Protect Workers and Taxpayers by Improving State & Local Retirement Policy

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Retirement benefits are an important and valued part of public workers' total compensation package.

Helping all those who work hard and play by the rules reach a secure retirement is a worthwhile policy goal.

However, governments have failed to responsibly manage their retirement systems.

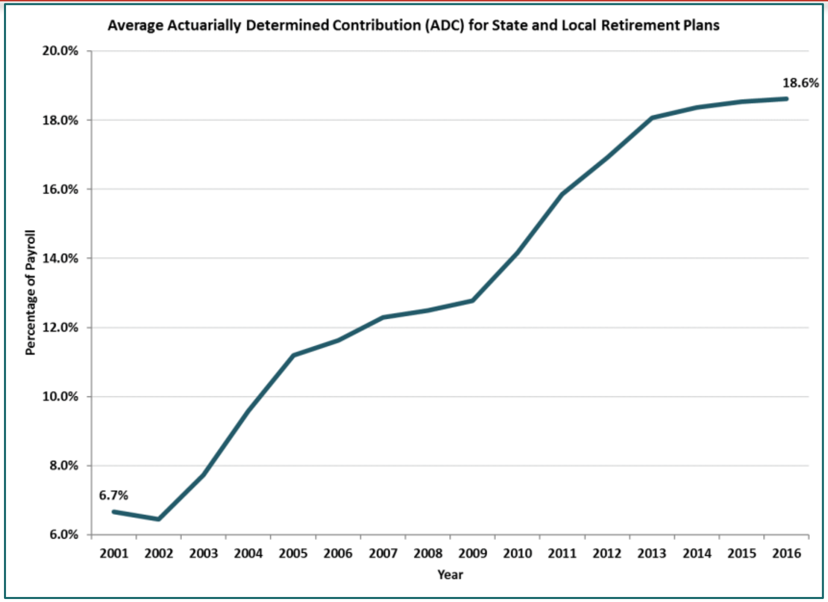
Budgets are strained. Public services are suffering. Workers have endured benefit cuts, wage freezes, and job reductions.

By taking steps to address the issue today, we can prevent a crisis tomorrow.

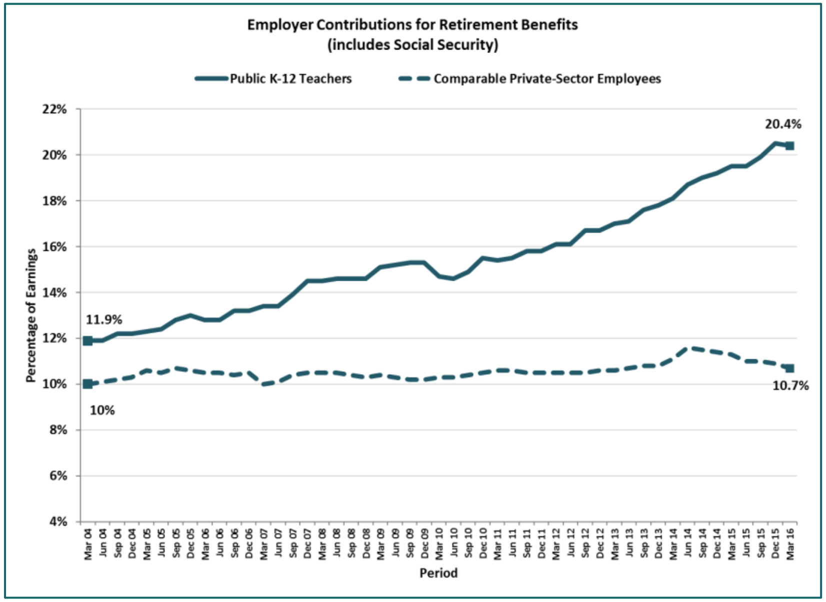
What is the current situation?

Rising retirement costs are making it difficult to adequately fund essential public services.

Retirement contributions have nearly tripled, primarily for benefits workers have already earned, which leaves less money for public workers and services.



This is especially true for public schools, where rising retirement costs are limiting the funds for today's classrooms and teachers' salaries.



Public leaders are voicing their concerns about the effects of rising retirement costs.

