State Pension Funding and Models for Success

Rhode Island Pension Advisory Working Group
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Strengthening Public Sector Retirement Systems
The Pew Charitable Trusts

Pew

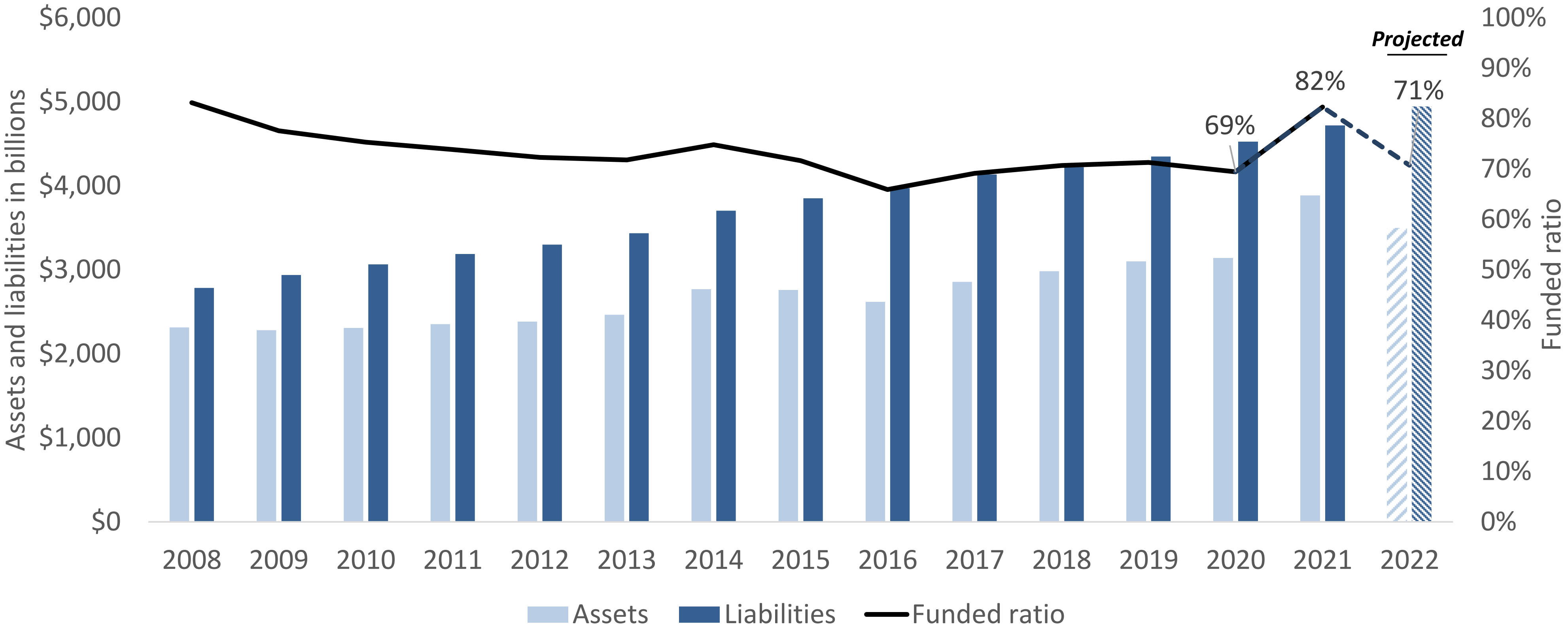
Overview

- Trends in public pensions
- Practices of successful pension systems
- Pensions in Rhode Island

Trends in Public Pensions

Pension Plan Assets And Liabilities Over Time

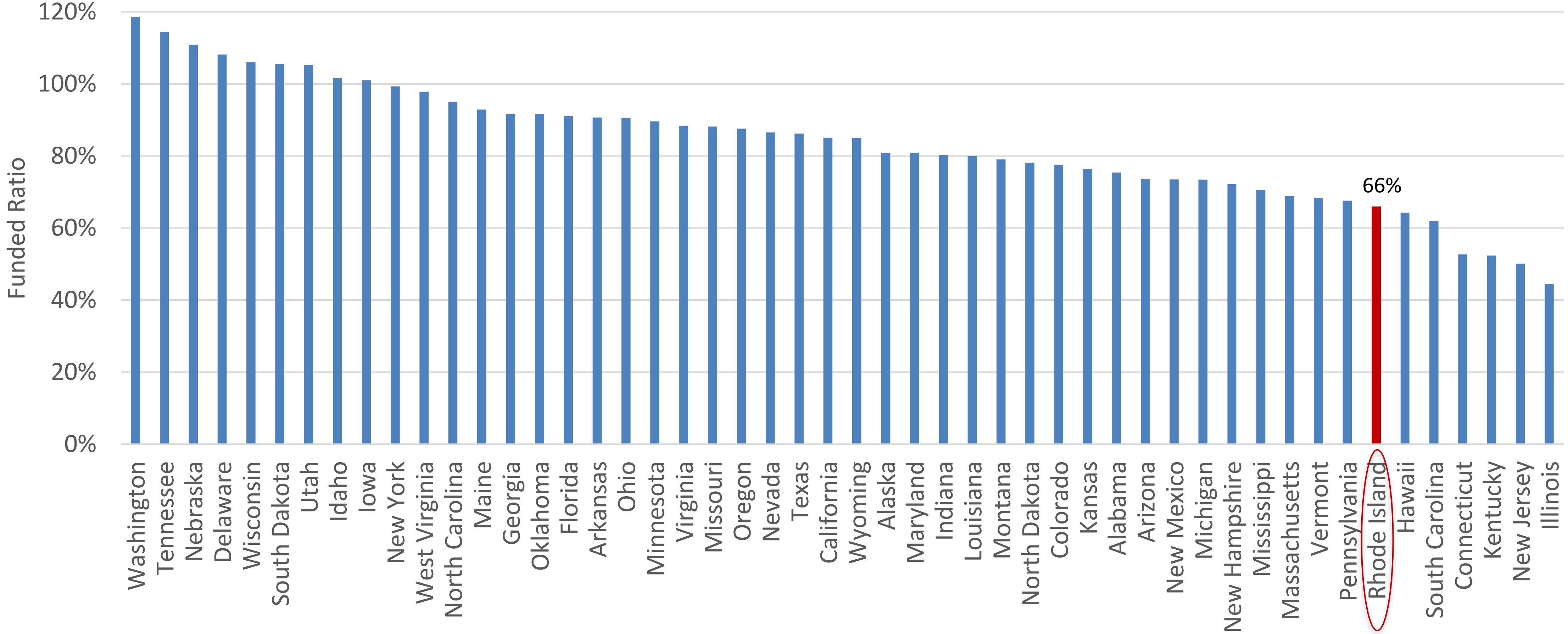
Windfall investment returns pushed the funded ratio above 80% in 2021 but subsequent losses have erased those gains.



Source: State annual financial reports, pension plan financial reports, and plan actuarial valuations

