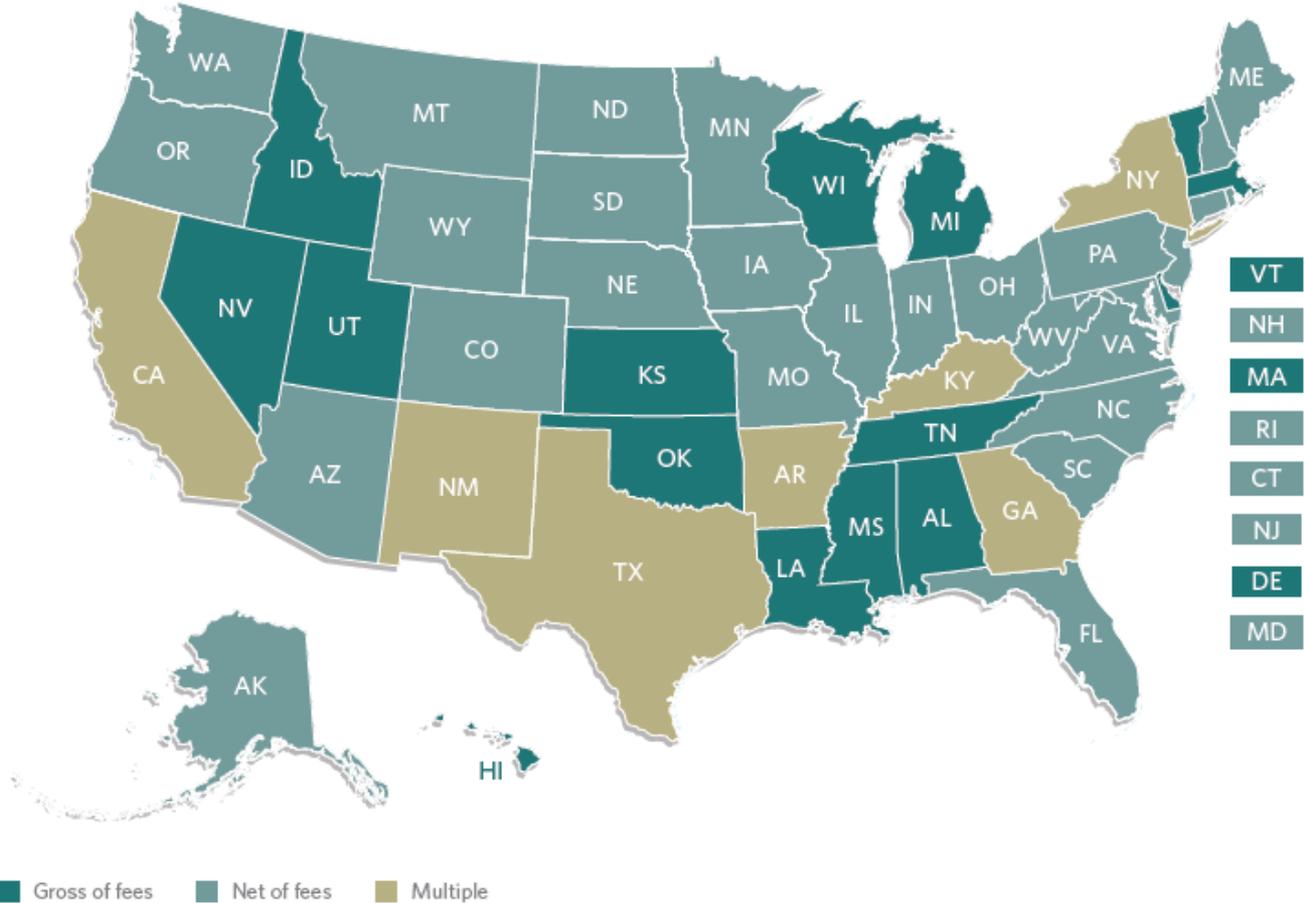
Source: Analysis by the Pew Charitable Trusts of State Comprehensive Annual Financial Reports, Public 100, and the Federal Reserve Financial Accounts of the United States
©2014 The Pew Charitable Trusts

Investment Management



- PA pays higher fees (80 bps) than most states due to its higher allocation to alternative investments
- Governor's proposal: transition to index fund approach (~\$200M annual savings), similar to approach implemented in Montgomery County
- SB 1071/1082: review commission to study investment approaches

Investments: Most States Report Performance After Fees



Notes: South Dakota discloses performance as both net and gross of fees. The states marked as having multiple reporting methods have two funds included in our 73 list that report performance differently from each other.

Sources: State Comprehensive Annual Financial Reports, 2013 and 2014; state treasury reports; quarterly investment reports; and state responses to data inquiries

Key Fiduciary Provisions of the Model Act (Uniform Management of Public Employee Retirement Systems Act)

Fiduciary Provision	States Adopting
Solely in the Interest of Participants	33
Exclusive Purpose of Providing Benefits	50
Prudent Investor Rule	49
Duty of Impartiality	17
Appropriate & Reasonable Expenses	31
Good Faith Interpretation of the Law	9
Diversification of Assets	39
Economically Targeted Investments only When Prudent	20

Note: Based on preliminary review of state statutes and constitutions.

Society of Actuaries Recommendations

From the Blue Ribbon Panel on Public Pension Plan Funding:

- Governance systems should encourage payment of recommended contributions and disclosure of a plan's financial information, and discourage use of funding instruments that increase risk or delay cash funding.
- Sufficient information and institutional structures to analyze risk, including guidelines on appropriate levels of risk for trustees.
- Access to appropriate education and training for trustees.
- Careful consideration of plan changes.

