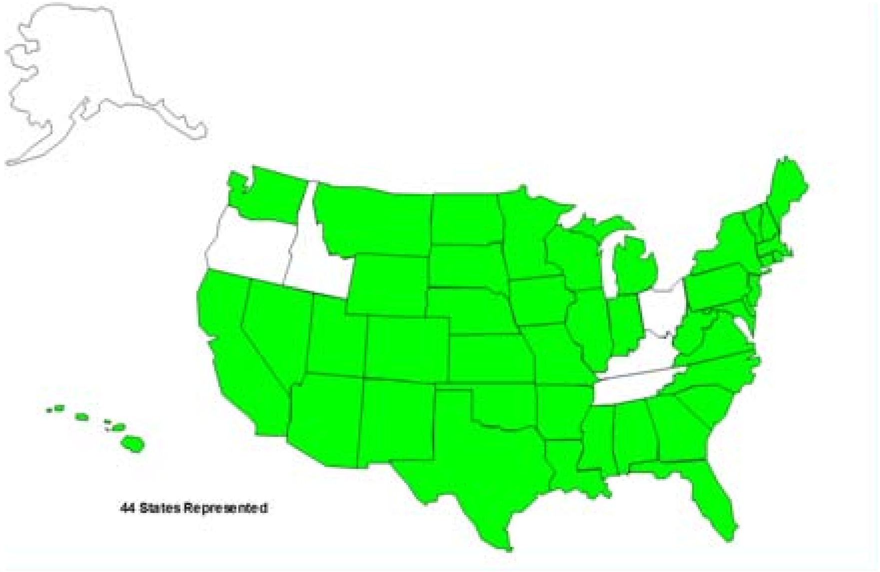
Pension Reform and Plan Design: Around the Country



Linda L. Bournival, FSA
Consulting Actuary
KMS Actuaries, LLC

September 20, 2012

Agenda

- State of the State Public Sector Pensions
- Highlights of 2012 Pension Reform
- Pension Reform Since 2009
- Case Studies
- State Defined Contribution & Hybrid Plans
- Investment Return Assumptions

State of the State Public Sector Pensions - 2010

- $3.07 trillion - Total pension liability
- $2.31 trillion – Total pension assets
- $757 billion – Unfunded liability
- How did the States fare?
  - 11 states considered “solid performers”
  - 7 states considered “needs improvement”
  - 32 states considered “serious concerns”

Source: “The Widening Gap Update”, PEW Center on the States, June 2012.

KMS ACTUARIES LLC

Pension Reform

- Average plan funding level - 75.2%
- Multi-year wave of pension reform intended to address long-term funding issues
  - Severe investment losses in past two recessions
  - Slow growth in the economy
  - Slow recovery of state revenues