Rhode Island Remains Underfunded

Funded ratios for states' pension plans in 2021



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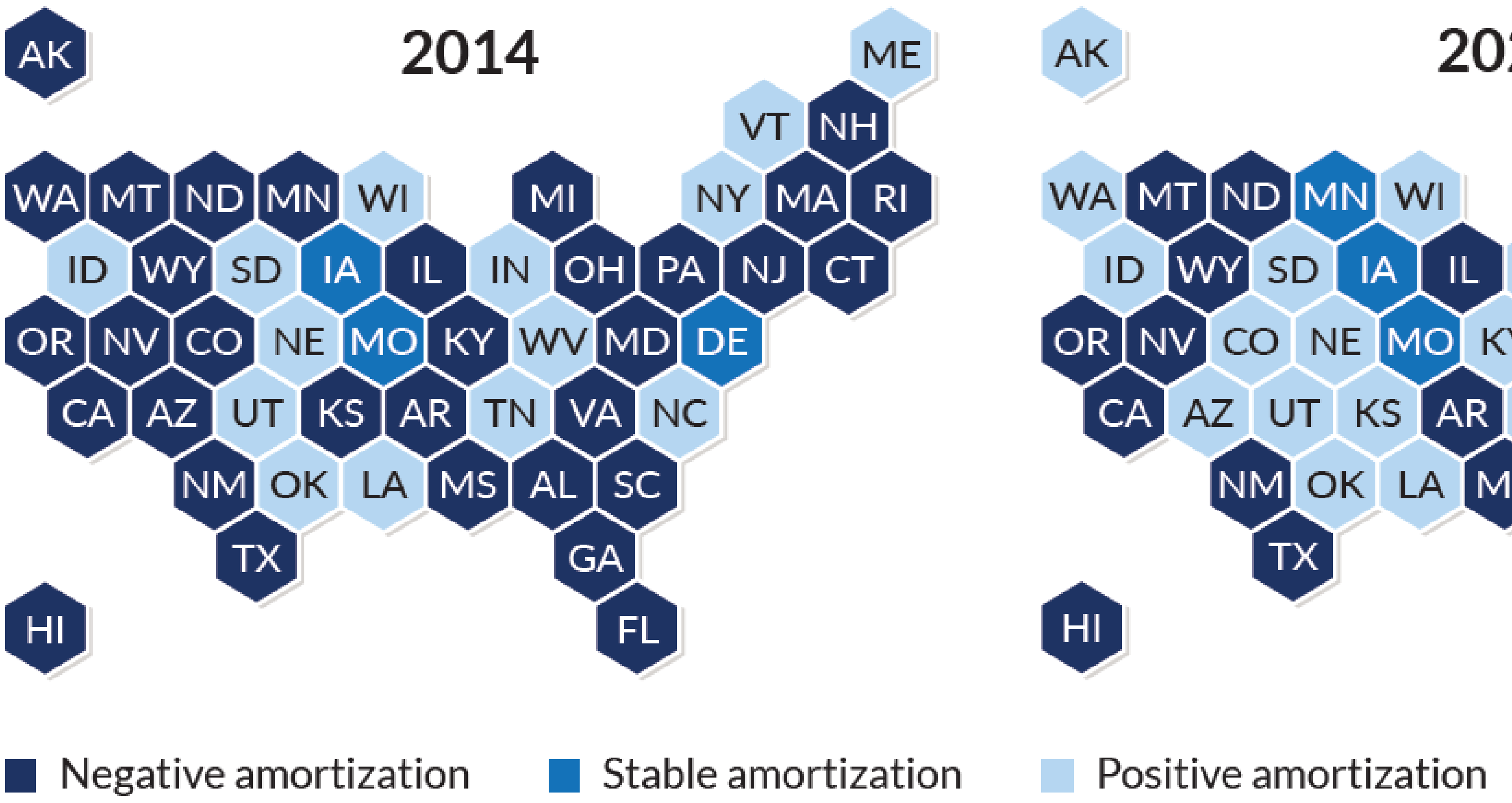
Most States Met Contribution Benchmark In 2021

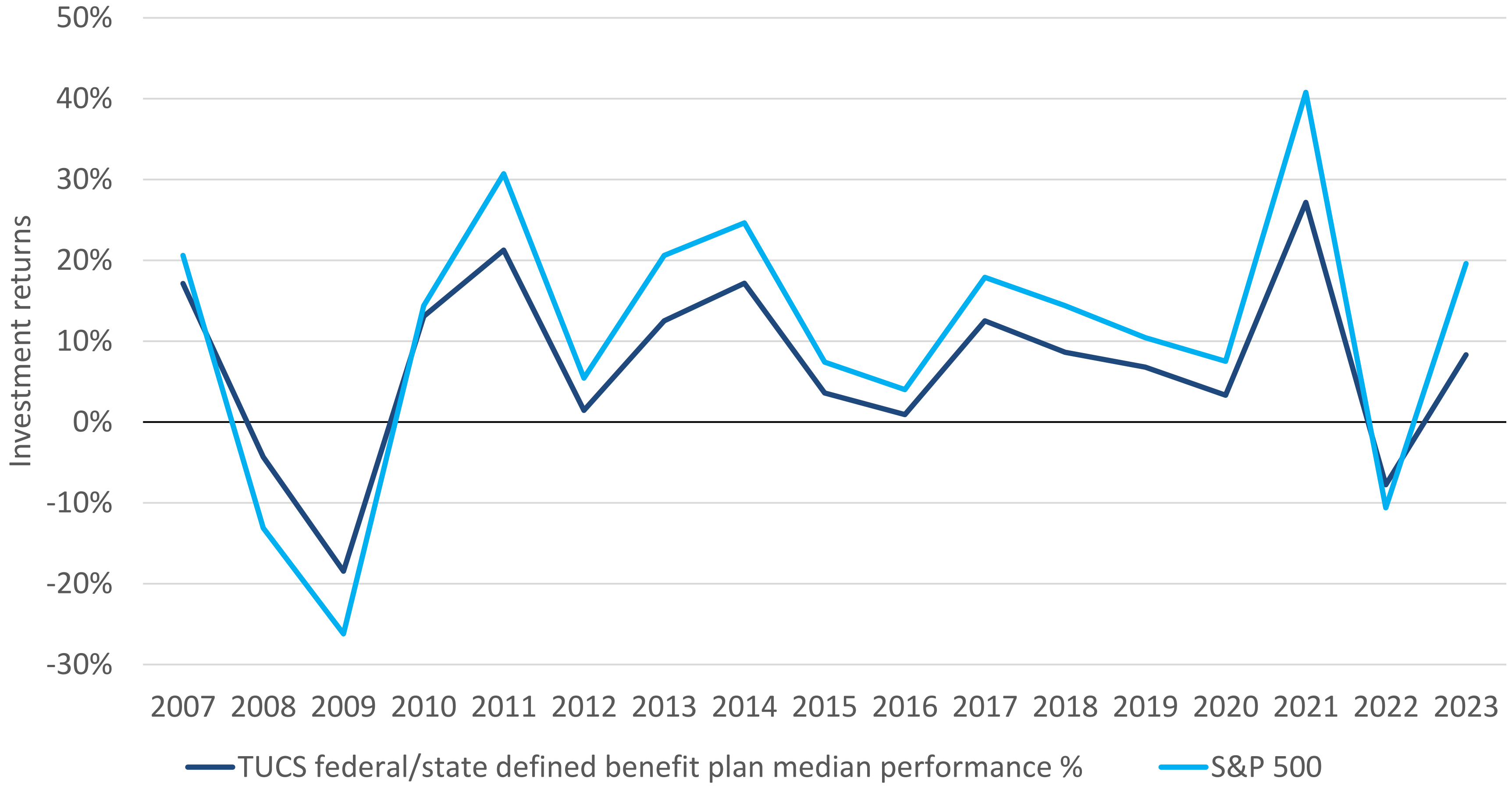
Twenty-nine states had positive or stable amortization in 2021, compared to just 17 in 2014. Still, 21 states remained below this threshold.



Source: Pew calculations based on state annual financial reports, pension plan financial reports, and plan actuarial valuations