Policy/Reform Updates— National

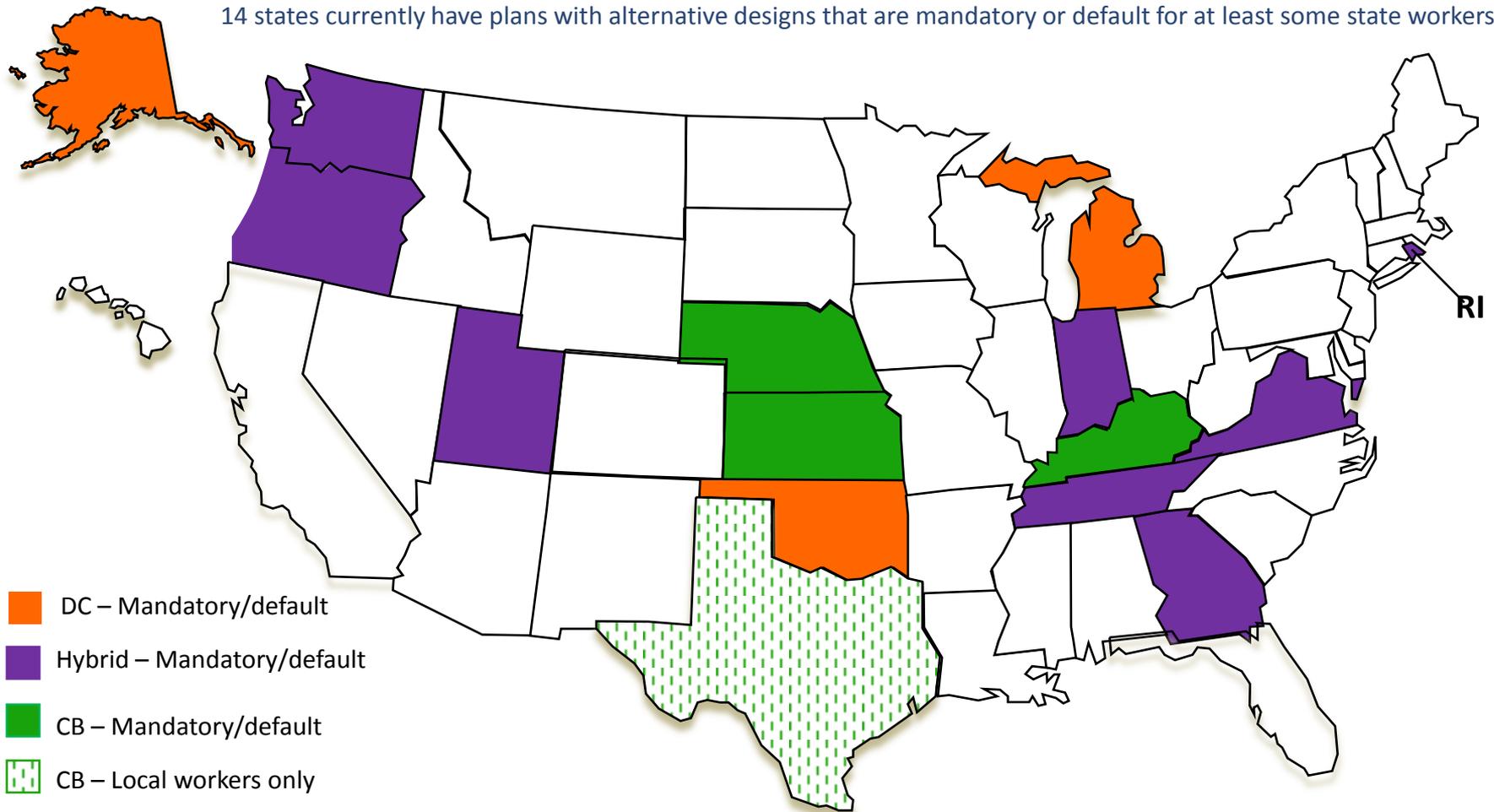
Summary of Recent Reforms in States

- 48 states have implemented some kind of reform between 2009 and 2015.
- Many reforms changed plan provisions for new workers, but kept the basic structure of the plan.
- A number of states passed reforms that affected current workers or retirees between 2009 and 2015:
 - 15 states reduced COLAs for retired employees.
 - 8 reduced COLAs for active employees only.
 - 36 states increased employee contributions for either current or new members (at least 24 increased contributions for current members).
- Between 2009 and 2015, 9 states passed reforms that changed the mandatory benefit design for new employees. Overall, 20 states have a mandatory or optional alternative benefit design.

Sources: National Council of State Legislatures, NASRA, The Pew Charitable Trusts

Wide Variety of Approaches in States

14 states currently have plans with alternative designs that are mandatory or default for at least some state workers.

