Sustainable Funding for Public Pension Plans

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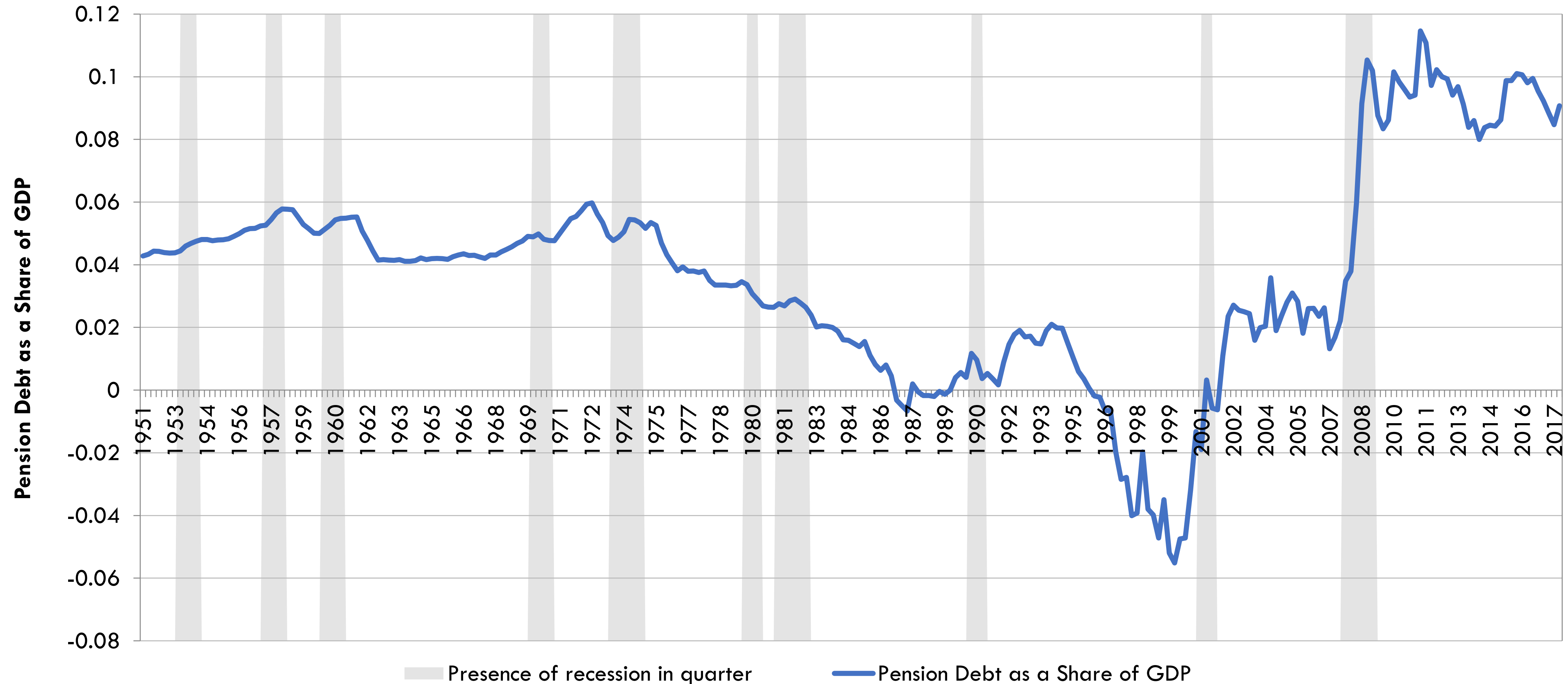
What is Stable Funding for State and Local Pension Plans?

- Costs will be sustainable and predictable across the business cycle.
- Intergenerational equity will be preserved—costs and risks for services rendered today will be paid for by current taxpayers.
- Almost all public pension plans have a long-term target of full funding and many state and local pension plans are taking steps to pay down pension debt to achieve the above goals. However, severely underfunded systems will pose difficult tradeoffs regarding how rapidly to target full funding.