Pension Plan Investments Track Stock Performance

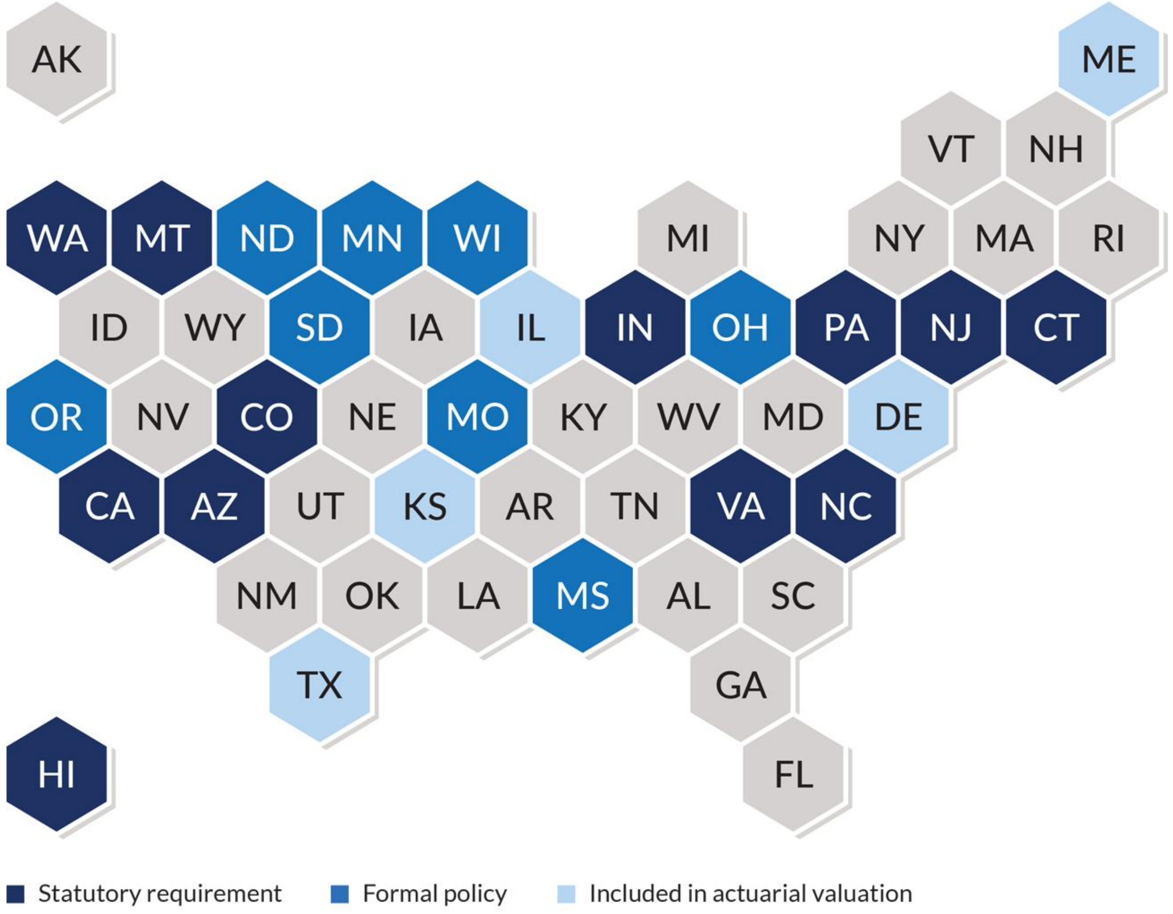
The typical pension plan's investments follow the ups and downs of equity markets.



Sources: Analysis by The Pew Charitable Trusts using data from Wilshire Trust Universe Comparison Service

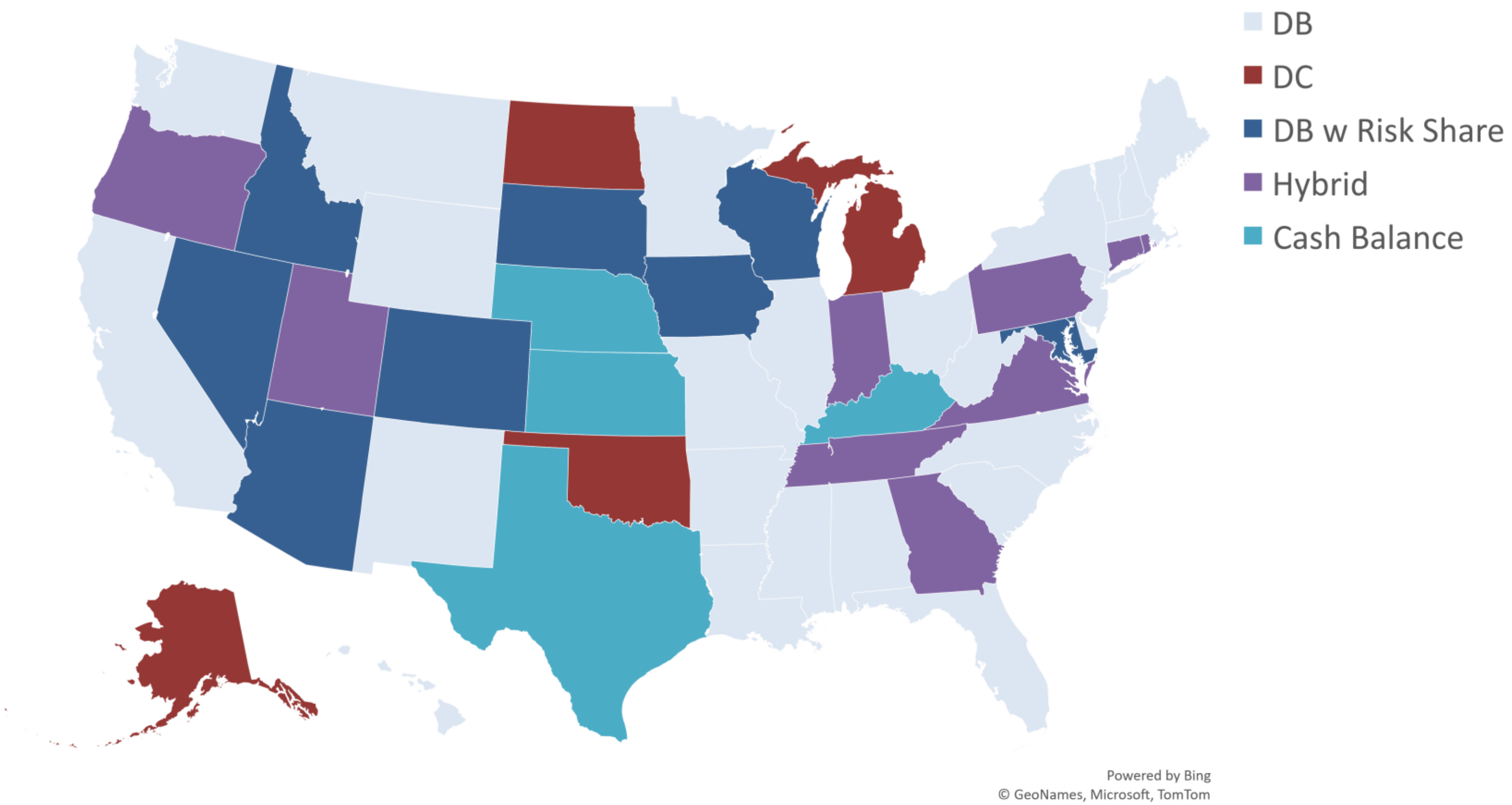
State Risk Reporting Practices

25 states conduct forward-looking assessments of investment risk on pension plan funding and contributions.



Plan Design for State Workers

States have a variety of options for how to manage risk



Note: Map shows plan design for retirement system covering state workers. DB with Risk Share describes plans with employee contribution risk-sharing, variable COLAs, or both.

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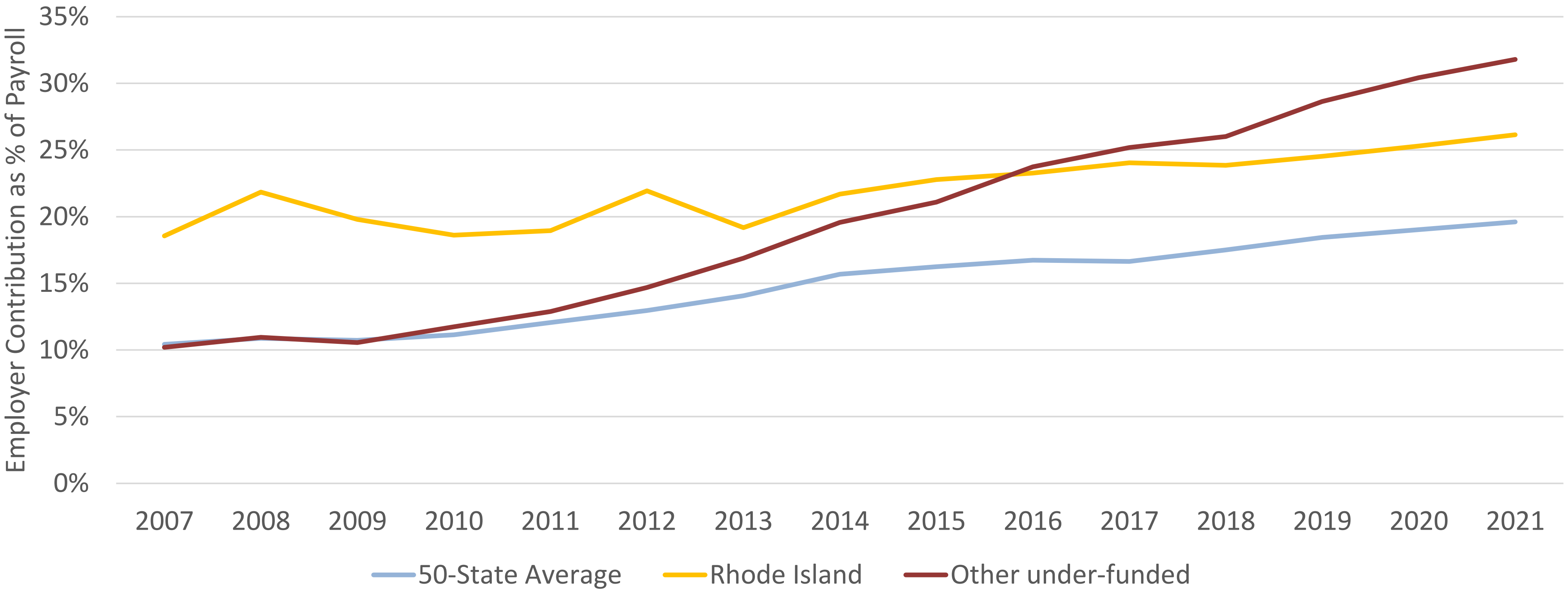
Policy Can Make a Difference