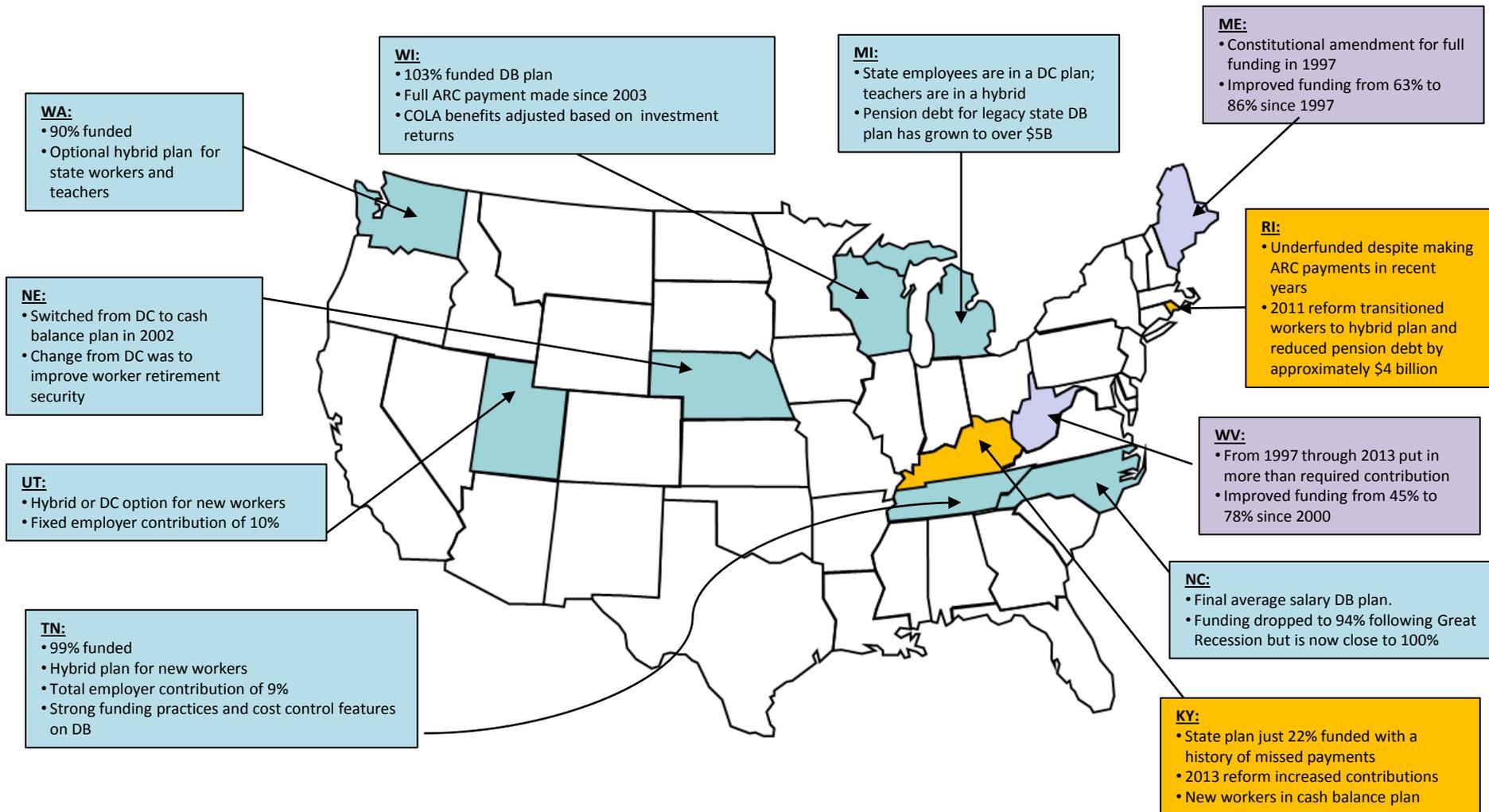


Notes:

- In addition, more detailed versions of this table from [NASRA](#) and NCSL make note of optional alternative states plans in the following states: Colorado (DC), Florida (DC), Montana (DC), North Dakota (DC), Ohio (DC and hybrid), and South Carolina (DC).
- In cases where a state has more than one alternative plan, the plan type with the greater number of participants is marked on the map. This includes Indiana where workers choose between a hybrid and DC plan, Michigan where state workers are in a DC plan and teachers are in a hybrid plan, and Utah where workers choose between a hybrid and DC plan
- Texas provides a cash balance plan to over 400,000 local workers through the state's Texas Municipal Retirement System and Texas County and District Retirement System.

Sources: NCSL, NASRA

Pension Promises in Other States – No One-Size-Fits-All



Municipal Reforms

		Reform Summary (For details, see Appendix)				
City	Challenge	Year of Reform Effort	Increase in Funding	Change to Employee Contributions	Change to COLA Benefits	Change to Benefit Structure
Atlanta, GA	\$1.5B in pension debt	2011	✓	✓		✓
Baltimore, MD	Employees' Retirement System had \$686M in pension debt	2014		✓		✓
Chicago, IL*	\$20B in pension debt	2014	✓	✓	✓	
Cincinnati, OH**	\$862M in pension debt	2014	✓		✓	
Jacksonville, FL	Police and Fire Fund had \$1.65B in pension debt	2015	✓	✓	✓	
Lexington, KY	Police and Fire Pension Fund had \$296M in pension debt	2013	✓	✓	✓	
Memphis, TN	\$551M in pension debt	2014				✓

*Chicago's reform only applied to the laborers and municipal employees retirement funds. In 2015, a lower court struck down the reforms. The city is appealing to the Illinois Supreme Court.

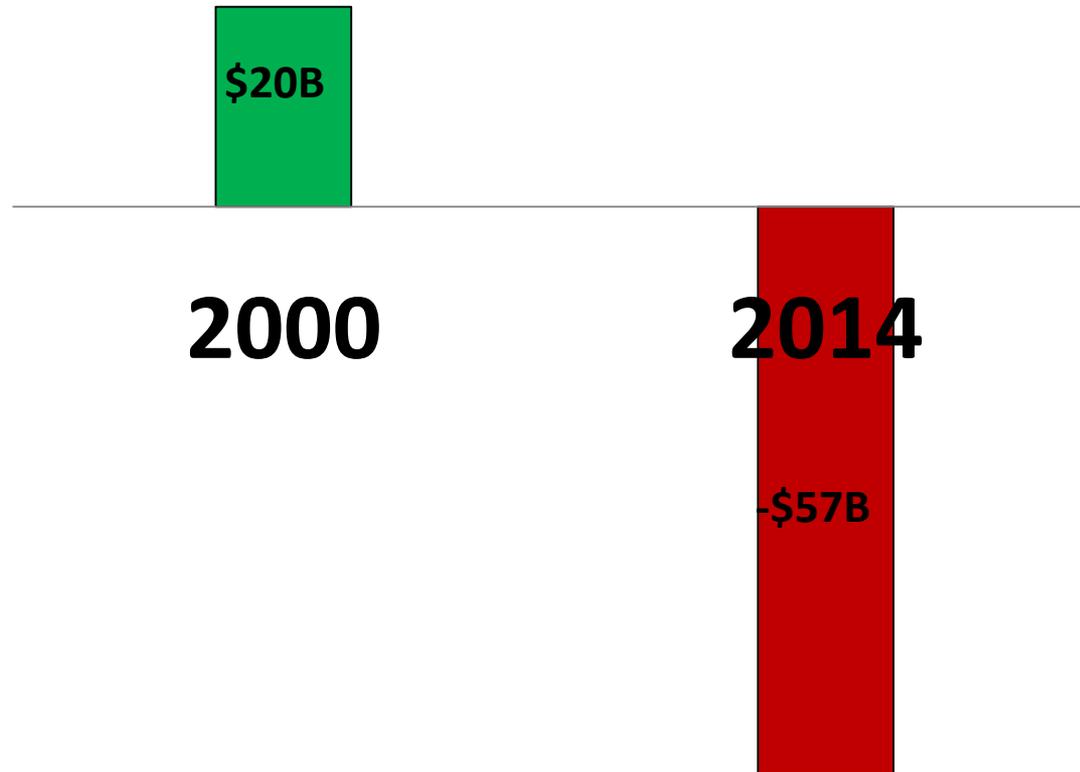
** The reform deal is pending approval from a federal judge.