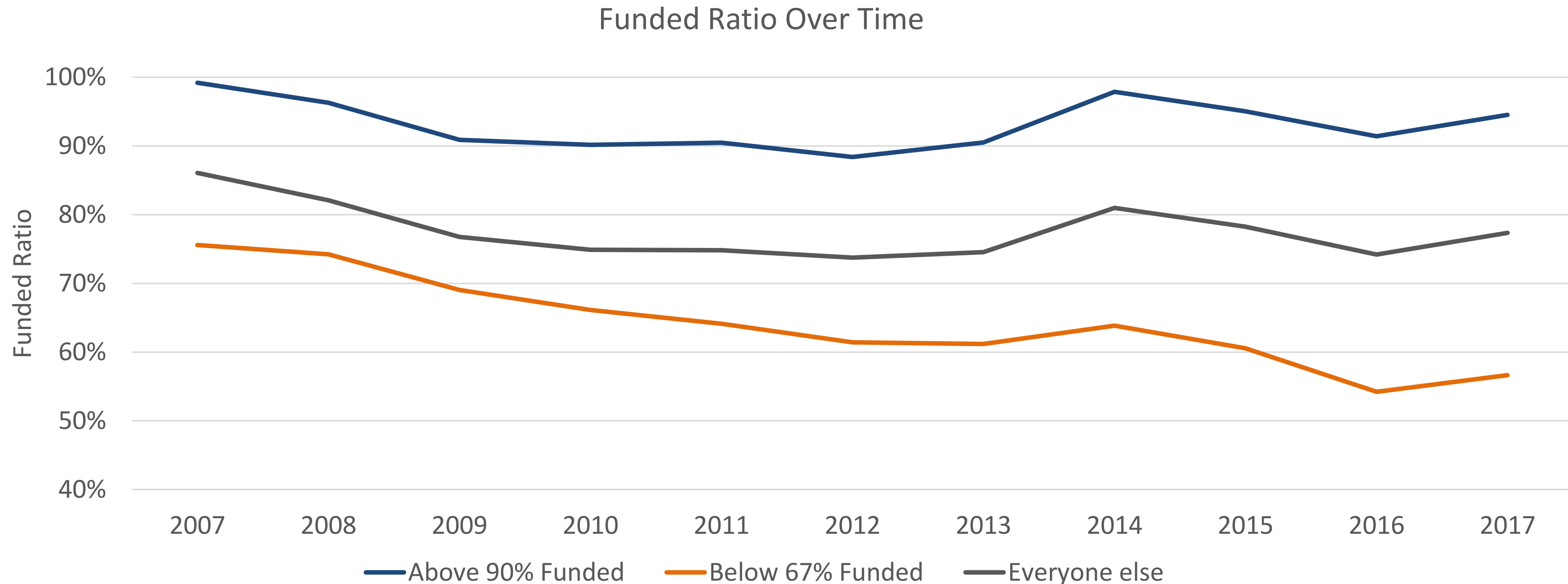
State Pension Debt Remains at Historically High Levels



Sources: The Federal Reserve and U.S. Department of Commerce Bureau of Economic Analysis