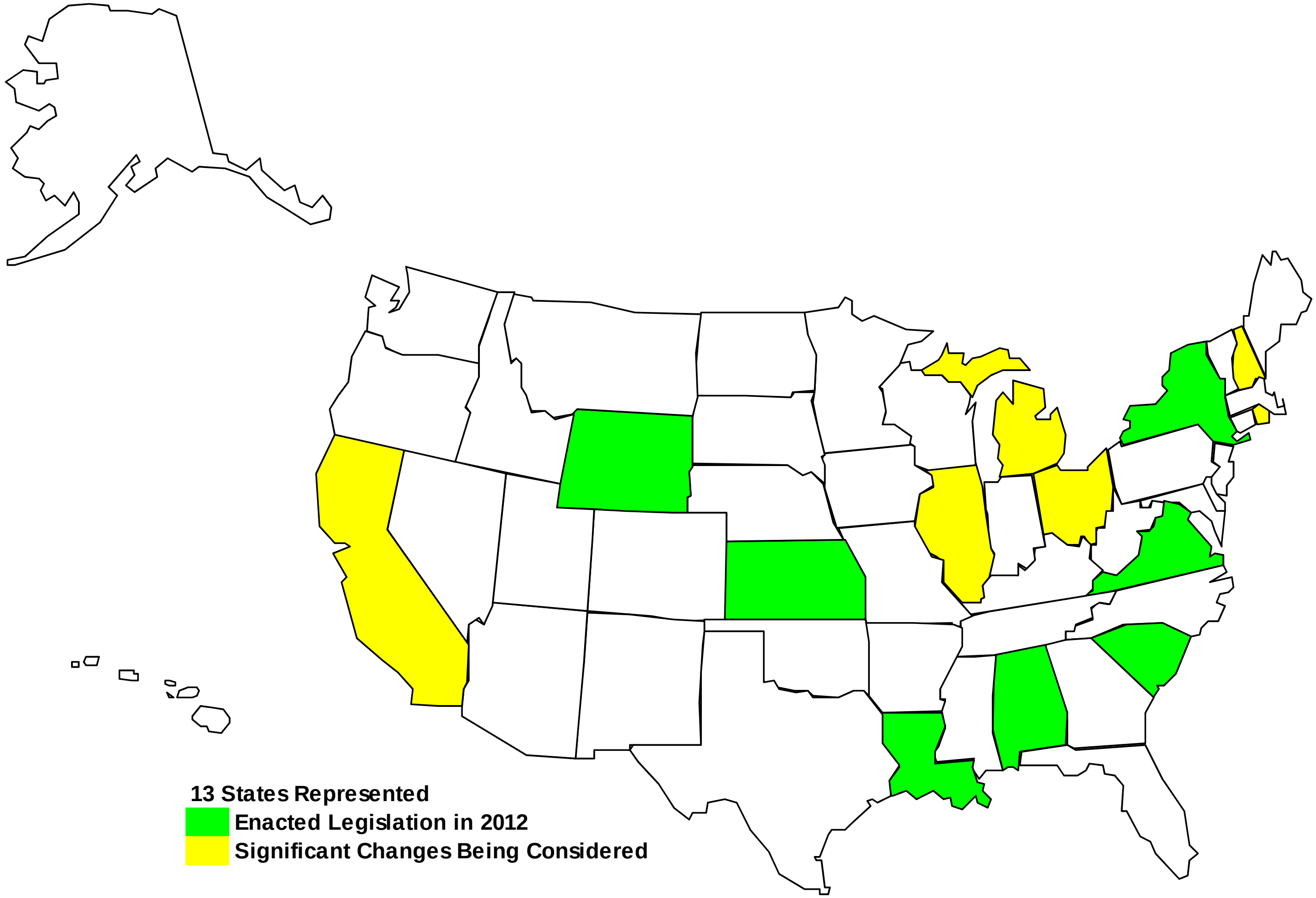
KMS ACTUARIES LLC

Highlights of State Pension Reform

- Seven states have enacted sweeping structural pension reform in 2012
  - Alabama, Kansas, Louisiana, New York, South Carolina, Virginia, Wyoming
- Six of the seven had undertaken pension reform in the past three years
- 44 states have enacted major reforms since 2009