Key Takeaways from Other States/Municipalities

- **Key design considerations:** Retirement Security; Recruitment and Retention; Cost; Cost Predictability
- **There are no panaceas:** Fiscal health and retirement security depend on funding policy and practices. Even well-funded states have taken steps to improve. Changes to plan design for new workers does not address current unfunded liabilities.
- **Increased attention to managing investment risk and fees:** CalPERS, Dallas Police and Fire, and Montgomery County, Pennsylvania
- **No one-size-fits-all approach on benefit design:**
 - DB plans with substantial employee risk-sharing (AZ, WI, IA)
 - Side-by-side hybrid with DB and DC components (GA, IN, MI, OR, RI, TN, UT, VA)
 - Cash balance plans for new employees (KS, KY, NE)
 - DC plans (AK, MI, OK)
 - Recent / Current examples in cities: Atlanta, Jacksonville, Memphis

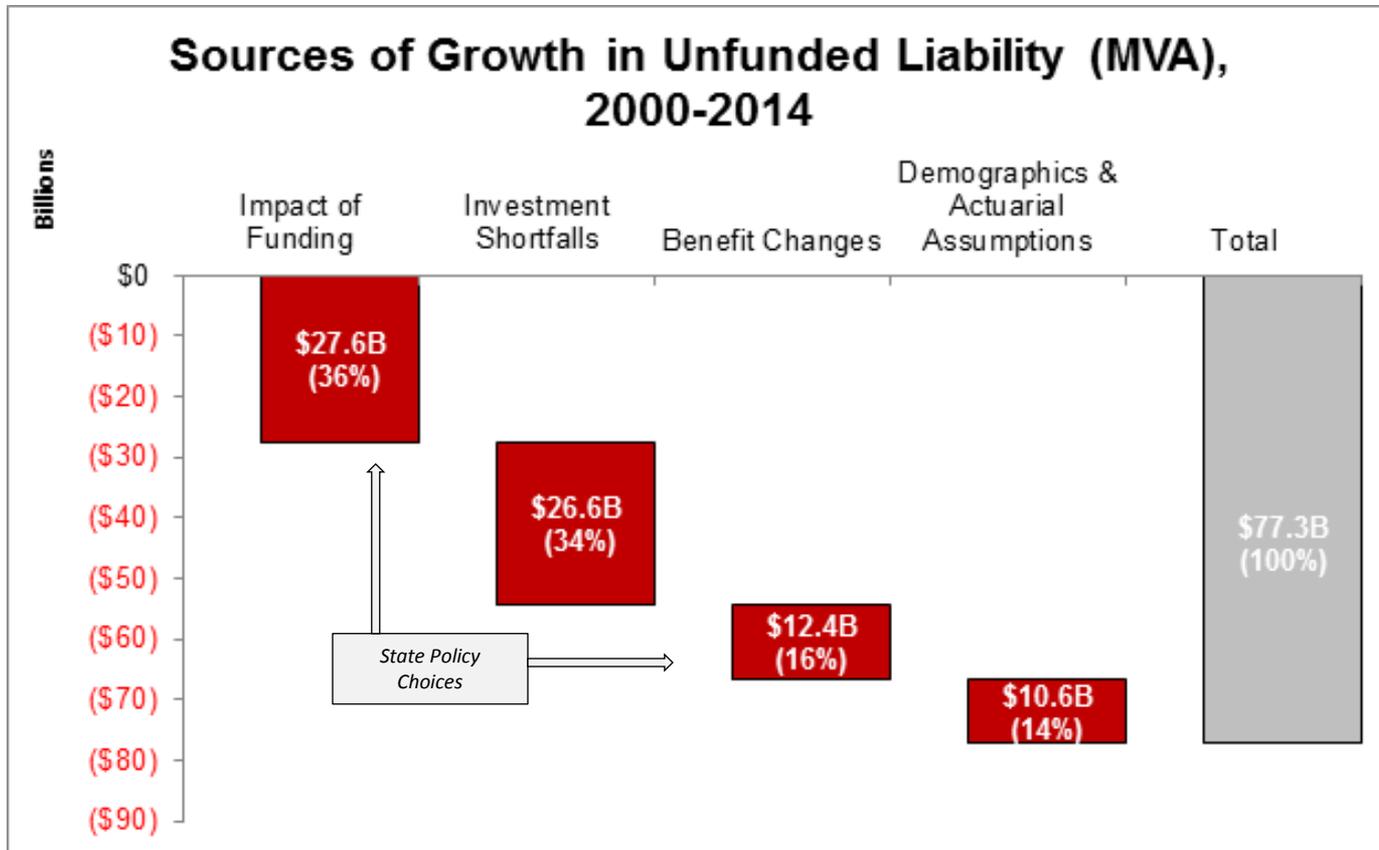
Policy/Reform Updates— Pennsylvania

PA Pensions: A \$77B Swing in 14 years



Sources: SERS and PSERS actuarial valuations and CAFRs.