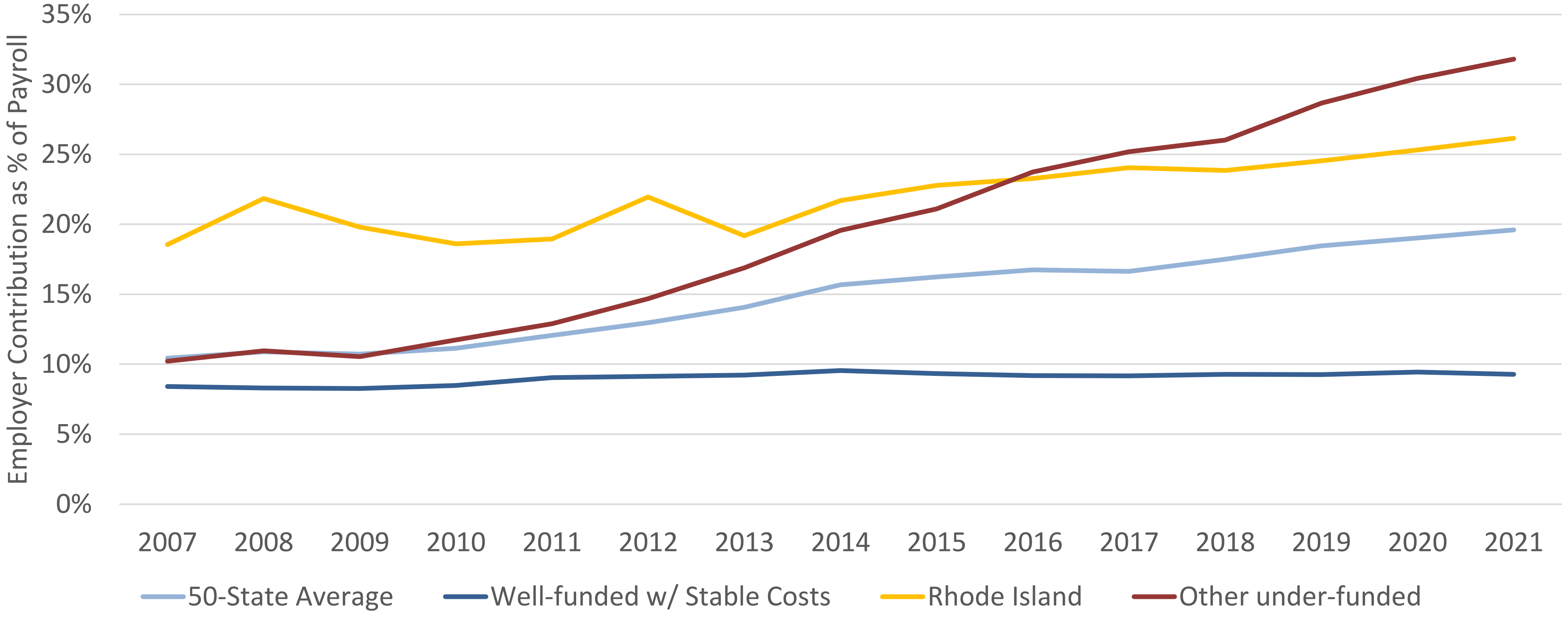
Decisions that led to underfunding state pension plans put increasing pressure on state budgets.



Well-funded states with stable costs include Idaho, Nebraska, South Dakota, Tennessee, and Wisconsin. Other well-funded states includes Delaware, North Carolina, New York, Utah, and Washington. The 10 worst funded states as of 2021 were Connecticut, Hawaii, Illinois, Kentucky, Massachusetts, New Jersey, Pennsylvania, Rhode Island, South Carolina, and Vermont.

Good Policy Can Make a Difference Too

Well-funded states with tools to manage risk can keep costs stable over time.



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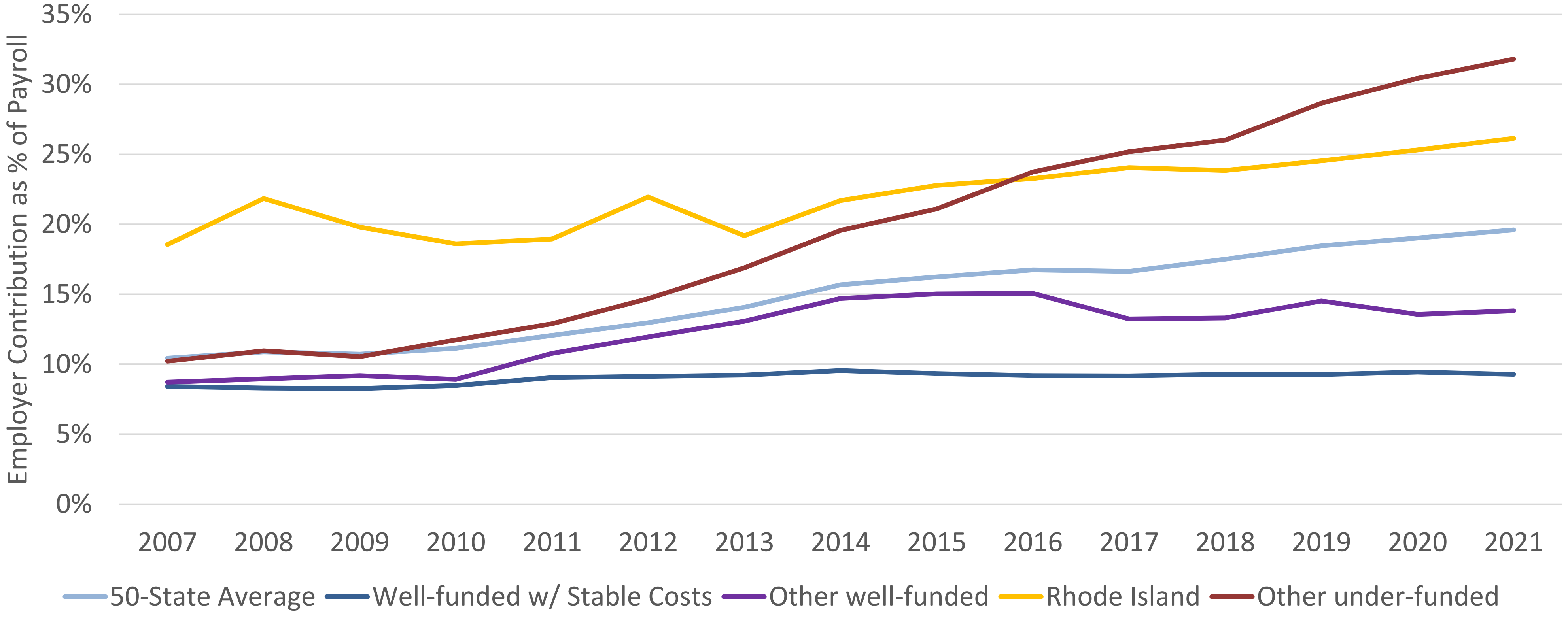