KMS ACTUARIES LLC

Significant Changes in 2012

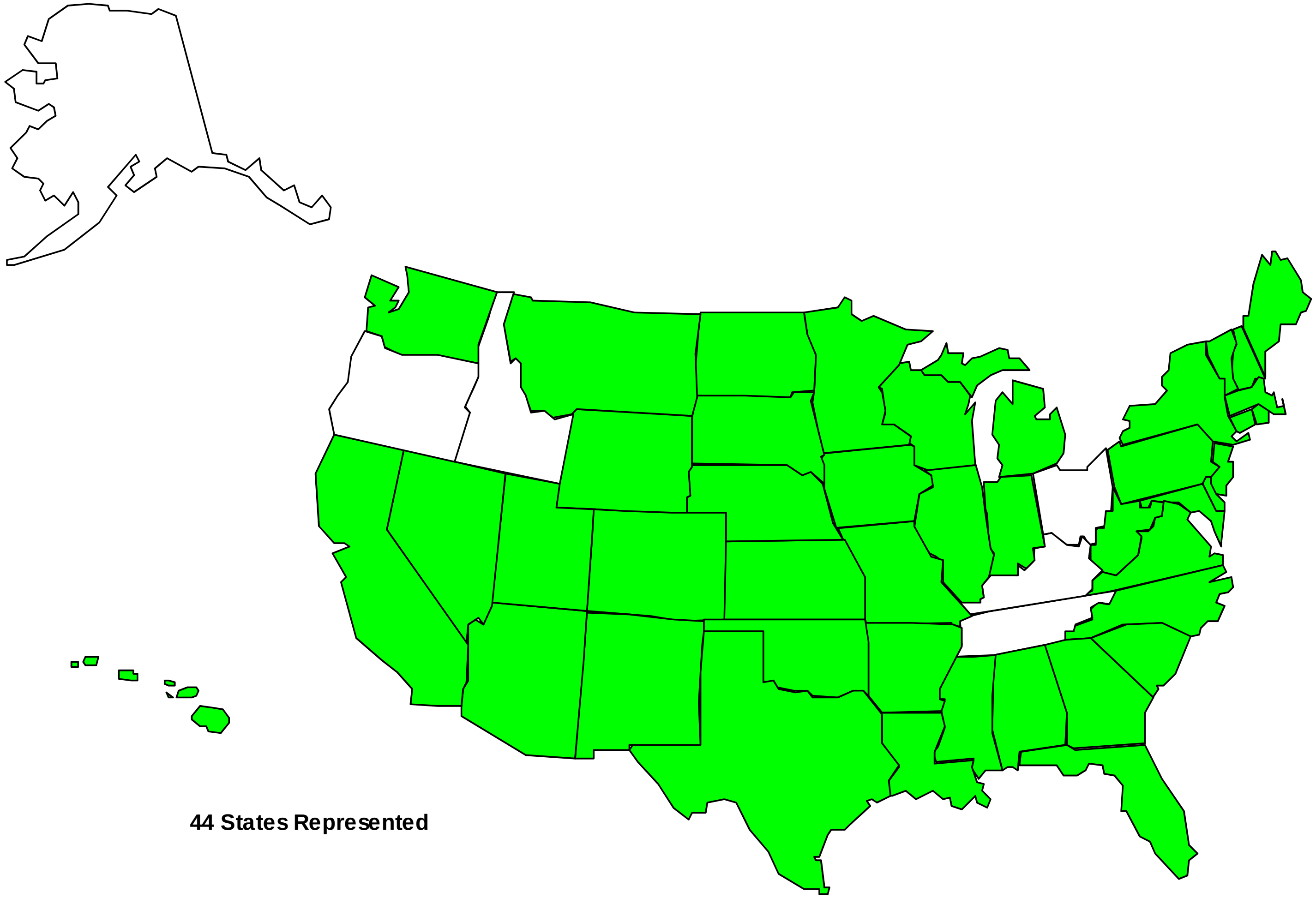


More 2012 Legislation

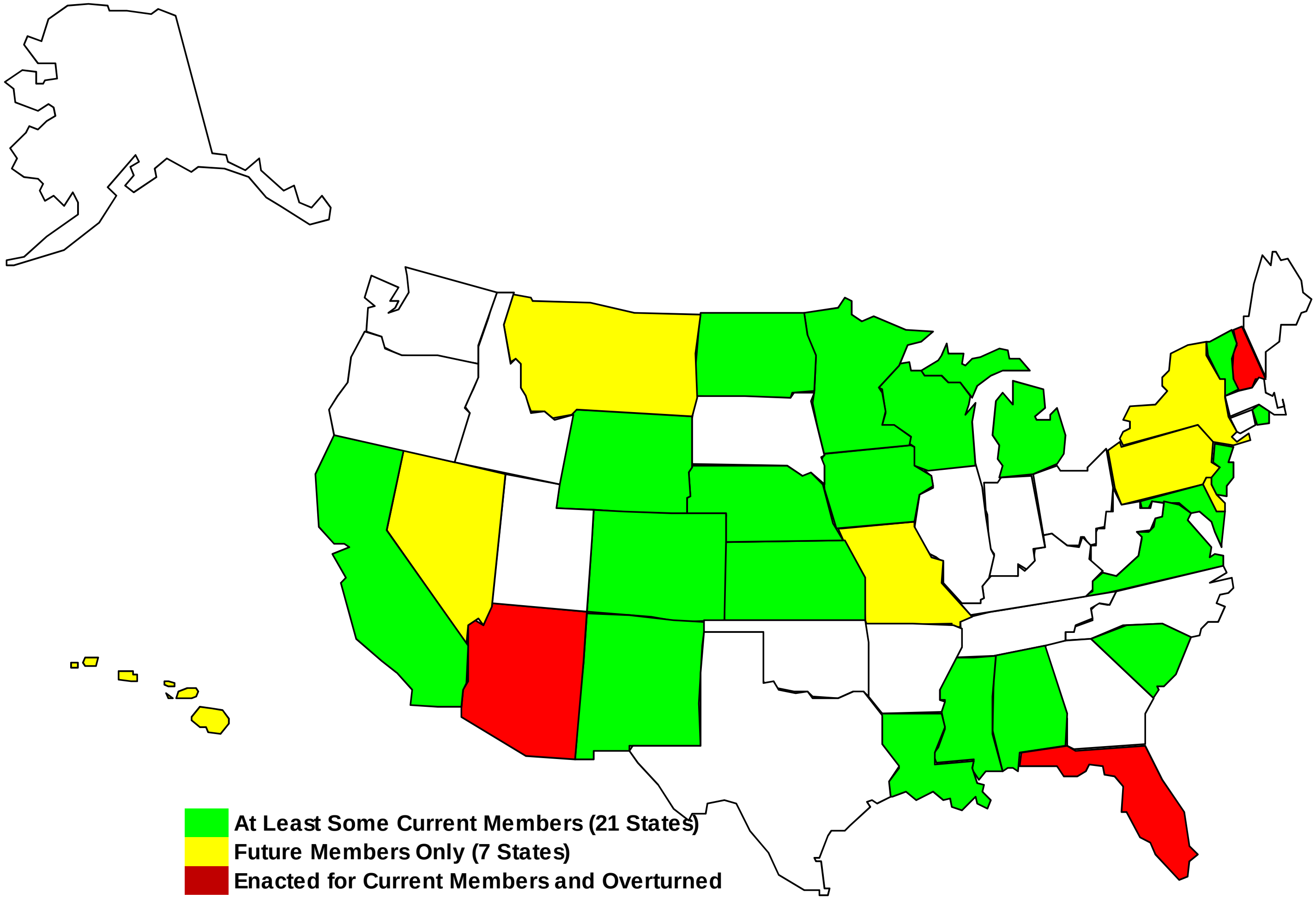
- Illinois proposals – Died at end of session
  - continue COLA and eliminate retiree health insurance or modify COLA and retain retiree health insurance
  - No future salary increases in final average salary calculation
- Ohio proposals – on hold for now
  - Higher age and service requirements
  - Reductions in benefit formula
  - Reduced COLA
  - Increases in member contributions

