Panel: State of Public Pensions and Its Impact on Collective Bargaining

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Available at: http://thekeep.eiu.edu/jcba/vol0/iss11/58

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State of Public Pensions and Its Impact on Collective Bargaining

43rd Annual Conference
National Collective Bargaining Center
April 5, 2016

Diane Oakley
Executive Director
Retirement Benefits Important Component of Compensation

Figure 24: Retirement Benefits are Significantly More Important to Public Workers as Compared to Private Sector Workers

When making job decisions, how important are the following job features to you?

- Salary Extremely or Very Important
- Retirement Benefits Extremely or Very Important

<table>
<thead>
<tr>
<th>Public Sector Employees</th>
<th>Private Sector Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>57</td>
<td>65</td>
</tr>
<tr>
<td>88</td>
<td>82</td>
</tr>
</tbody>
</table>
Financing of Public Pension Plans, 1993-2012

Sources of pension fund receipts.

- 12.3% Employee
- 24.5% Employers
- 64.2% Investments

How Are Contributions Public to Defined Benefit Determined?

• The Annual Required Contribution (ARC) is determined by actuarial analysis and consists of:

\[
\text{Normal Cost} + \text{Payments on any Unfunded Liability} = \text{ARC}
\]

• Key Factors: Investment Return Assumption, Amortizations Period and Method, Actuarial Cost Method.
What are Funding Gaps? Where do they Come From?

1. Contributions into the plan are not adequate to cover promised benefits

2. Sharp downturns in financial markets
Lessons from Well-Funded Public Pensions: Key Findings

1. Employers paid pension contributions equal to the full ARC, and that at least equal the normal cost;
2. Employee contributions to help share the plan cost;
3. Benefit improvements that are actuarially valued before adoption and properly funded upon adoption;
4. COLAs granted responsibly;
5. Anti-spiking measures that ensure actuarial integrity, transparency;
6. Economic actuarial assumptions that can reasonably be expected to be achieved long term.
Funding of Public Pension Plans

Actuarial value of assets and liabilities, and funding level, FY 01 to FY 13
What Caused Recent Public Pension Funding Shortfalls

During the period 2001 to 2013, the follow items contributed to the underfunding of public pensions.

• Investment returns lower than assumed return was responsible for 60.4 percent of unfunded liability.
• Employer pension contributions lower than the Normal Cost plus interest on the unfunded actuarial liability caused 23.7 percent of the unfunded liability.
• Actuarial experience worse than assumed added 2.4 percent of the unfunded liability.
• Benefit changes had a small (0.8%) net reduction in the unfunded liability.

Actuarial Required Contributions Increased from $28b to $93b

Figure A. Combined Annual Required Contribution and ARC received, for statewide plans

States’ Funding of Pensions – Half Paid 95% or More

Figure B. Median and annual and weighted average contributed to statewide plans

State-by-State Funding of ARC

Figure C1. Weighted average of Annual Required Contribution paid, by state

Public Pensions – Downward Trend on Interest Assumption

Public Pensions – FY 2015
Median Investment Returns

MEDIAN PUBLIC PENSION INVESTMENT RETURNS FOR PERIODS ENDED 6/30/15

Source: Callan Associates
State & Local Pensions
Rolling 30-Year Investment ROR

Source: Census of Governments and Public Fund Database.
Public Pension Reforms After 2008 Financial Crisis

Every State modified their DB pension:
- increased Employee contributions;
- reduced DB benefits for new hires, including higher retirement age
- Cost of Living Adjustment (COLA) reductions for retirees and existing worker
- Only a few states moved to hybrid plan and only one moved to a Defined Contribution plan.
Reforms In States to Ensure Sustainability of Public Pensions

Types of Changes Enacted

- Reduced benefits for new hires: 39 states
- Employee contribution increase: 29 states
- Reduced COLA for current members: 16 states
- Employer contribution increase (statutory): 9 states

Source: Author’s analysis of NCSL data. Changes affect some or all members of state-run plans in each state.
Improvements in Public Pension Funding Anticipated over Time

Impact of Public Pension Changes and Added Funding

<table>
<thead>
<tr>
<th>Scenario and year</th>
<th>GASB old</th>
<th>GASB new</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market assets</td>
<td>Market assets/combined rate</td>
</tr>
<tr>
<td>2013</td>
<td>72.0 %</td>
<td>75.3 %</td>
</tr>
<tr>
<td>Baseline</td>
<td>75.2</td>
<td>80.6</td>
</tr>
<tr>
<td>2014</td>
<td>77.4</td>
<td>81.6</td>
</tr>
<tr>
<td>2015</td>
<td>79.4</td>
<td>82.7</td>
</tr>
<tr>
<td>2016</td>
<td>81.2</td>
<td>83.7</td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Spending on Public Pensions as Percent of Total Direct Spending

State and Local Pension Spending in 2013 Remains Modest.

Source: NASRA calculations using data from the U.S. Census Bureau, March 2016