RETIREMENT SYSTEMS

PENSION POLICIES THAT PERFORM

Disciplined funding practices have helped some states withstand market volatility.

BY ANNA PETRINI

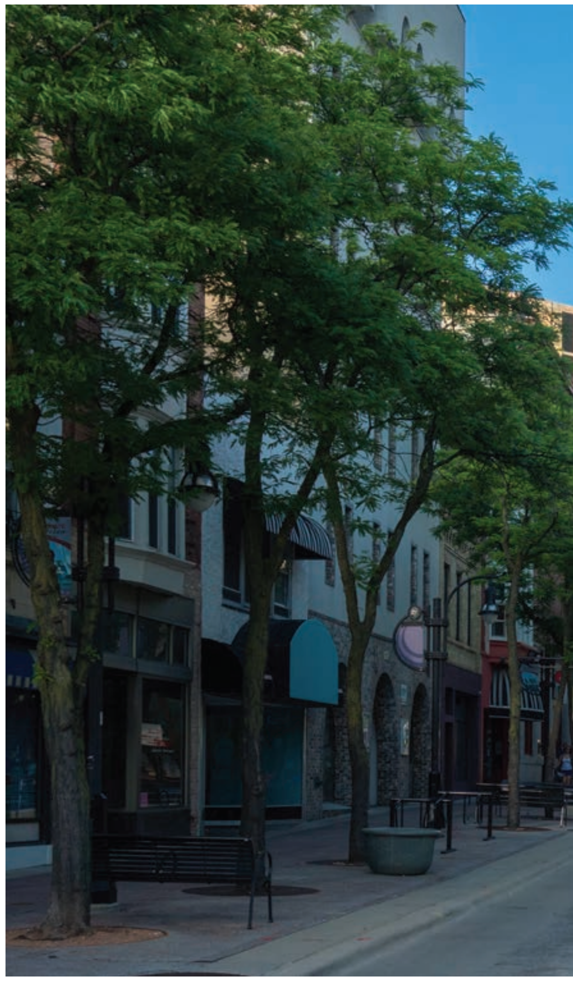
After nine years of economic recovery from the Great Recession, some state pension plans have regained their financial footing. Others never lost it. But many continue to struggle, despite healthy investment returns, according to a new report from The Pew Charitable Trusts.

The report highlights three states with disciplined funding policies that have helped them withstand market volatility while still providing benefits that put workers on the path to retirement security. It also raises questions about how well states with severe funding woes can weather another economic downturn. Pew collected 50-state data for pension systems in fiscal year 2017 and found a cumulative $1.28 trillion deficit—an improvement from the $1.35 trillion gap reported for FY 2016 but an indication that certain funds are straining to cover their obligations to employees and retirees.

Aggregate data about costs and funding can belie significant variations. Public pension plans are not monolithic. They have different funding histories, face different challenges and occupy different fiscal positions as a result. For example, Wisconsin had 103% of the assets it needed to fully fund pension liabilities in 2017. Kentucky? Just 34%.

Between 2012 and 2017, the median pension plan boasted investment returns over 9%. But even with a strong investment performance, the worst-funded plans continued to report declines. Illinois, Kentucky and New Jersey saw an average 15% decrease in their funded ratios.

In contrast, South Dakota, Tennessee and Wisconsin claim funded ratios between 97% and 103% and have never dipped below 89% over the last two decades. How have three states, with different pension plan designs and funding policies, maintained such good financial posture as the recession set so many back on their heels? Pew cites two factors: full contributions in good times and in bad, and sound risk management policies that allowed them to weather volatility.

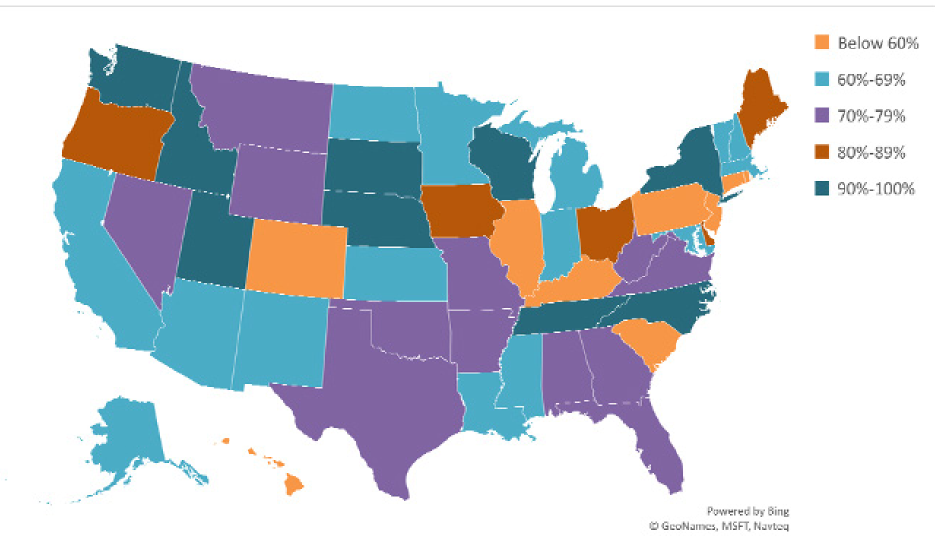


The Wisconsin Capitol, above, seen from State Street in Madison. The state is one of only 10 that have paid the full actuarial contribution to its pension fund every year from 2007 to 2013.

Notable features of the Wisconsin Retirement System include a commitment to making full actuarial contributions and a formal risk-sharing arrangement, which spreads the costs of poor investment returns and the benefits of solid ones between employers and employees. Retirees' cost of living adjustments also ratchet

State Pension Funding

Just nine states were at least 90% funded and 23 were less than 70% funded in 2017.



Note: Numbers reflect GASB reporting standards as of 2017.

Source: The Pew Charitable Trusts

$1.28 trillion

Cumulative 50-state deficit for pension systems in fiscal year 2017, less than the $1.35 trillion gap in 2016.

up or down based on investment performance and plan funding.

South Dakota's defined benefit pension plan has fixed employee and employer contributions, and the state automatically adjusts benefits through a variable COLA. The South Dakota Retirement System also recently began stress testing its plan assumptions and releasing the results publicly, so officials and plan members can assess how the plan would fare under different economic and investment-return scenarios.

When Tennessee saw investment gains in 2010 and '11, it raised employer contributions, speeding its return to full funding and creating a funding cushion to stabilize costs when markets become volatile. In 2013, Tennessee adopted a risk-managed "hybrid" pension plan for its new employees that combines a traditional defined benefit plan with a 401(k)-type defined contribution arrangement.

Employer contributions to the Tennessee Consolidated Retirement System are set to exceed expected costs. Excess employer payments are set aside in a stabilization reserve. The plan includes five additional "shock absorbers" that adjust benefits and contributions, if needed, to keep the plan on track to full funding.

By minimizing pension debt, Wisconsin, South Dakota and Tennessee have achieved full funding with limited demands on taxpayer dollars. But, as Tennessee plan director Jamie Wayman reminded participants during a recent webinar, every state's position is unique.

"It's not one size fits all for everybody," he said. "Every jurisdiction is going to have to do what's best for them."

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