"… we coped with those rising {pension} costs by reducing our workforce … we cut services in every part of the city. There's no department that escaped the cuts ... we laid off firefighters, we laid off cops, we laid off librarians. We cut, cut, cut for a decade…"
-San Jose Mayor Chuck Reed

"We are not yet at the point where we are making decisions about {whether} we are going to pay for pensions or plow roads, but it is very close to that."
-Syracuse Mayor Stephanie Miner

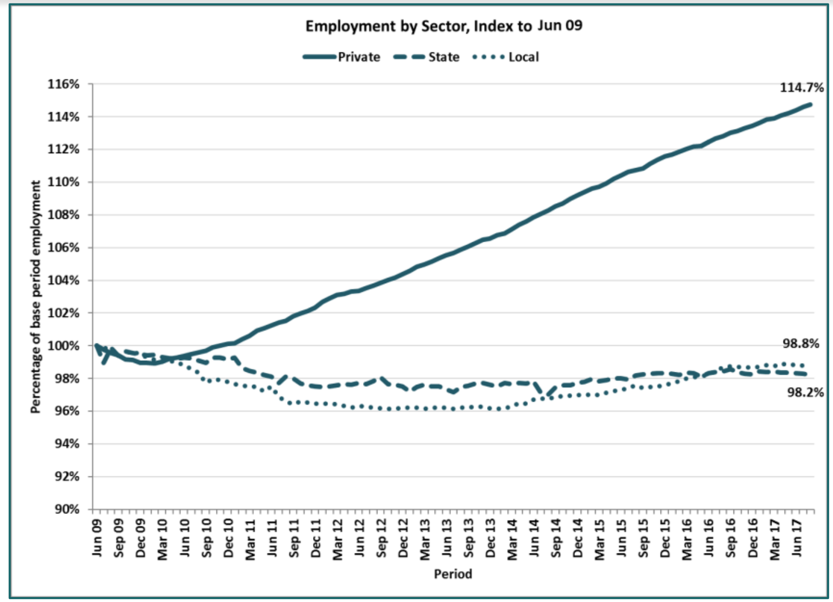
"Without {pension} reform, we cannot make the critical investments in our future and the future of our children. Without reform, we cannot be the city that we want to be."
-Chicago Mayor Rahm Emanuel

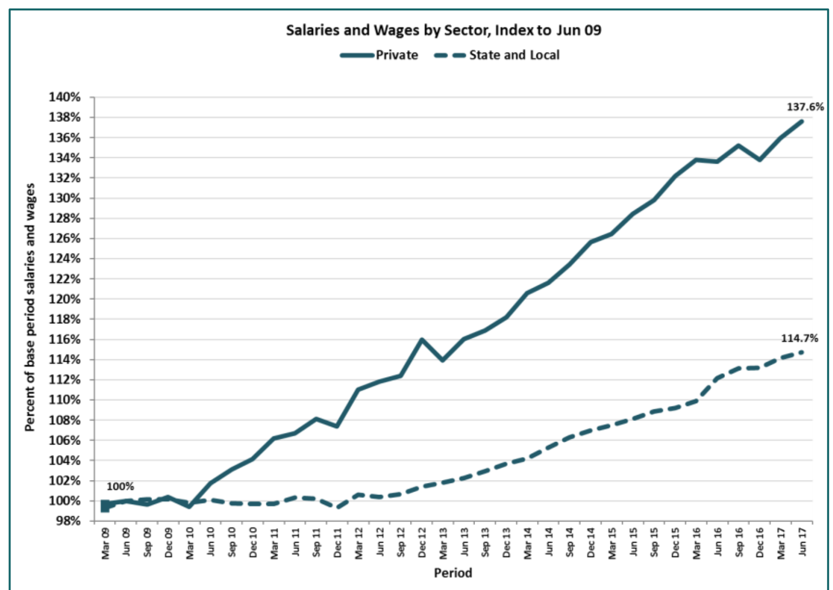
When public retirement systems are underfunded, workers pay the price.

Governments are paying more for legacy costs, leaving less money for current and future workers.

While private sector wages and jobs are growing, there are fewer teachers, police officers, firefighters, and other public workers in our communities today. And those that are on the job often have not received a pay raise in many years and have seen benefits reduced.