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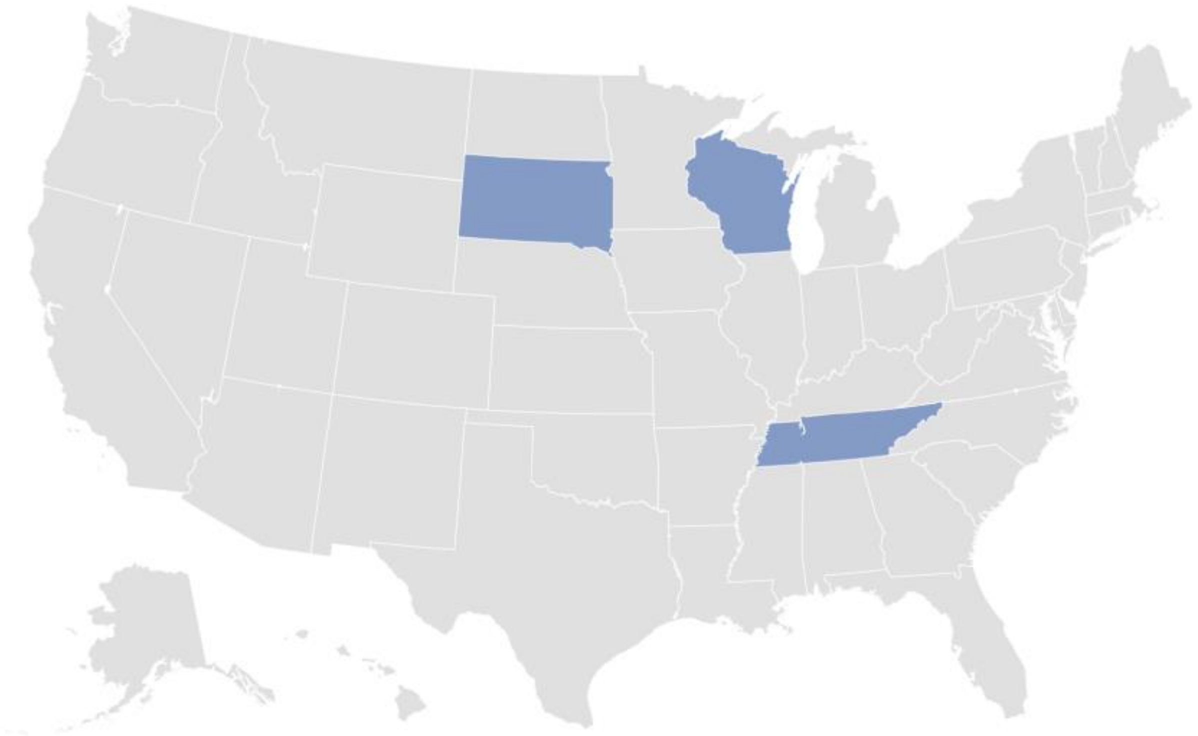
Practices of Successful Retirement Systems

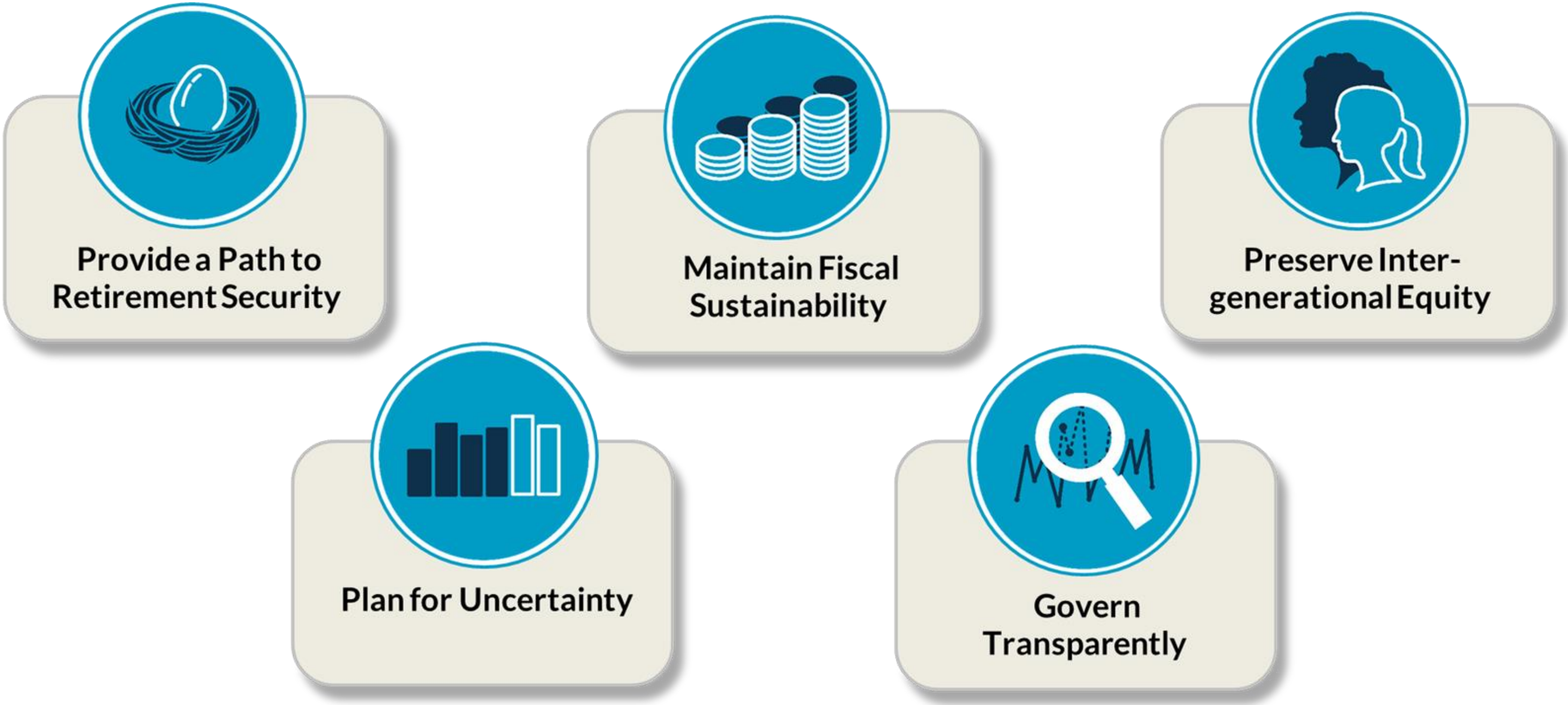
Spotlight on Three State Pension Plans:
No One-Size-Fits-All

Different policies but all three were well funded with stable costs and strong outcomes for retirement security.



- **Wisconsin Retirement System—**Shared risk design
- **South Dakota Retirement System—** Adjustable benefits
- **Tennessee Consolidated Retirement System—** Risk-managed hybrid

5 Practices of Highly Successful Retirement Systems



How Do We Measure Retirement Security?

Replacement income ratio: percentage of a worker's pre-retirement take-home pay covered by their combined income from a state or city retirement plan benefit plus Social Security.

Retirement savings rate: the level of savings, expressed as the percent of annual salary, that an employee can withdraw from their pension fund when leaving employment prior to reaching retirement eligibility.

For more details, see Pew's factsheets How Measuring Replacement Income Can Aid Assessment of Public Plans and Savings Rate Fills Out Picture of Workers' Retirement Security.