KMS ACTUARIES LLC

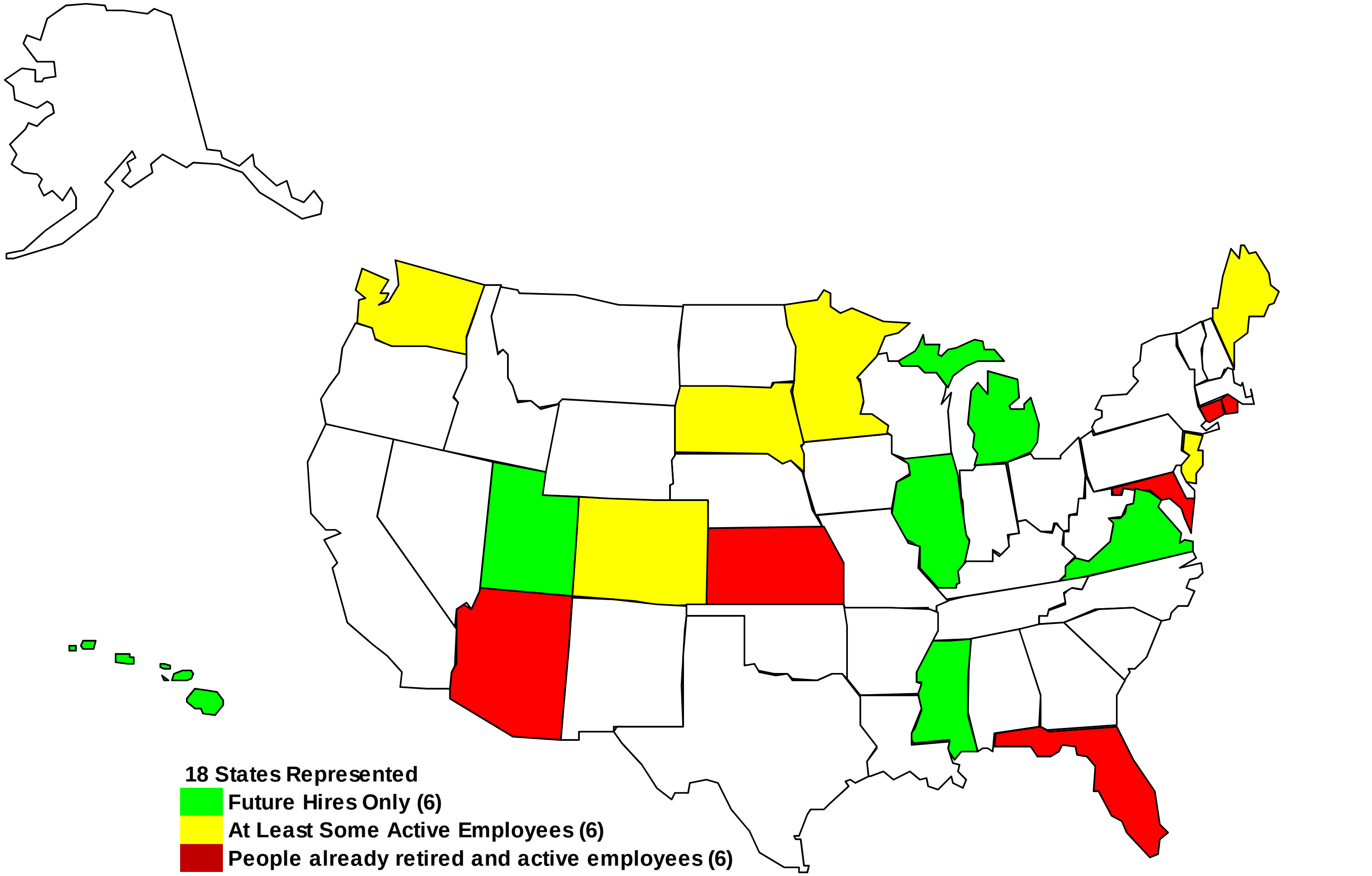
Major Pension Legislation in 2009-2012



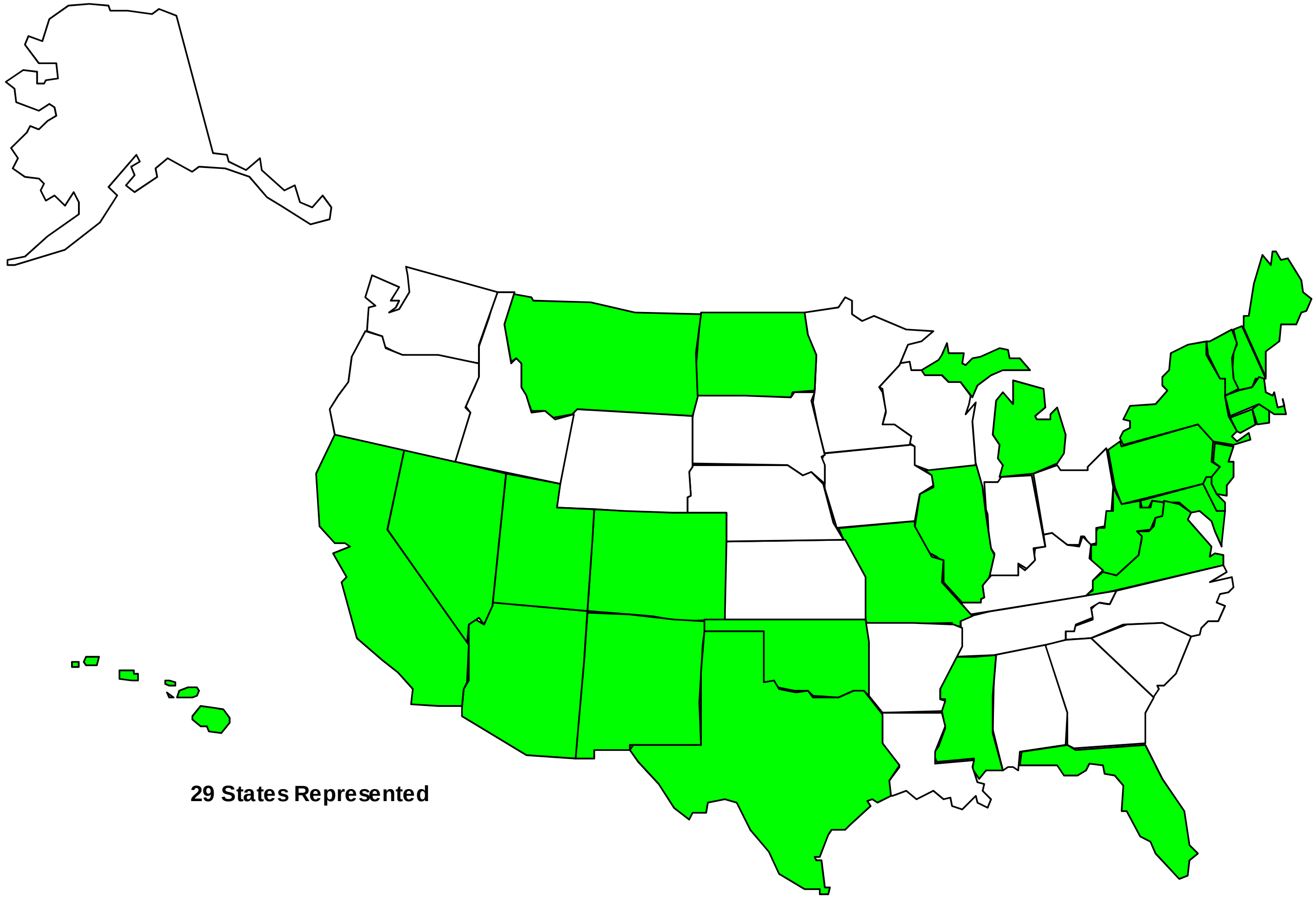
Increases in Employee Contributions, 2009-2011



Reductions in Post-Retirement Benefit Increases Enacted in 2010 and 2011



Higher Age and Service Requirements for Normal Retirement, for New Members, 2009-2011



Case Studies

KMS ACTUARIES LLC

Case Study

- Reform spearheaded by State Treasurer Raimondo
- New DB+DC Plan enacted for all current and future employees
- COLA deferred until funding improves
- Benefits accrued at transition are frozen
  - Future benefits at 1% of average pay
- Normal Retirement increased to Social Security age
- Employer contributions decreased

Case Study

- Alaska provides retiree healthcare through retirement system
- DB Plan closed to new employees effective 2006
  - Reform initiated by legislature
  - Replaced with DC accounts at roughly same cost
  - Included Health Retirement Savings account plus modest post-Medicare healthcare
- Closing DB plan did not help with unfunded liability
- Legislation introduced to add new DB choice

Case Study

- Illinois statewide plans are among most poorly funded in US
  - Recent reform made major benefit reductions for new tiers
  - But employer contributions still inadequate
  - Pension obligation bonds have only been band-aid
  - Targeted to become 90% funded by 2044
- Illinois Municipal Retirement System is in much better shape
  - Compulsory employer contributions, at least equal to Normal Cost, unless over 120% funded