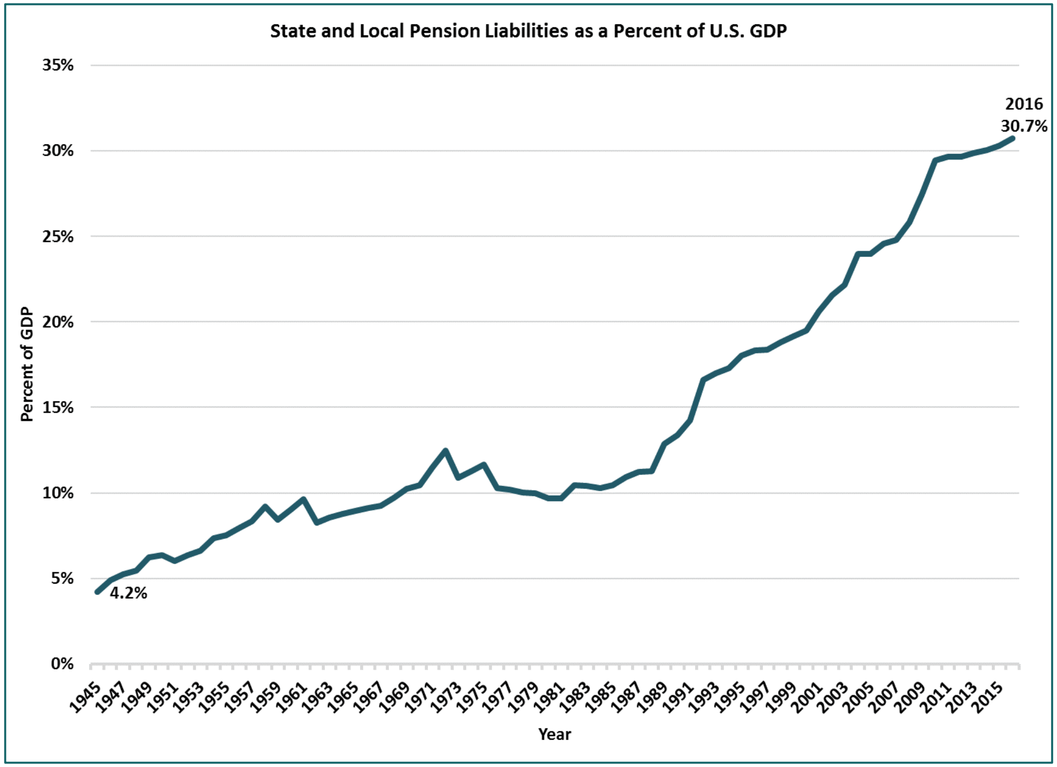
These trends are at least partially explained by the downward pressure created by rising retirement costs.





What does this mean for the future?

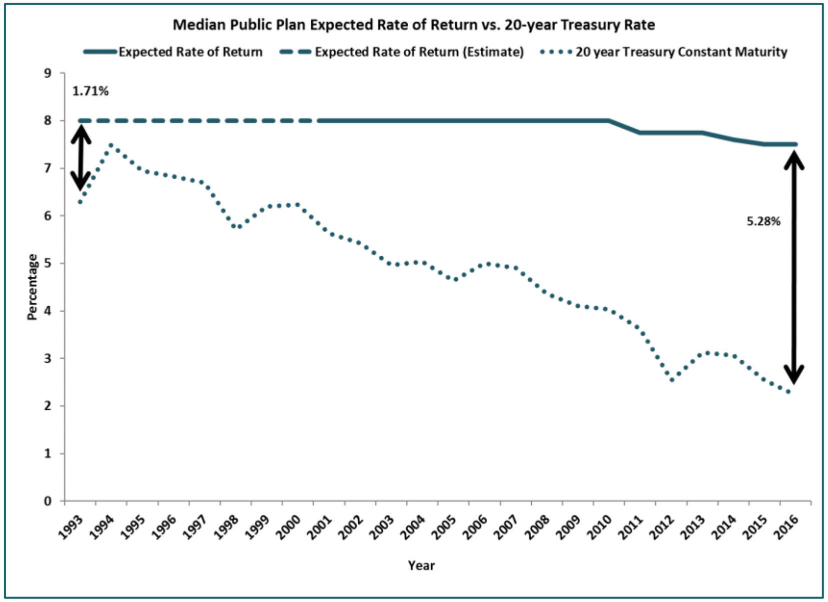
Government pension promises are now 30.7 percent of U.S. GDP.