Best-funded states are able to recover after a recession

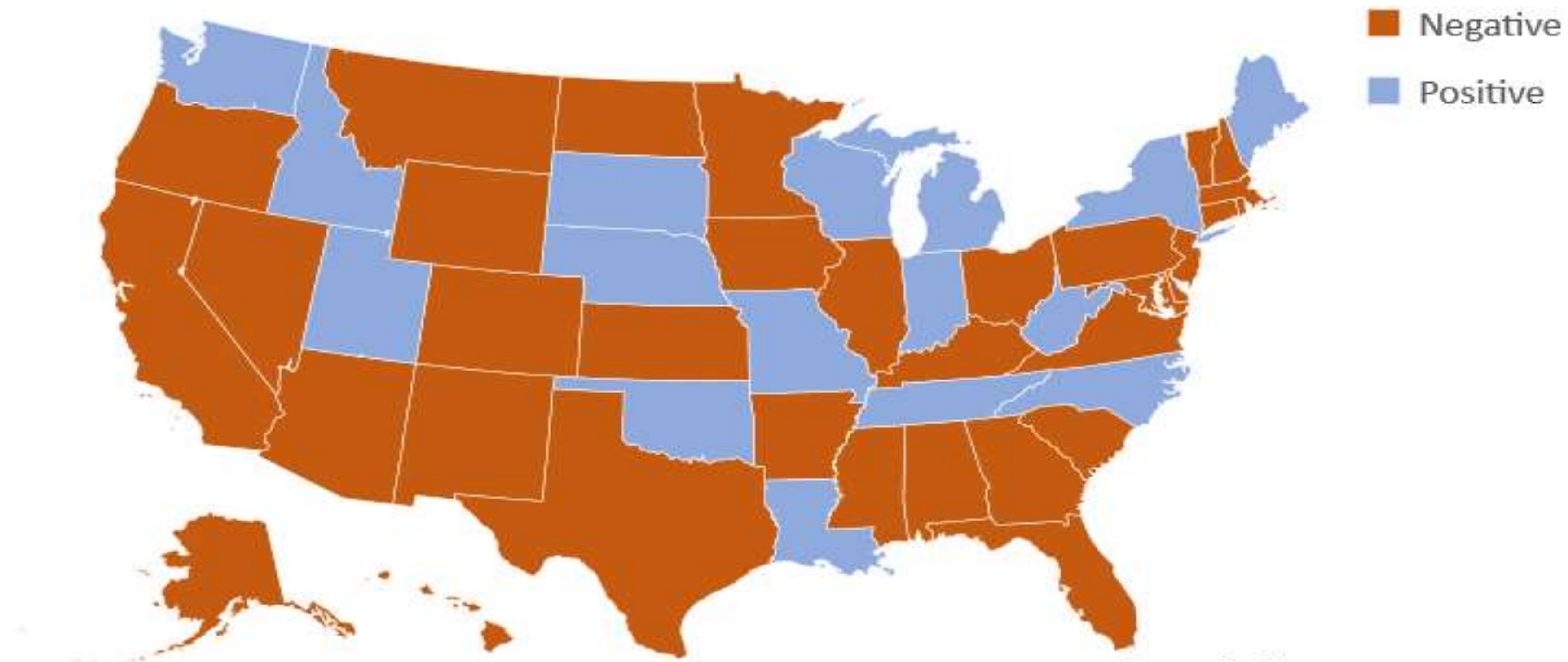
The eight states at least 90 percent funded in 2017 saw funding levels improve between 2012 and 2017 while the states below two-thirds funded saw funding levels drop further despite strong investment performance.



Sources: Comprehensive annual financial reports, actuarial reports and valuations, other public documents, or as provided by plan officials.