  - Employees contribute 4.5%, about half the normal cost
  - Strong position enabled slight funding break for employers in 2010

Case Study

- New Jersey had historically been one of the most poorly funded
  - Pension Obligation Bonds
  - Contribution holidays
  - SEC action over improper bond disclosure of pensions
- Governor Chris Christie campaigned on fiscal responsibility, including pension reform
- Reform completed 2011
  - Increased employee contributions
  - State agrees to make required contributions
  - Eliminated COLA until funding is improved
  - Later retirement for new tier
  - Governance changes

Case Study – NY STRS

- Many features have contributed to NYSTRS strong position
  - Over 100% funded
  - Employer contributions are only 7.63% of pay
  - 9.8% average return 1985-2009
- Employers contribute ARC
  - Conservative actuarial methodology
- Limited automatic COLA (half of COLA, but only on first $18,000)
- Anti-spiking provisions
- 2010 new tier made modest cut to benefit formula and increased employee contribution from 3% to 3.5%

KMS ACTUARIES LLC

Case Study

- Reform spearheaded by State Senator Dan Liljenquist
  - Now candidate for US Senate
- New employees have choice of:
  - DB plan with 1.5% multiplier & 10% employer contributions
  - 10% employer funded DC plan
- Employee contribution is voluntary; to 401(k)
- If 10% employer contribution is insufficient, employees must contribute the excess cost
  - If 10% is too much, excess goes into DC
- No change to closed plan, continued to be funded