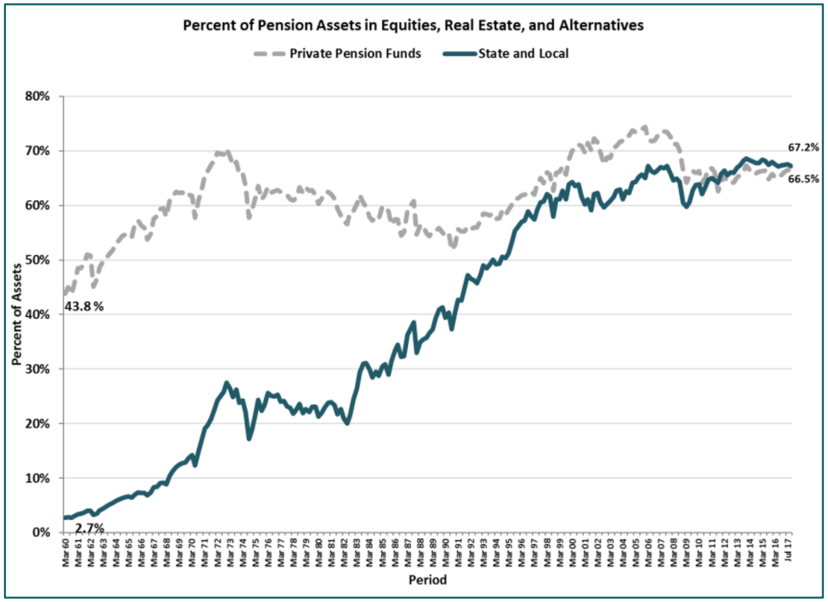
Public retirement promises are larger relative to the size of our economy than in previous years, resulting in a reduced ability to pay for downside risk. So minor investment return shortfalls can translate into serious budgetary pressure.

Governments are making riskier bets with workers' retirement savings.

Public plans are expecting markets to yield a return that is three times larger than it was in the early 1990s relative to risk-free rates.

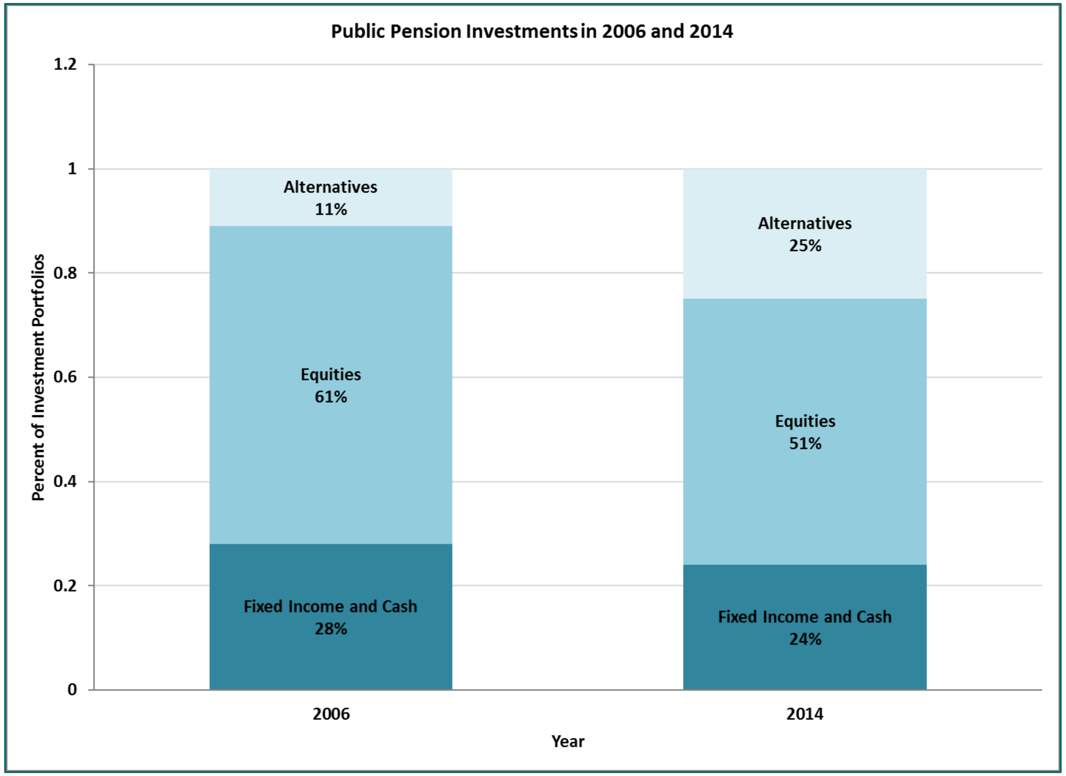


To achieve this return, plans are investing in riskier assets. The share of assets invested in equities, real estate, and alternatives is close to the all-time high.