Causes of the Growth in Unfunded Liability

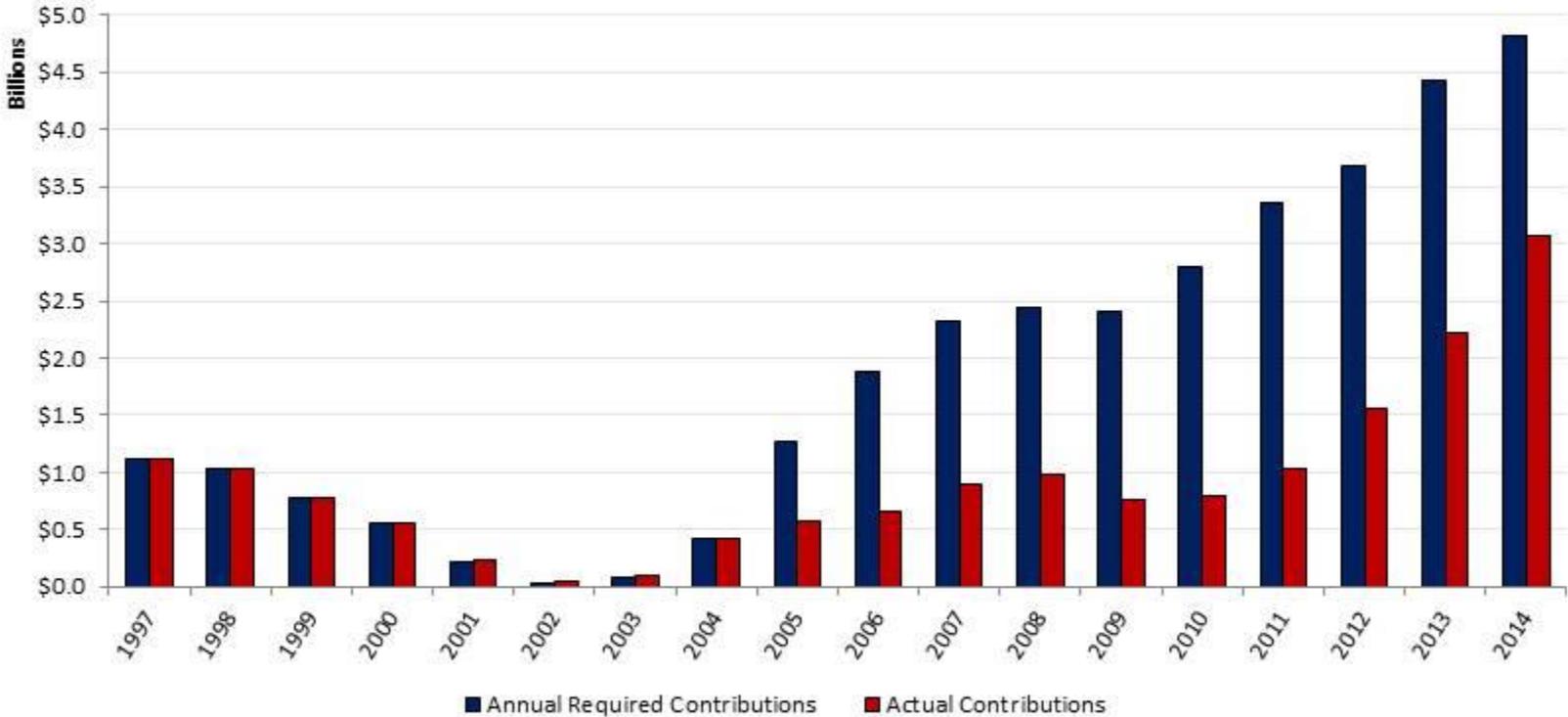


*Values calculated using market value of assets. State contribution shortfalls reflect ARC underfunding and negative amortization. Benefit changes reflect the change in the liability at the time the benefit changes were implemented; cumulative impact as of 2013 reporting is substantially higher.

Sources: Primary data from plan CAFRs and actuarial valuations; analysis provided by the Terry Group

PA's State Contribution Shortfalls

Annual Required Contributions vs. Actual Contributions



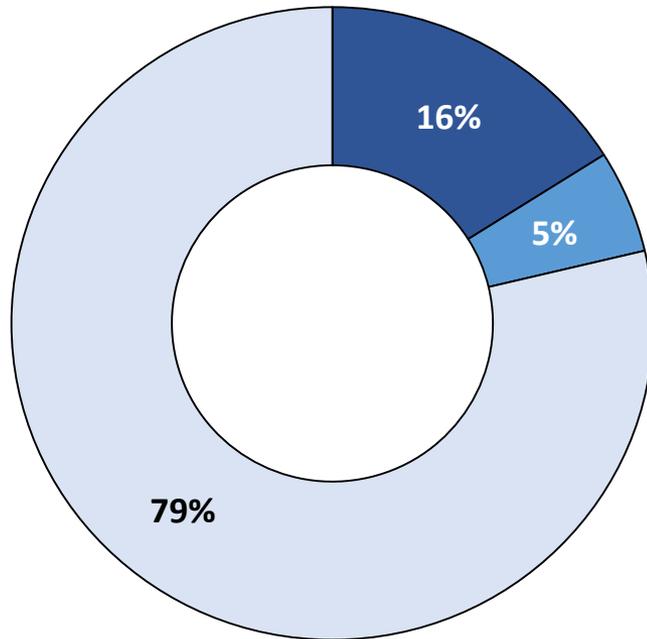
Sources: State and pension plan CAFRs and pension plan actuarial valuations (SERS and PSERS)
 Note: *The FY2015 PSERS employer contribution was \$2,596,731,000 (69% of full ARC); SERS actuarial data is not yet available for FY2015.

