



Public Pension Challenges

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Public Pension Challenges

- ◆ A former Governor of Illinois summarized the situation succinctly when he stated “Unless we reform the way we fund our pensions...we will never eliminate the structural deficit that takes money away from education, from health care, from law enforcement, from parks and from everything we care about.”
- ◆ The bottom line is some public pension plans are in good actuarial condition; but too many are not and for those entities with significantly underfunded plans, something needs to be done to correct the problem and soon—it will not fix itself and you cannot invest your way out of the problem.



Framing the Issue

Retirement Environment Today

- ◆ The pension funding crisis continues to put stress on government budgets and will likely continue to worsen without action
- ◆ Funding of Postemployment Benefits Other Than Pensions (OPEB) creates even more budgetary stress
- ◆ The U.S. Economy is slowly struggling to improve
- ◆ Continued investment market fluctuations and volatility create uncertainty
- ◆ A shift in benefit philosophy has occurred: empowerment is in and paternalism is out



Framing the Issue

Retirement Environment Today

- ◆ The ability of Baby Boomers to afford to retire (or not and be forced to continue working) creates even more uncertainty
- ◆ Awareness by members, rating agencies, press, tax payers, etc. of worsening public pension problem is increasing
- ◆ GASB Exposure Draft creation of separate accounting and funding “numbers” may cause additional confusion about the “real” costs and funded status of a public pension plan



Framing the Issue

How and Why Did the Pension Problem Develop?

- ◆ Lack of prefunding requirements
- ◆ Investment market downturns of 2001-2002 and 2008-2009
- ◆ Benefit expansions
- ◆ Smaller employee contribution share
- ◆ Aging workforce
- ◆ Real Level of Costs Masked by 1990s Stock Market Boom
- ◆ Attraction/necessity of reducing pension contributions in order to free resources to spend towards other priorities
- ◆ “It won’t be my problem after I am out of office” mentality
- ◆ Difficulty of modifying retirement plans



Framing the Issue

Challenges

◆ Ability to Pay

- Is the projected growth in pension funding requirements affordable in the near term as well as in future years?
- Will the projected growth in pension funding requirements crowd out opportunities for the Municipality to invest in education, economic development, and health care.
- Is the current level of pension benefit sustainable in the future?

◆ Financial Rating

- Are/could unfunded pension liabilities create an issue with rating agencies?
- What impact does GASB 45 unfunded accrued liability for employees and retirees participating in Municipality sponsored, post-retirement benefit create?
- Is the governance of any of the retirement programs being questioned?



Framing the Issue

Challenges

- ◆ Competitiveness and Reasonability
 - How do benefit levels and features compare to other public and private plans?
 - Are you aware of design features that present plan participants and/or employers with the opportunity to manipulate the ultimate benefit level? (or “game” the system?)
 - Do current benefit levels allow members to retire at, above or below their pre-retirement standard of living?



What are Other Municipalities Doing?

Roadmap For Improvement

LONGER TERM REFORMS

- Restructure Basic Benefit
- Change Ancillary Plan Provisions
- Change Investment Policy
- Issue Pension Obligation Bonds
- Find Alternative Funding Sources
- Increase Employee Contributions
- Change Funding Policy
- Reduce Administrative Costs
- Change Assumptions and Methods
- Close Loopholes

SHORT TERM FIXES



What are Other Municipalities Doing?

Close Loopholes

◆ Examples

- Limit definition of what's included in pensionable compensation
- Limit eligibility for “special risk” or public safety benefits
- Limit eligibility for “special benefits”
- Limit purchases of additional service credits
- Tighten opportunities for employees to spike final earnings amounts
 - Eliminate consideration of large compensation increases in the last years prior to retirement
 - Tighten overly generous sick leave policies



What are Other Municipalities Doing?

Reduce Benefits for New Hires (2-Tier System)

◆ Examples:

- Reduce the basic benefit multiplier
- Revise unreduced early retirement eligibility and reduce subsidy
- Limit the definition of pensionable compensation
- Change definition of “final average compensation”
- Change COLA
- Eliminate special grandfather or minimum benefit formulas

What are Other Municipalities Doing?

Increase Employee Contributions

- ◆ Shift contributions to employees (ultimate plan cost doesn't change, but employer's share is reduced)
 - Eliminate any employer "pick-up"
 - Subject to collective bargaining for union employees?
 - Could be difference between loss of jobs or higher employee contributions
 - One way is to link employee contributions to total plan costs—i.e., as total plan costs increase so do employee contributions

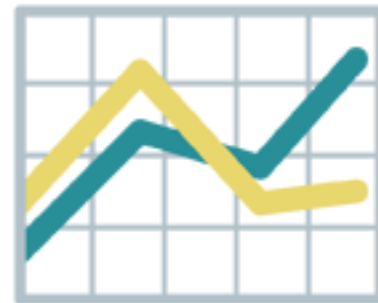




What are Other Municipalities Doing?

Change Funding Policy

- ◆ Review funding goal
 - Is current annual contribution policy consistent with and sufficiently related to actuarial needs of plans?
 - Are projected plan contributions affordable today and in future years?
 - Does plan need to be 100% funded or is a lesser funded percentage (90%) fiscally appropriate
 - When (how fast) should plan meet funding goals?



What are Other Municipalities Doing?

Find New Revenue Sources

- ◆ Identify untapped revenue sources which could be used to fund pension obligations
 - Proceeds from license sales
 - Sale of unused property
 - Sale of public toll roads
 - Sale of lotteries, etc.
 - Other



What are Other Municipalities Doing?

Issue Pension Obligation Bonds

- ◆ Consider Pension Obligation Bonds
 - Issue at low interest rates and reinvest bond proceeds into higher-yielding financial investments
 - Timing and amount of debt service versus recognition of bond proceeds





What are Other Municipalities Doing?

Defer Costs by Changing Actuarial Assumptions/Methods

- ◆ Actuarial funding method
 - ▶ Consider more aggressive “projected unit credit” method*
- ◆ Actuarial assumptions
 - ▶ Interest rate
 - ▶ Salary scale
 - ▶ Demographic assumptions (mortality, turnover, retirement and disability)
- ◆ Asset valuation method
 - ▶ Market value versus smoothed value of assets*

**Questionable if GASB Exposure Draft is adopted*



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