Since 2006, public retirement plans have more than doubled the share of assets invested in alternatives.

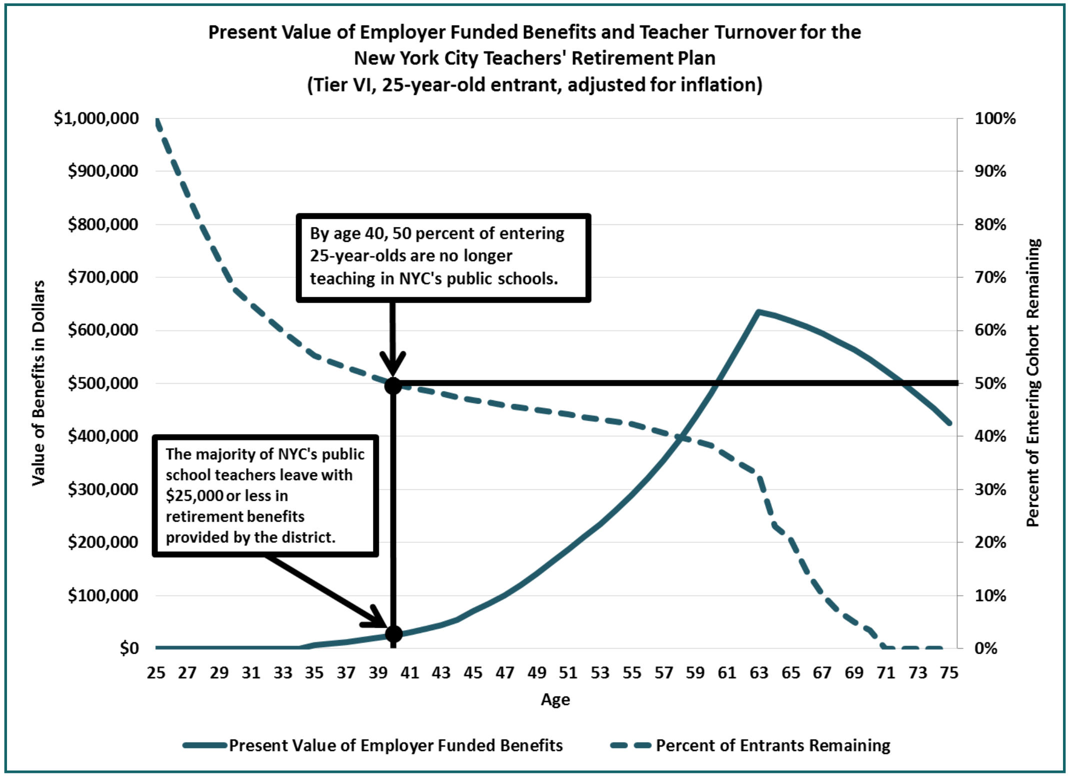
Alternatives, like hedge funds and private equity, are hard to value, have uncertain returns, and have higher fees. As plans have increased their holdings of risky assets, money management fees have increased by more than 30 percent.



Is the structure of retirement benefits a problem?