Funding Policy

- Meeting Minimum Actuarial Contribution Standards
 - Over half of states continue to fall short
 - Several states recently committed to full actuarial required contribution (ARC) (CT, CA, KY)
 - Other states began making full ARC payments in the '90s and have seen funding levels improve (ME, WV)
- Calculating the ARC
 - ARC doesn't always signal true fiscal health
 - Common approach often fails to pay down debt and allows unfunded liabilities to grow:
 - 30-year
 - Open amortization
 - Back-loaded contribution policy
 - The Society of Actuaries and rating agencies have noted ARC limitations
 - Alabama and Arizona recently strengthened contribution policies
- Assessing Contribution Policy Going Forward
 - New GASB reporting standards will eliminate the ARC as a required disclosure while providing additional data points that give a better perspective on changes to assets and liabilities
 - Opportunity to look at new measures of contribution policy

Projected Costs – Under Act 120

SERS & PSERS (FY16 to FY35)



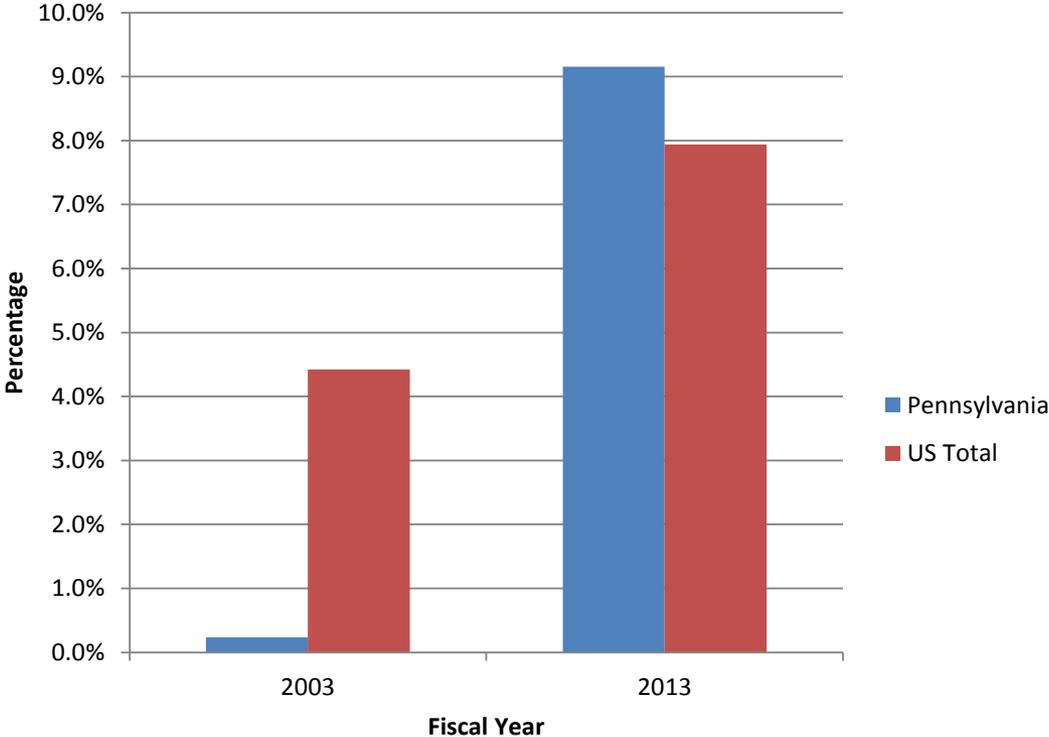
- Current Employee Normal Cost
- Future Employee Normal Cost
- Amortization of Unfunded Liability

- Costs for New Workers are only 5% of Total Costs over 20 Years
- Benefit changes for new workers will not address the unfunded liability

Pension Cost Growth as Share of Budget Outpaces National Rate

PA's Annual pension costs grew from 0.2% to 9.2% from 2003 to 2013

State Pension Costs as a Share of Revenue



Source: Pew Charitable Trusts analysis of SERS' and PSERS' Annual Comprehensive Financial Reports and the US Census Bureau

Pension Contributions Have Grown for PA School Districts

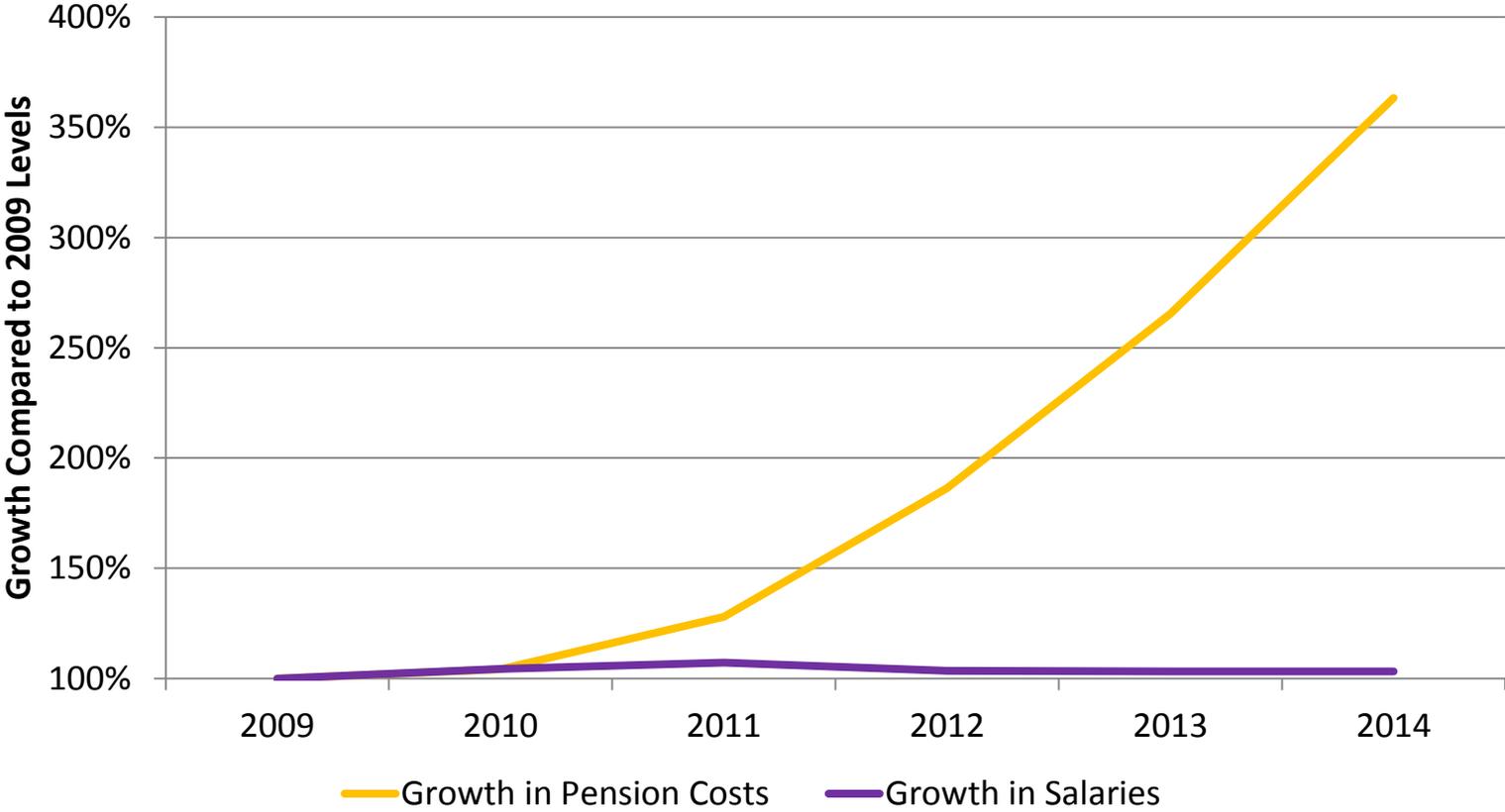
Annual teacher pension contributions were nearly \$2B in 2014, a more than \$1.4B jump from 2009