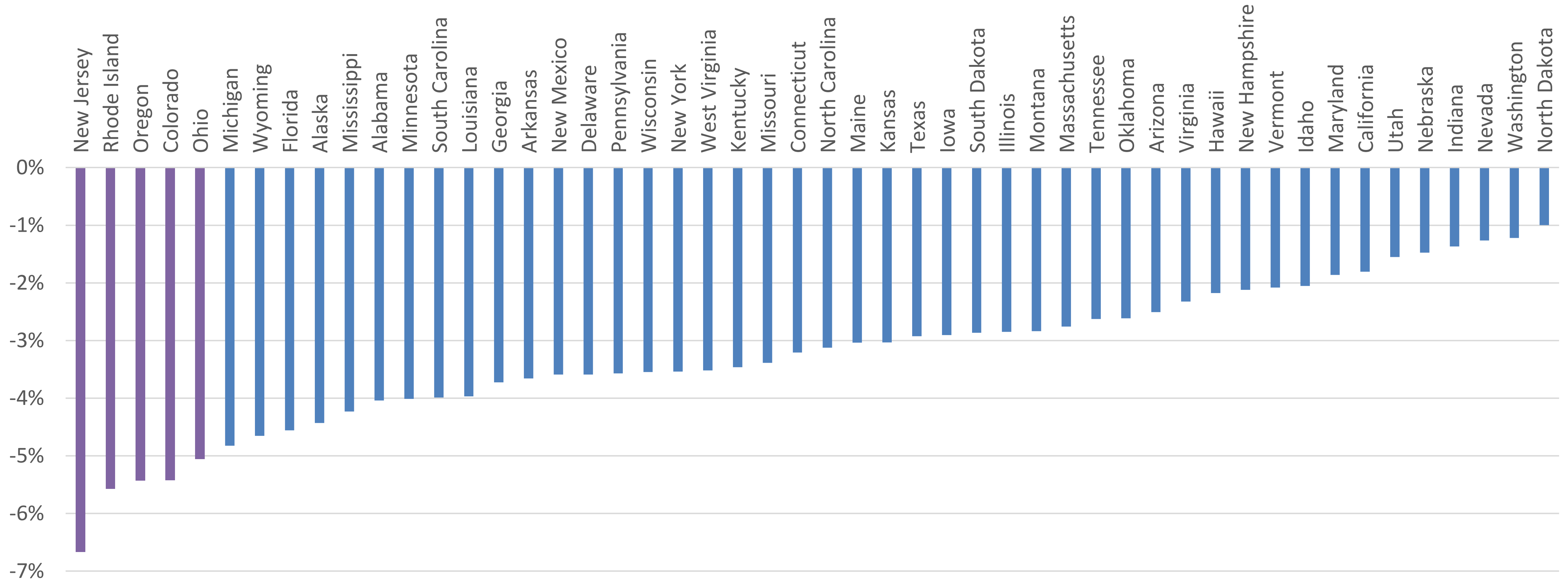
Most States Fell Short of Contribution Benchmark

In 2017, sixteen states were making sufficient payments to expect to make progress on paying doing pension debt. Though contributions fell $26 billion short, many states have been taking steps to strengthen funding levels.



State Pension Plans Vary in Cash Flow Situation

Overall the operating cash flow ratio in 2017 was -3.3% of assets and five states were below -5%, an early warning indicator.



Examples of Public Plans that Achieved Fiscal Stability

Plan	2017 Funded Ratio	Combined Contribution Rate	Net Amortization as % of Payroll	Operating Cash Flow Ratio
Wisconsin Retirement System	103%	14%	1%	-3.5%
South Dakota Retirement System	100%	12%	2%	-2.8%
Tennessee – Public Employees Retirement Plan	96%	14%	4%	-2.5%
Nebraska – State and County Employees Pension Plans	110%	12%	3%	-0.8%
Utah Retirement System	90%	23%	5%	-1.3%
US Average	69%	21%	-4%	-3.3%

Sources: Comprehensive annual financial reports, actuarial reports and valuations, other public documents, or as provided by plan officials.
Net amortization as a percent of payroll shows the amount of expected reduction in pension debt as a percentage of payroll—negative numbers mean that pension debt was expected to increase.. The operating cash flow ratio is calculated as the difference between employer and employee contributions and benefit payments and other expenses calculated as a percentage of plan assets.

Key Takeaways on Financial Stability in Public Pensions

- No-one-size fits all—variety of successful approaches to plan design and contribution policy.

- Pension policies that achieve financial stability and intergenerational equity often include:
  - Fifteen to 20 year amortization periods (examples include NC, UT, TN, and WI)
  - Contribution floors
  - Cost-sharing features

- Net amortization and cash flow offer useful indicators of financial stability.

- Stress testing and forward looking projections are the best tool to evaluate whether funding policy for a public pension plan will achieve sustainable and predictable costs across the business cycle.

- Policy can differentiate between how to ensure full funding of future benefits while providing a sustainable plan to manage legacy liabilities.

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