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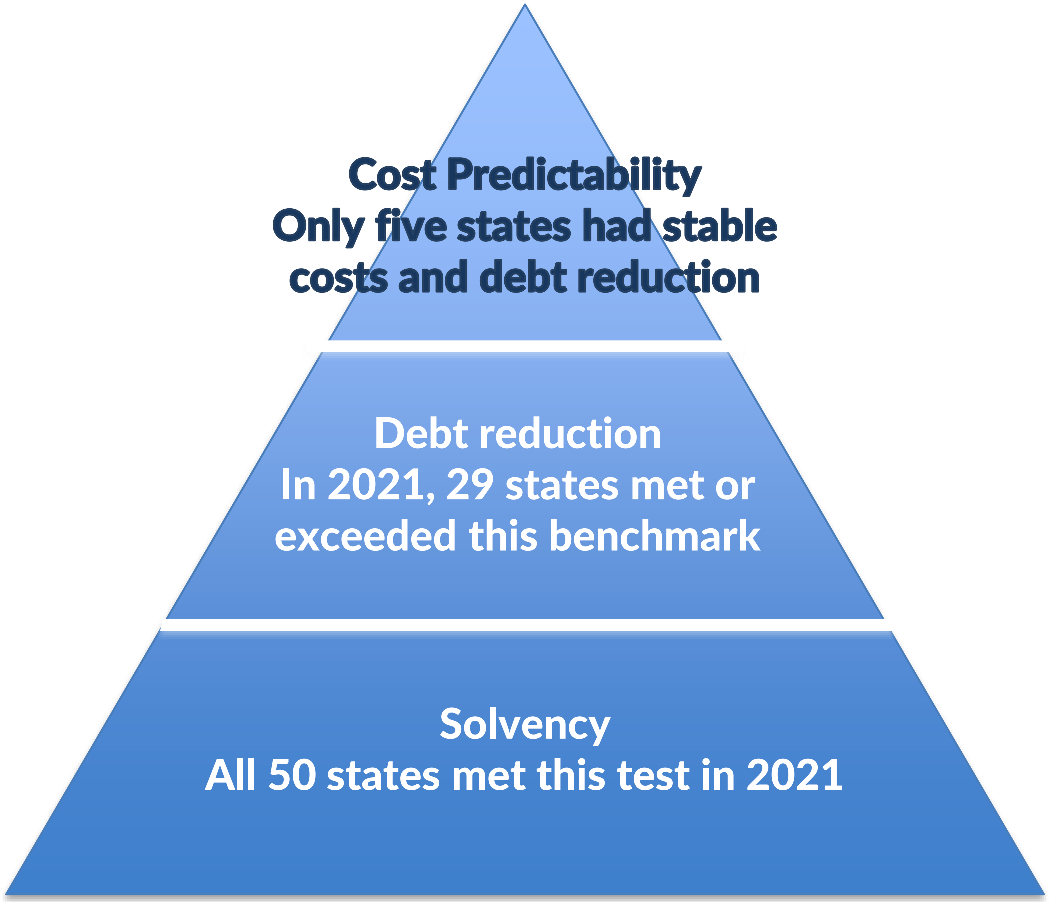
How Do We Measure Fiscal Sustainability?

- Solvency is measured by whether the operating cash flow ratio is below -5%.
- Debt reduction is based on whether employer contributions are enough to keep the funding gap stable or to pay down pension debt.
- Cost predictability is based on the range of employer contribution rates.



Lessons From Successful States

- Ensure actuarial funding is met.
- Manage to a target cost.
- Variable cost-of-living adjustments are a powerful stabilizer.
- Fiscal sustainability allows benefits that match workforce needs and retirement goals.
- Conduct stress testing and risk analysis.

Pensions in Rhode Island

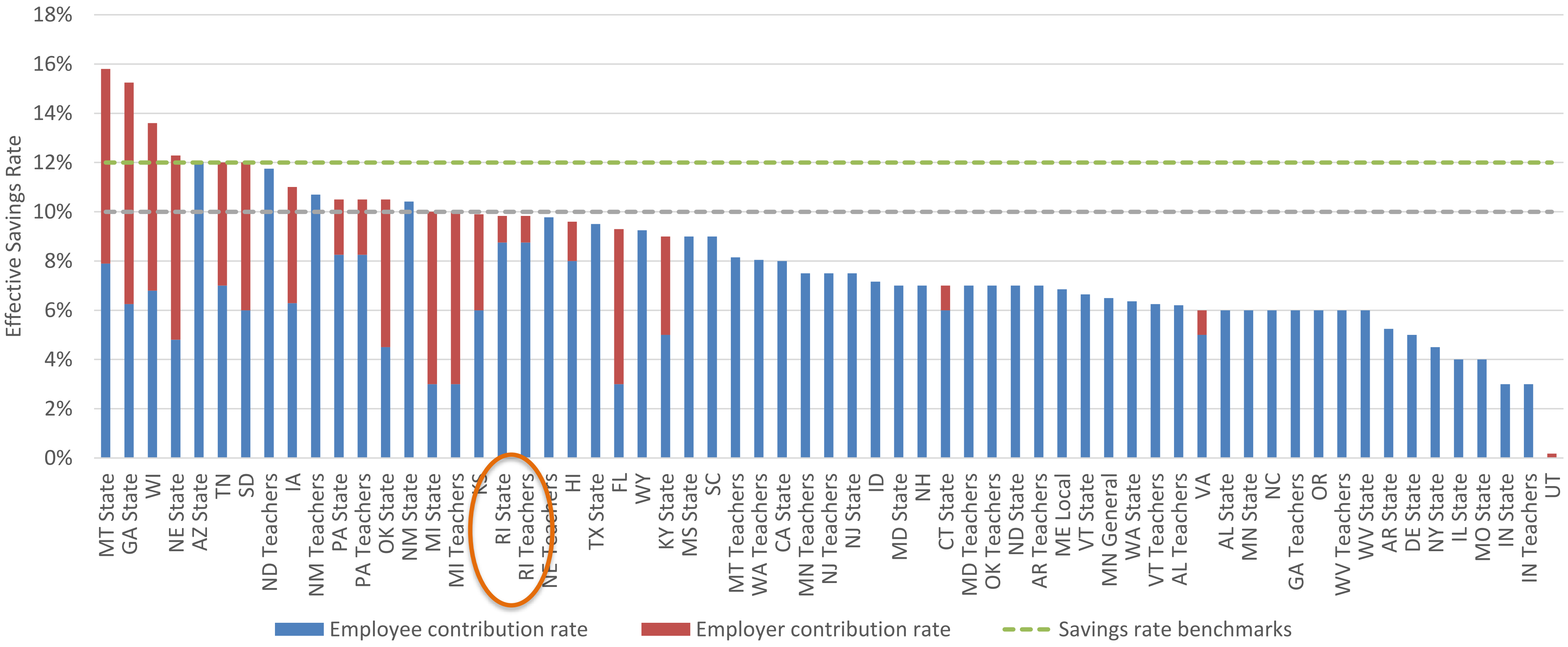
Rhode Island Has Improved On Fiscal Sustainability

The state is now meeting thresholds for fiscal sustainability by paying down pension debt and managing cash flow.

Rhode Island	2014	2015	2016	2017	2018	2019	2020	2021
Assets	$6,562,351	$6,338,857	$5,976,301	$6,320,816	$6,485,178	$6,587,825	$6,554,728	$8,027,963
Liabilities	$10,802,545	$11,106,191	$11,119,013	$11,774,878	$11,966,274	$12,098,031	$12,088,024	$12,178,007
Percent Funded	61%	57%	54%	54%	54%	54%	54%	66%
Unfunded	$4,240,194	$4,767,334	$5,142,712	$5,454,061	$5,481,096	$5,510,206	$5,533,296	$4,150,044
Net Amortization Benchmark	$424,811	$386,427	$404,779	$432,110	$438,285	$440,384	$444,112	$443,173
Employer Contributions w/ Interest	$368,492	$393,937	$406,078	$430,576	$433,127	$460,243	$490,539	$505,547
Net Amortization % Pay	**-3%**	0%	0%	0%	0%	1%	2%	3%
Cash Flow	-$394,514	-$374,769	-$348,896	-$332,746	-$328,427	-$307,551	-$276,993	-$268,857
Operating Cash Flow Ratio	**-6.5%**	**-5.7%**	**-5.5%**	**-5.6%**	**-5.2%**	-4.7%	-4.2%	-4.1%