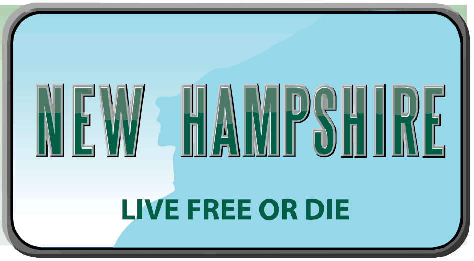
Case Study

- Became primarily a Defined Contribution plan in 1991
- Switched back to DB in 2005
  - Average DC investment returns lagged DB returns in both up and down markets
  - The 4,500 members who switched in 1991 found it hard to retire after 2000-2001 down market
  - State concluded that properly funding a DB would be less expensive than funding an adequate DC
  - 78% elected to switch back in 2008
  - Funding was strengthened, including using tobacco securitization bond proceeds

Case Study

- Historically among best funded state plans
- SDRS is considered a hybrid DB plan with DC features
- History of substantive benefit improvements funded by favorable investment results – included retirees
- Fixed member and employer contributions
- Statutory triggers requiring Board recommendations for corrective actions/no higher employer contributions
- Primary benefit change tied COLA to funded ratio and CPI
- Retirees received smaller COLA as a result

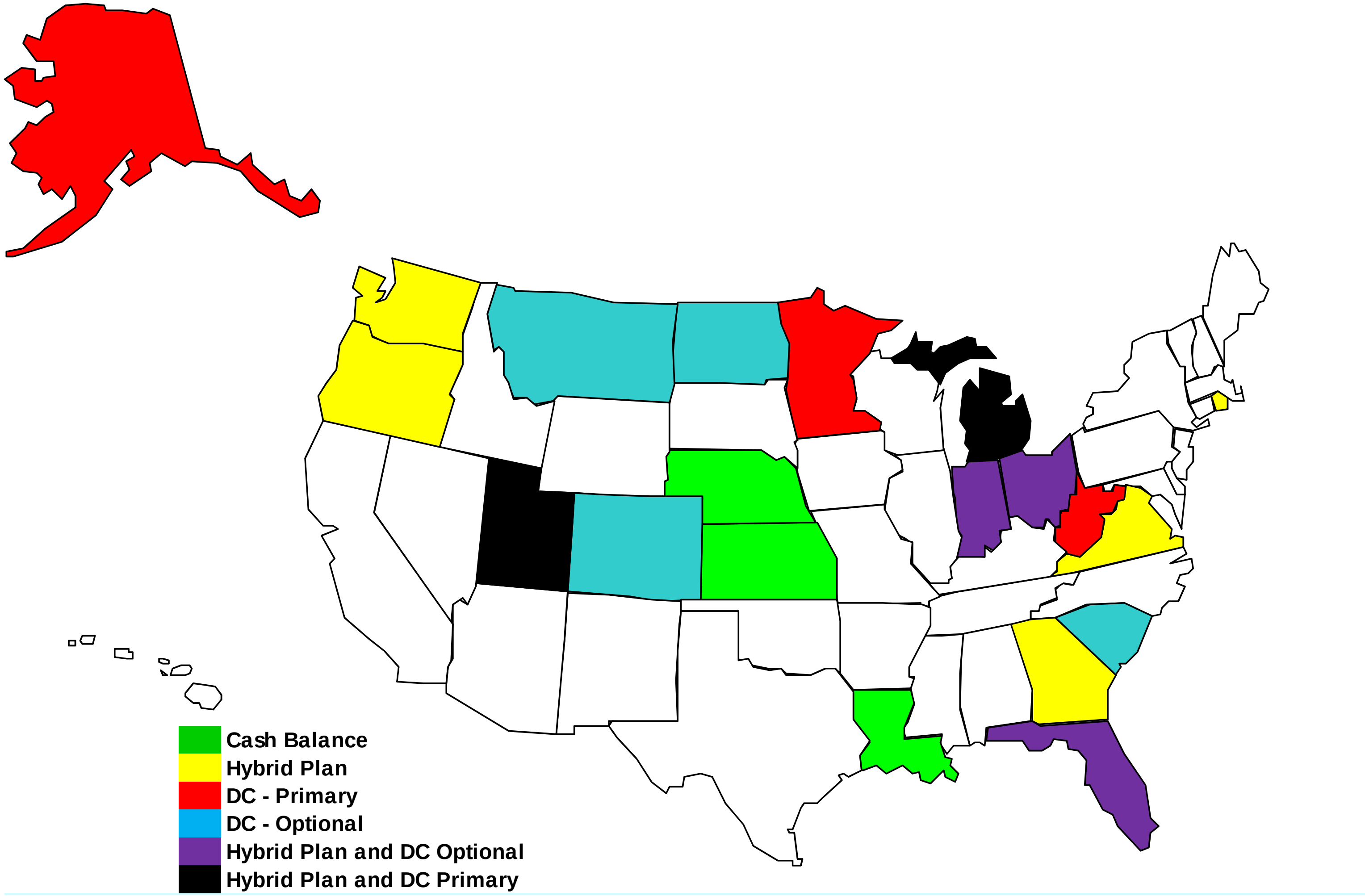
Case Study



- Introduces new tier for employees hired after July 1, 2011
- Increased employee contributions
- Eliminated the state's cost sharing
    - Employers pay 100% of employer contribution rate
- Increase age and service requirement for new hires
- Froze medical subsidy at 2011 levels
- Limited the amount of special duty pay in earnable compensation
- Legislature to study closing the DB plan and replacing with DC plan – mandatory for new state employees, optional for municipal employers