Based on Annual Financial Reports submitted by school districts to the PA Dept. of Education

Pension Costs Have Outpaced Salaries

School district spending on salaries was 2% greater in 2014 compared to 2009. Pension spending in 2014 was 360% greater than 2009 pension spending.



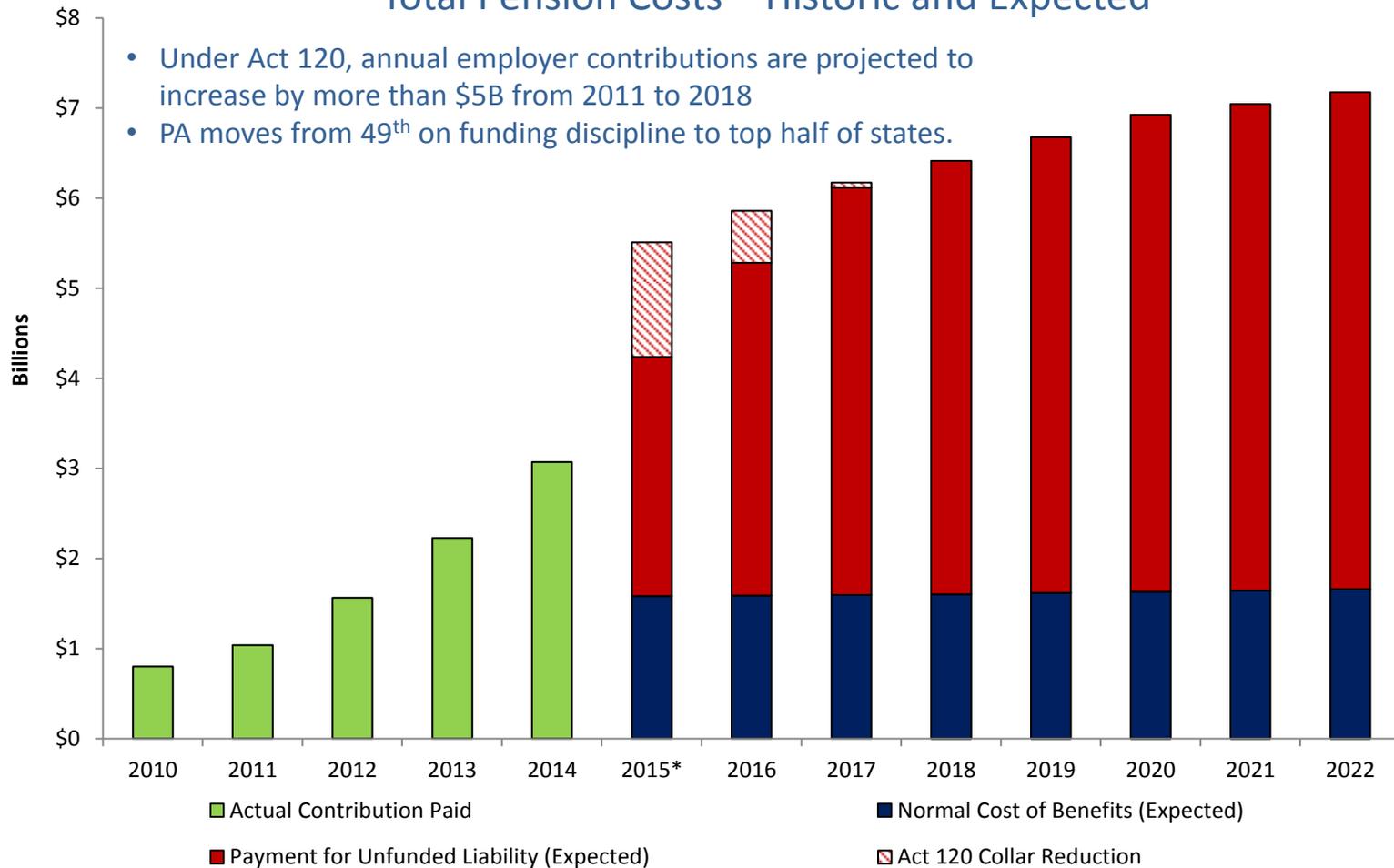
Based on Annual Financial Reports submitted by school districts to the PA Dept. of Education

Pension Reform Passed in 2010 (Act 120)