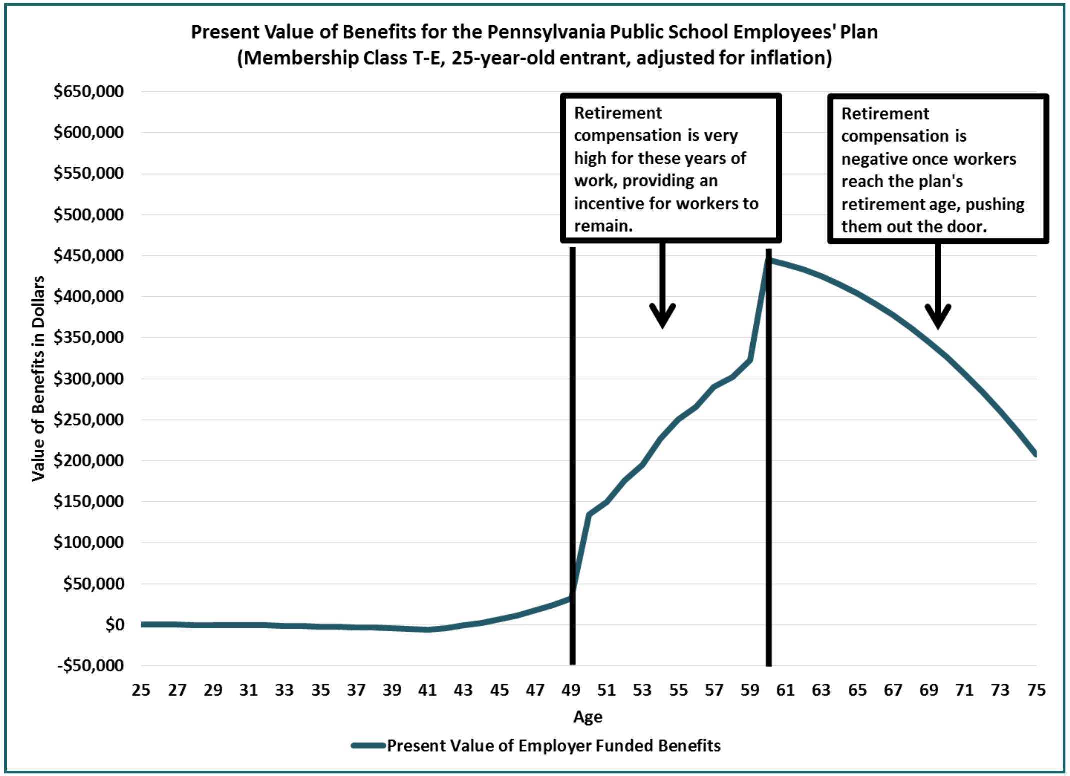
Under many plans, the majority of workers leave before earning a substantial benefit.

FAS DB plans leave many workers without enough savings for a secure retirement: those who work less than a full career in the public sector, take time off for family, or move to another city or state.



FAS DB plans pull workers into a plan's retirement age and push them out thereafter.

The FAS DB structure gives workers the incentive to work only until the plan's retirement age and then to retire regardless of their desire to keep working or performance.



FAS DB plans are challenging to manage sustainably because they are very complex, and cost is uncertain, hard to predict, and difficult to understand.

Given that benefits will be paid in the distant future, FAS DB plans give politicians the opportunity and incentive to avoid making responsible payments.

What should pension reform seek to accomplish?

Governments can take the following steps to address their pension problems:

1. Formulate a plan and commit to paying down the current pension debt as quickly as possible;
2. Establish responsible funding and investment practices; and
3. Adopt plans that protect public servants and are simpler and easier to manage.

A responsible plan to pay down a government's current pension debt will:

- Use a forward looking discount rate to set funding;
- Pay off the debt in 30 years or fewer (closed period, preferably level $); and
- Include no negative amortization.

Responsible funding and investment practices include:

- Funding plans consistent with the recommendations of the Society of Actuaries Blue Ribbon Panel on Pension Funding including:
  - Forward looking discount rates
  - Layered, closed amortization of 20 years or fewer
- Detailed investment policy that includes a full discussion of investment allocation, risk, and expected return
- Full transparency on investment return and fee history
- Stress testing

FAS DB plans often fail to support all workers, are very complex and hard to manage, and provide the opportunity and incentive to underfund benefit promises.

Adopting simpler, easier to manage plans will better support all workers, make retirement funding more responsive to changing economic and demographic conditions, and improve accountability.

All plan designs can incorporate important protections for workers including:

- Adequate savings/benefit accrual rates.
- Pooled, professionally managed, low-fee, and appropriately allocated investments.
- Limited lump sums and annuities upon retirement.

State-Level Reforms

- Adopt Texas State Pension Review Board model
- Allow cities to negotiate benefits and manage plans locally
- Set limits on costly benefit elements such as Cost of Living Adjustments (COLAs) and Deferred Retirement Option Programs (DROPs)
- Set non-negotiable minimum funding requirements

Reporting Improvements

- Market Liabilities
- Include discussion of future cost and cost uncertainty:
  - Cash Flows
  - Require projections of future financial condition and cost under multiple scenarios (stress testing)
- More detailed information on investments
  - Investment returns and fees by asset class
  - Detailed fee and performance information on all alternative investments

By taking steps to address the issue today, we can prevent a crisis tomorrow.

Everyone—workers, taxpayers, and governments—must work together to arrive at a solution.