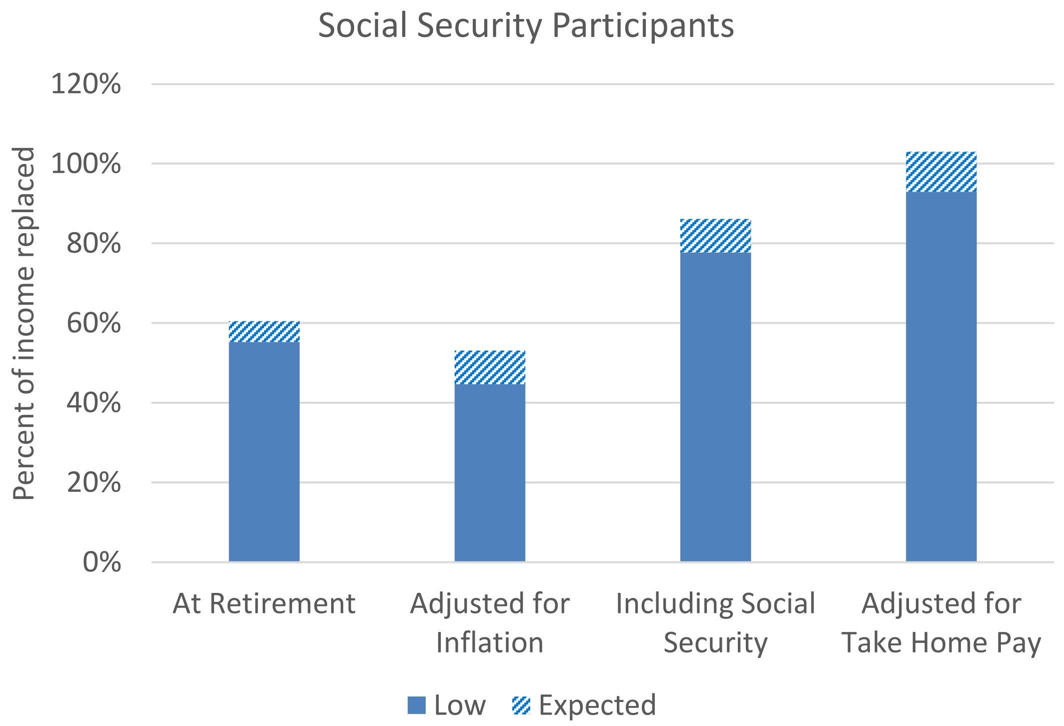
Rhode Island Employee Savings Rate

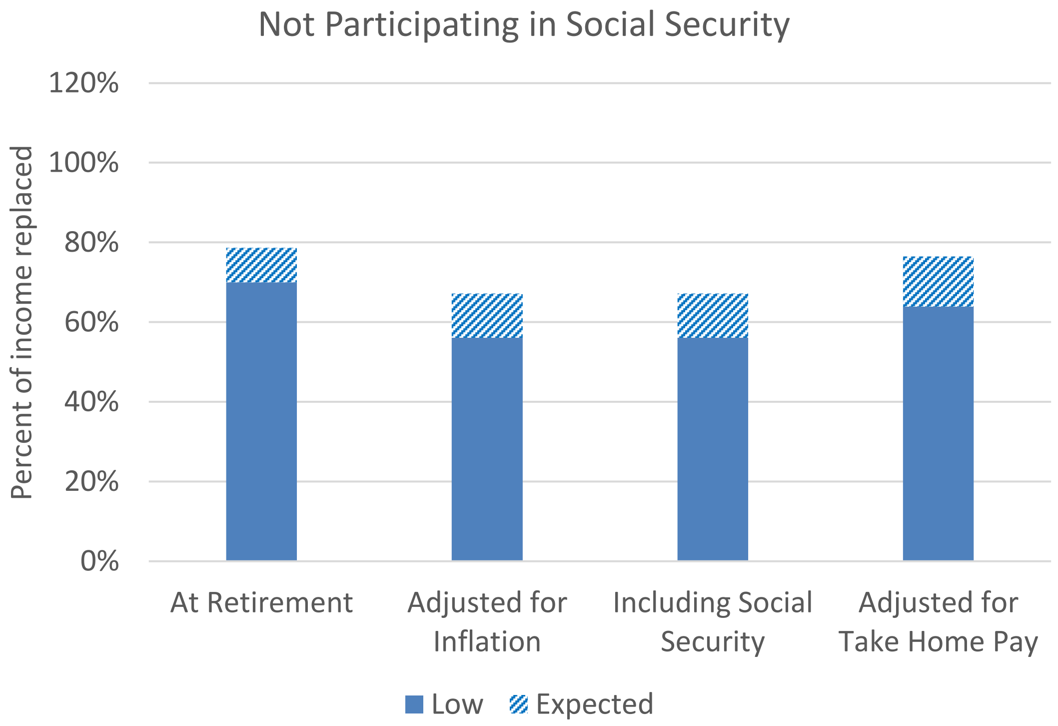
The effective savings rate from employer benefits for workers who separate



Rhode Island Replacement Income

Share of take-home pay replaced in retirement for a retired teacher with and without Social Security

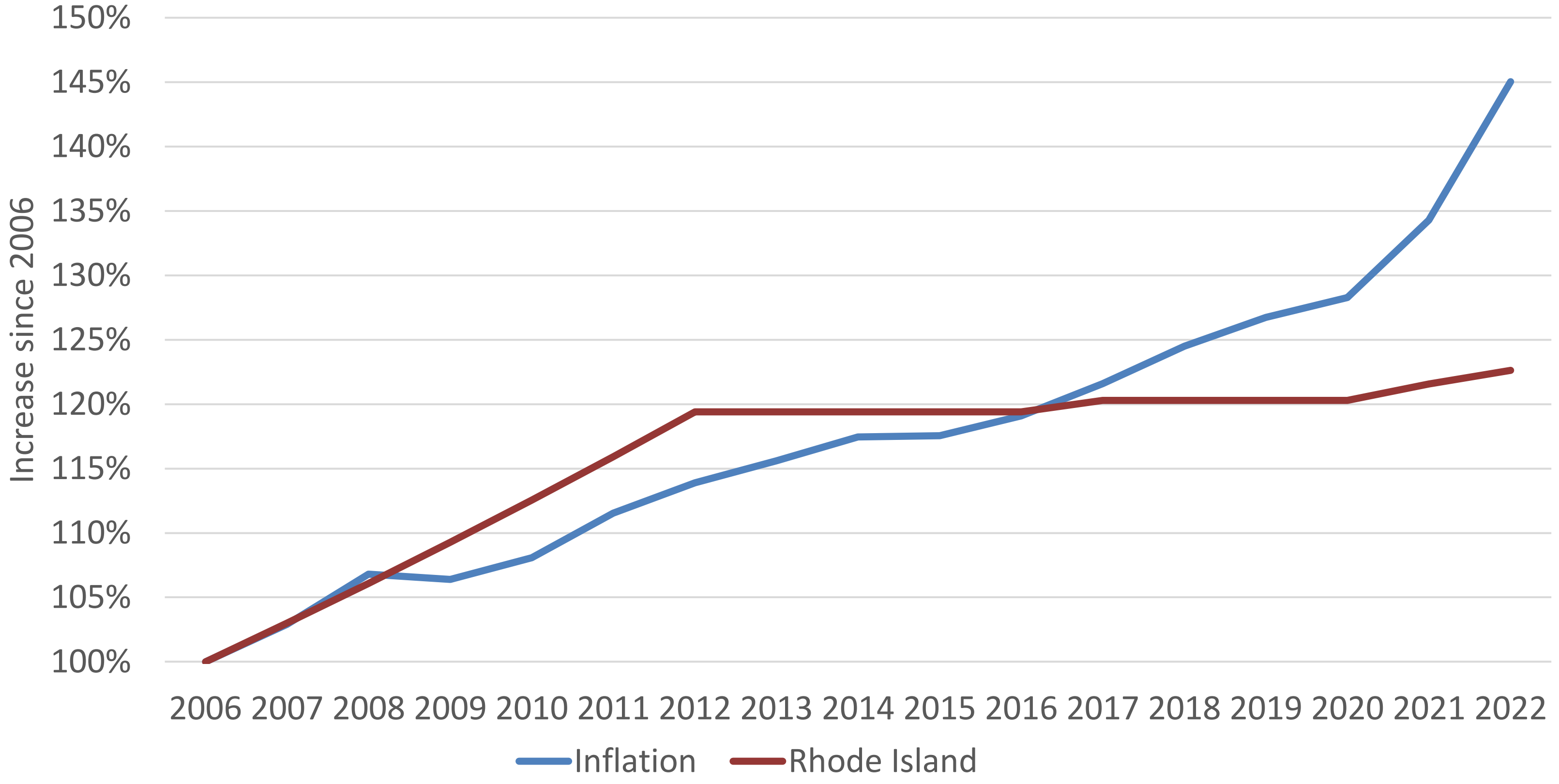




Note: For a teacher starting at age 27 and retiring at age 67. To adjust for inflation, we estimate the level of benefit at halfway through retirement compared to salary at separation. Benefits are shown based on expected return performance on DC accounts and expected COLAs as well as levels based on lower-than-expected returns.