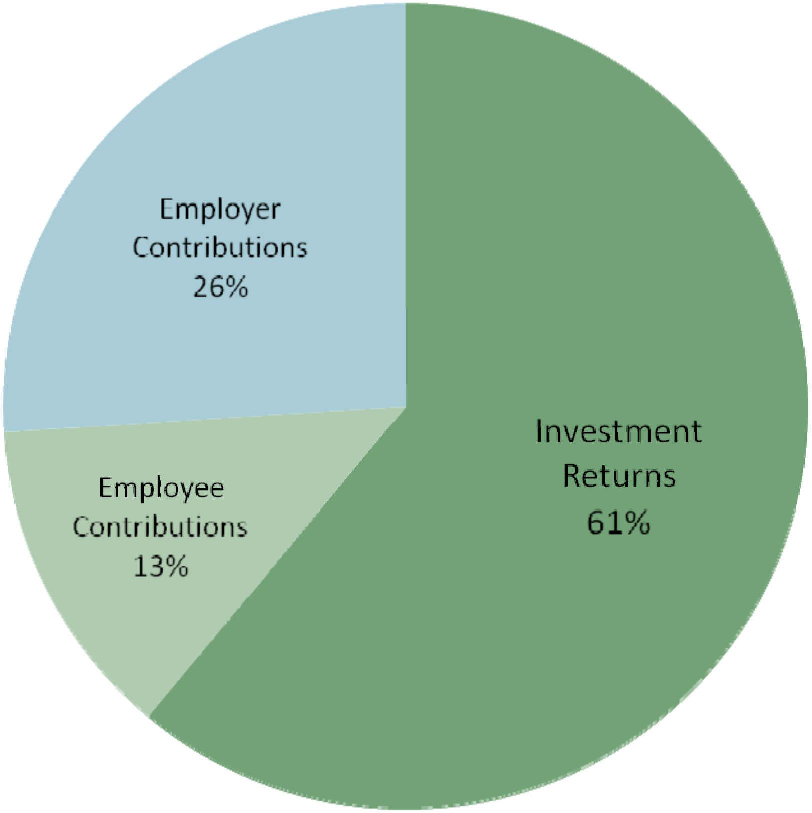
KMS ACTUARIES LLC

State Defined Contribution Plans and Hybrid Plans



Public Pensions Sources of Revenue, 1982 - 2010

- Investment earnings account for a majority of revenue for a typical public pension fund
- Public pension funds have accrued an estimated $4.8 trillion in revenue
- $2.9 trillion, or 61%, is estimated to have come from investment earnings