- **Set new “ramp up” funding schedule**
 - Full actuarial required payments in 2018
 - Despite budget challenges, state has continued pension payment ramp up, which positions PA as most dramatic turnaround in state pension funding
- **Benefit Changes**
 - Reversed benefit increases of 2001/2002 for new employees
- **Established a modest cost-sharing mechanism**
 - If investments underperform, employee contributions will increase

Act 120 Funding Plan

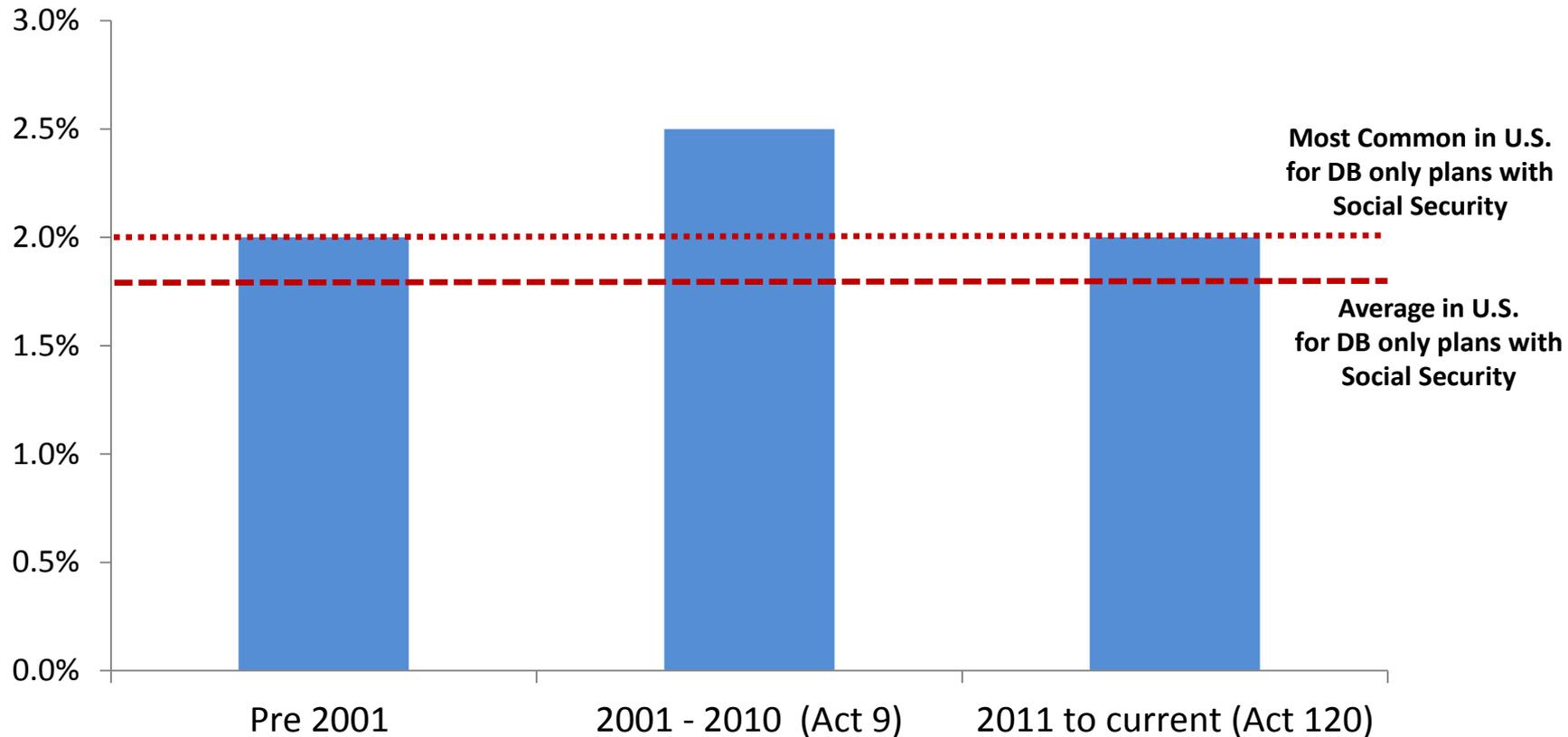
Total Pension Costs – Historic and Expected



* The FY2015 PSERS employer contribution was \$2,596,731,000 (69% of full ARC); SERS actuarial data is not yet available for FY2015.
Sources: Analysis by The Pew Charitable Trusts and The Terry Group based on data from SERS and PSERS actuarial valuations and CAFRs

PA's current (post 2010 reform) DB benefit is above average

History of Pennsylvania's DB Benefit Multiplier



The U.S. Average and Most Common figures apply to state and teacher plans that accepted new employees on or after 2000 and where members also receive Social Security.

Summary of Recent Benefit Reform Proposals in PA

Bill No.	Session	Sponsors	Benefit Design for New Workers
HB 1499	2015-16	Rep. Tobash	Stacked Hybrid (DB/DC)
HB 1353 (A06917)	2013-14		
SB 1071/1082	2015-16	Sen. Browne	Side-by-side Hybrid (DB/DC)
SB 1	2015-16	Sen. Corman	Cash Balance/DC Hybrid
HB 727	2015-16	Rep. Kampf/Sen. Brubaker	Defined Contribution
SB 922/HB 1350	2013-14		
HB 1353 (A07223, A09253)	2013-14	Rep. Grell	Cash Balance
SB 1185/ HB 2135	2009-10	Sen. Yaw/ Rep. Grell	Side-by-Side Hybrid (DB/DC)

Note: in 2015, the Governor proposed a stacked hybrid (DB/DC) plan with a salary cap of \$100,000.

PA Municipal Pensions

- Unique circumstances in Philadelphia, Pittsburgh, and Scranton compared to other cities in state (over 3,000 municipal plans in PA)
- Effective consolidation could include administration, investments, funding policy, benefit design, and/or reporting requirements (Governor's task force, Auditor General reports)
- Consolidation would not solve large underfunding problem; analysis needed
- Options related to Pennsylvania Municipal Retirement System