State COLA Practices

A number of states either changed COLAs following the Great Recession or had policies that would automatically adjust COLAs in response to a downturn



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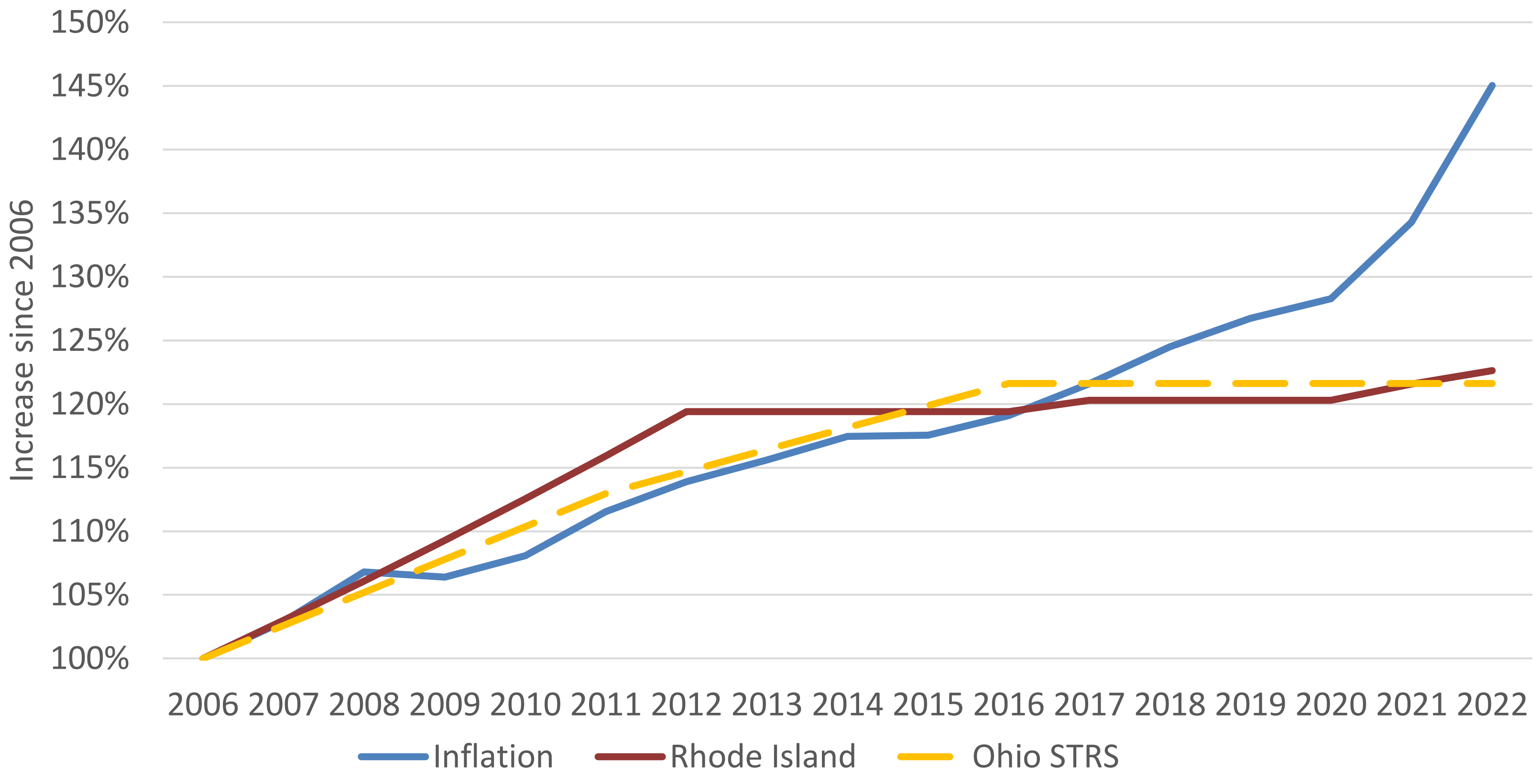

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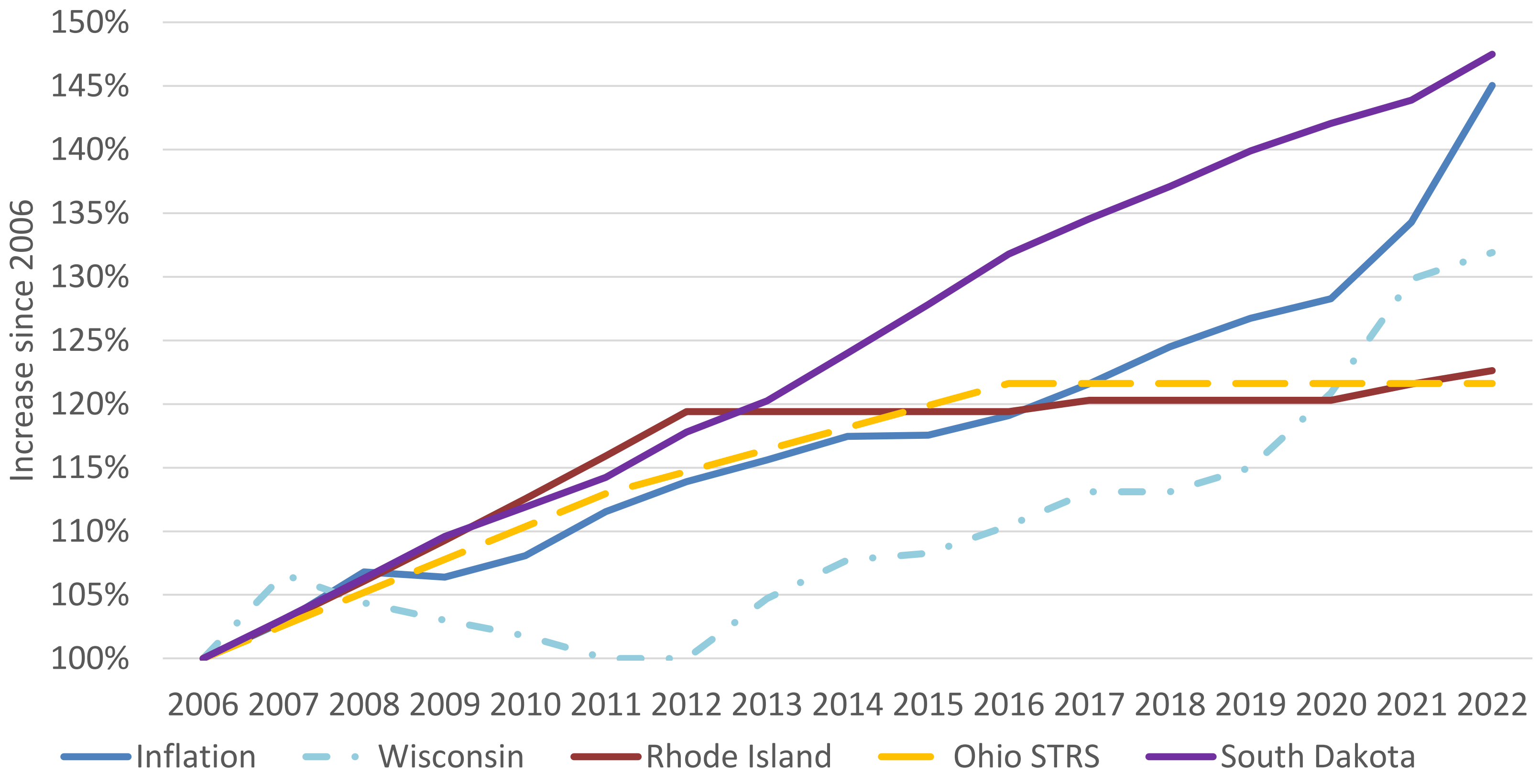

COLA Considerations

- Re-instating the full COLA rather than waiting until the 80% funded threshold is reached would add to liabilities and to risk.

- Policymakers considering how to balance retirement security, fiscal sustainability, and intergenerational equity should consider the following:
  - What is the increase to the liability from a benefit change and what is the increase in the contributions needed to amortize that increase, based on an actuarial valuation?
  - What is the increase in the risk to pension plan funding and employer budgets, based on a pension stress test or similar analysis?
  - Can the risk be addressed using variable benefit provisions or other tools?

Conclusion

- Effective and sustainable pension policy has allowed successful states to offer retirement benefits that are well-funded and have affordable and stable costs.

- A decade of reforms and increased contributions have stabilized the funding gap for state pension plans.

- Investment risk remains a significant challenge though states have looked to stress testing, plan design changes, and other policy adjustments to better measure and manage that risk.

- Rhode Island remains underfunded and any consideration of changes to COLAs should include an assessment of both risk and cost. An examination of successful plans shows that variable COLAs can be part of a stable and sustainable retirement benefit.

For more information:

https://www.pewtrusts.org/en/projects/public-sector-retirement-systems

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