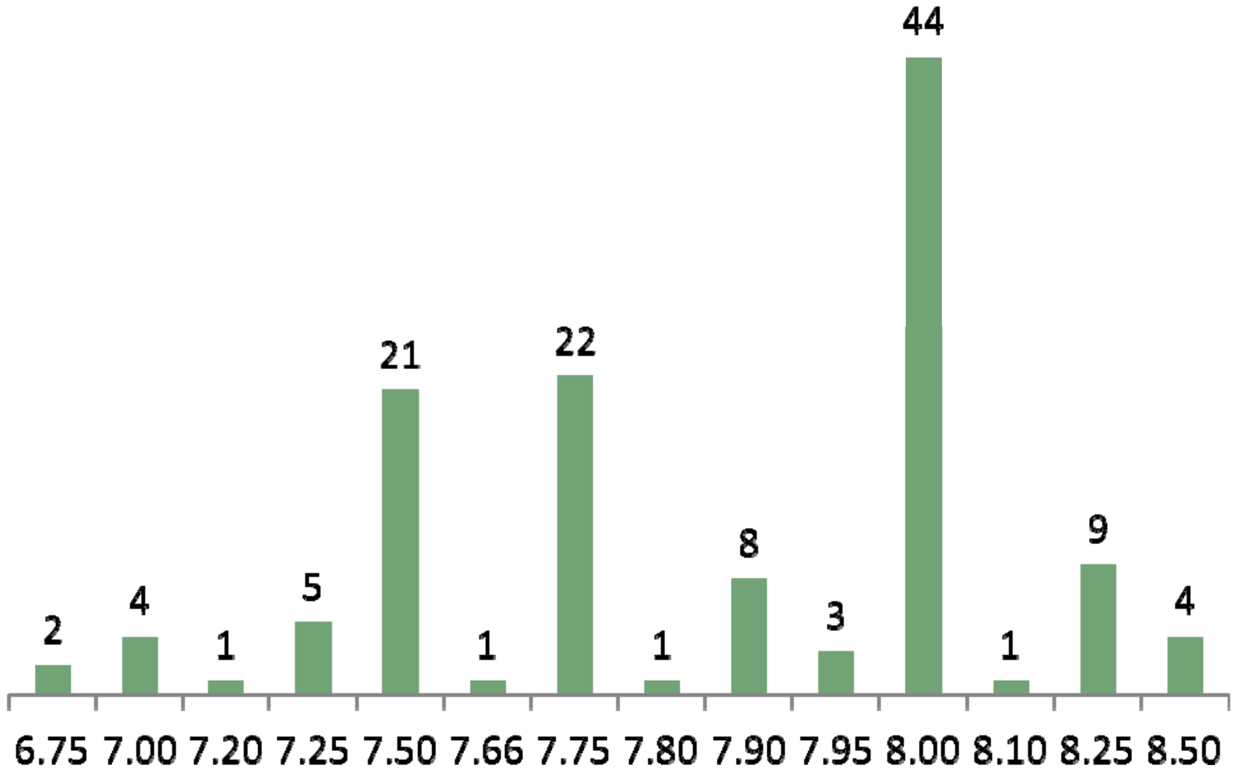


Source: U.S. Census Bureau

2012 Public Funds Survey

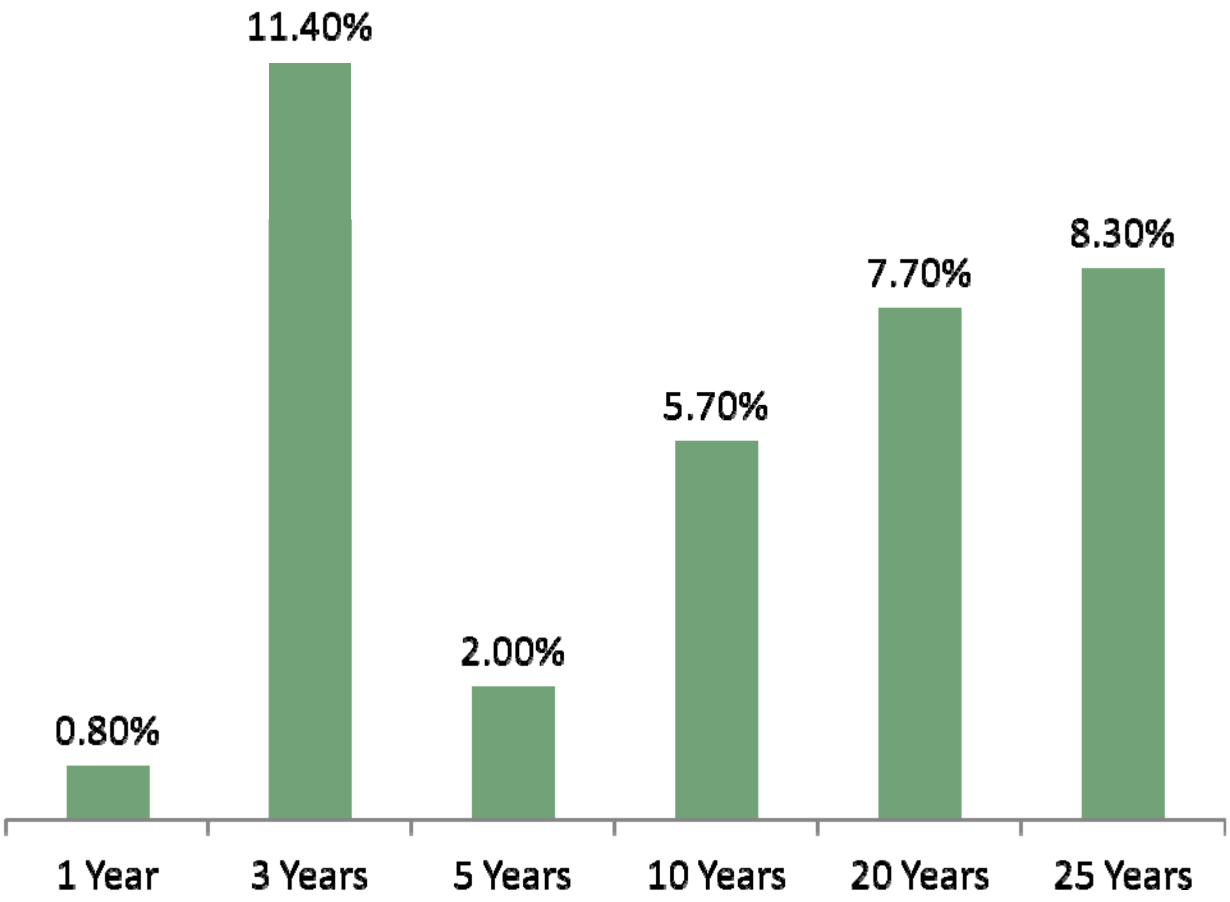
- 126 plans included in the Public Funds Survey
- 45 have reduced their investment return assumption since 2008
- 8% remains the predominant investment return assumption
- Average investment return assumption is 7.80%

Distribution of Investment Return Assumptions



Public Fund Survey August 2012

Median Public Pension Annualized Investment Returns for period ending 12/31/2011



Source: Callan Associates, Inc.

Sources

- 2012 Public Plans Survey, www.publicfundsurvey.org
- National Conference of State Legislatures, www.ncsl.org
- The PEW Center on the States, "The Widening Gap Update, June 2012, www.pewstates.org/state-pensions-update
- National Association of State Retirement Administrators, www.nasra.org

Next…

Pension Reform and Plan Design: