

The background of the slide is a photograph of Earth from space, showing a curved horizon with a blue sky and white clouds. The text is overlaid on this image.

Pension System Modernization Task Force

- *Comparison of Public and Private Retirement Benefits*
- *Approaches to Financing*
- *Changes Proposed in Other States*

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Task Force Benefits' Issues

- ↳ Comparison of Public and Private Retirement Programs
- ↳ Approaches for Financing Poorly Funded Pensions
- ↳ Changes Being Considered in Other States

Comparison of Public and Private Retirement Programs

- ↳ Funding
- ↳ Accounting
- ↳ Pension Plan Design

Public Pension Plan Funding

- ↳ Based on State Law
- ↳ Employees Share in Funding
- ↳ Often Related to GASB
 - Be 100% Funded within 30 Years
- ↳ State of Illinois Has Very Back-Loaded Funding Rules
 - Be 90% Funded within 40 Years
 - State Has Consequently Not Been Funding Adequately
- ↳ Actuarial Interest Rate Based on Fund Returns
- ↳ Typically Based on Projected Benefits

Private Sector Pension Plan Funding

- ↳ Based on ERISA
- ↳ No Employee Contributions
- ↳ Independent from FASB Accounting Rules
- ↳ For Defined Contribution Plan: Funding Equals Contribution
- ↳ For Defined Benefit Plan: Be 100% Funded within 7 Years
- ↳ Actuarial Interest Rate Based on Bond Yields
- ↳ Primarily Based on Accrued Benefits

Public Pension Plan Accounting

- Based on Governmental Accounting Standards Board (GASB) Statements
 - Number 25 – Plan Reporting
 - Number 27 – Employer Reporting
- Annual Required Contribution (ARC) Typically Has Two Components
 - Annual Normal Cost
 - Amortization to Be 100% Funded within 30 Years
- Generally Based on Assumed Asset Returns (e.g., 8%)
- If Employer Has Been Funding ARC, No Balance Sheet Liability

Private Pension Plan Accounting

- ↳ Based on Financial Accounting Standards Board (FASB)
- ↳ Typically Comparable Numbers to GASB
- ↳ Partially Based on Assumed Asset Returns (e.g., 8%)
- ↳ Partially Based on Bond Yields (e.g., 5.75%)
- ↳ Employer Funding Often Quite Different from Accounting
 - Often Results in Balance Sheet Liability or Prepaid Asset
- ↳ New Rules Recently Instituted That Increase Volatility, Reporting, and Impact

Public Pension Plan Design

- ↳ Most Illinois Public Employees Not in Social Security
- ↳ Employees Share in Plan Cost
- ↳ Final Average Pay-Based Pension Formula
- ↳ Subsidized Early Retirement
- ↳ Post-Retirement Cost-of-Living-Adjustments
- ↳ Targeted for Career Employee

Private Pension Plan Design

- ↳ Employees Covered under Social Security
- ↳ Post-Retirement Cost-of-Living-Adjustments Rare
- ↳ More Workforce Mobility
- ↳ 401(k) Plans Are More Typical
 - Employer Match Only
- ↳ Final Pay Pension Plans Are Less Prevalent
 - More Plans Being Frozen
 - More Plans Being Cut Back, Moved from Final Pay

How Have Private Industry's Pension Plan Sponsors Reacted to Changes?

↳ Frozen The Plan's Eligibility

- New Hires Covered by A Different Plan
- Replacement Plans Tend to Be Defined Contribution

↳ Frozen The Plan and Replaced Benefits

- No New Accruals for Any Participants – New Plan Required
- Replacement Plans Tend to Be Defined Contribution

↳ Cut Back on Plan Benefits

- Decreased Benefits, COLAs, Early Retirement Subsidies

↳ Increased Contributions and Changed Asset Allocations

Is the Problem Contributions or Benefits?

- Clearly, Contributions Are Part of The Problem
 - Full Actuarially Required Contributions Have Rarely Been Made
 - Pension Obligation Bonds Have Masked the Problem
- What about Benefit Levels?
 - Teachers Are Not in Social Security, for example
 - Comparison of Illinois with 9 Other Non-SS States:

| | Employee Contribution | Hypothetical Benefit * |
|-----------------------|-----------------------|------------------------|
| Illinois TRS | 9.40% | \$25,850 |
| Average Non-SS States | 8.14% | \$27,117 |

* \$50,000 salary, age 60, 25 years

Solutions for Poorly Funded Plans

↳ If Plan Anticipated to Be Insolvent in Short Time:

- Must Change Cash Flows in Short Time
- New Tiers Won't Help
- Time Is of The Essence

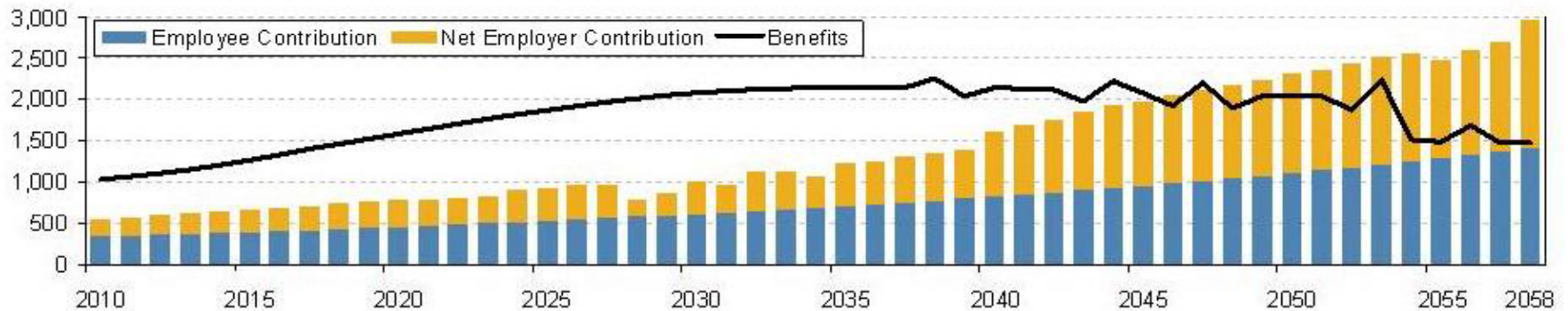
↳ Tools

- Contribution Increases
 - Members
 - Employers
- Benefit Cuts
 - Future Workers
 - Current Workers
 - Current Recipients
- Cash Infusion
 - Borrowing
 - Other Revenue Sources

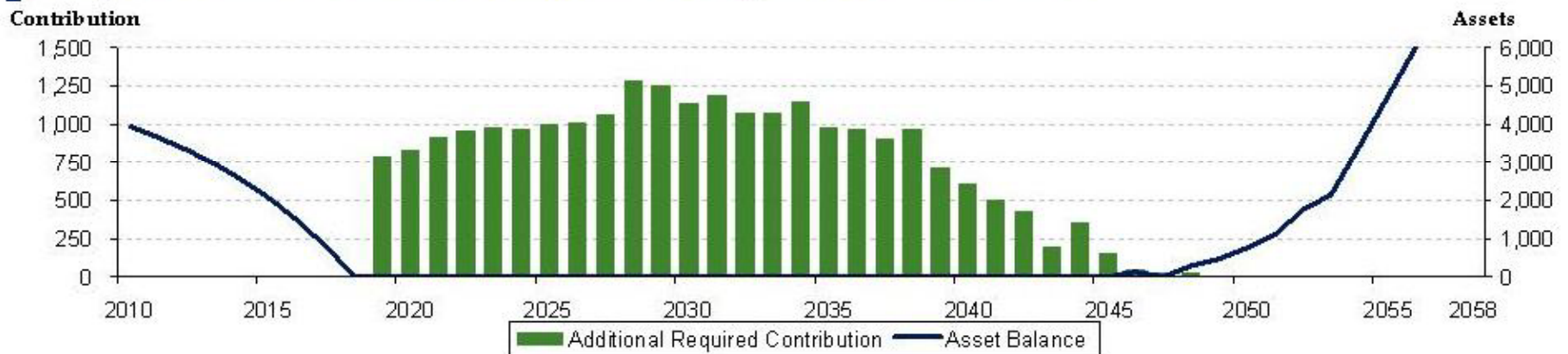
Radical Approach May Be Needed

Current Situation
Long-Term Projections

Estimated Benefits and Contributions



Projected Asset Balance and Additional Required Contributions



Approaches for Poorly Funded Plans - Examples

↳ Colorado

- Review Led by PERA
- Analysis of All Options
- Communication with Stakeholders
- Proposal to Legislature

↳ Philadelphia

- Declared in Funded Crisis by State Commission
- Proposed New Tier
- Larger Contributions Will Be Required
- Some Relief from Labor Contracts Possible

↳ Vallejo, California

- Bankruptcy
- Frees Up City to Renegotiate with Labor
- I Believe Pensions per se Were Not Reason for Bankruptcy Filing

Some Changes Have Been Made

- ↳ Some States Have Increased Employee Contributions
 - New Mexico – Increase by 1.5%
 - University of California – Increase by 2%
- ↳ Some Have Increased Employer Contributions
 - Nebraska
 - New Mexico
- ↳ Several States Have Introduced New Reduced Tiers
 - Georgia
 - Louisiana
 - Nevada
 - New Mexico
 - Rhode Island
 - Texas

Some Legislation Has Been Introduced

- ↳ Arkansas
- ↳ Georgia
- ↳ Idaho
- ↳ Illinois
- ↳ Indiana
- ↳ Nevada
- ↳ Utah
- ↳ Vermont
- ↳ Virginia

Recap

- Pensions More Prevalent in Public Than Private Sector
- Current Poor Funded Status Is Causing Rethinking
- Depending on Proximity of Projected Insolvency, Radical Approach May Be Required

Glossary

- GASB – Governmental Accounting Standards Board – GASB sets the accounting rules for governments and public sector plans.
- FASB – Financial Accounting Standards Board – FASB sets the accounting rules for businesses and their benefit plans.
- ERISA – Federal Pension and Benefit Law. Generally applies to private sector.
- Defined Benefit Plan – One that provides a specified lifetime benefit, typically based on pay and service. Pension Plans and Social Security are examples.
- Defined Contribution Plan – One that provides specified contribution to a fund (e.g., 401(k)).
- Accounting – How the employer, business, or government reports the costs and liabilities.
- Funding/Financing – How the employer, business or government pays for the benefits.
- Actuarial Liability – An estimate of the present value of future benefits assigned to the past.
- ARC – Actuarial Required Contribution – The GASB annual cost.
- 100% Funded – When the assets equal the Actuarial Liability.
- Unfunded Liability – Actuarial Liability not covered by Assets.
- Balance Sheet Liability – The amount on the books of the entity. Generally the amount of cumulative annual cost that has not been funded.

Questions

