National Conference on
Public Employee Retirement Systems
The Voice for Public Pensions

On the Record Statement
Regarding the Funding and Transparency
of State and Local Pension Plans

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Before the Committee of Ways and Means Subcommittee on Oversight
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Introduction

Thank you for allowing my organization, the National Conference on Public Employee Retirement Systems (NCPERS), to submit this on-the-record testimony for your review. The growing national debate over public pension funds has raised a wide range of concerns. Some of those concerns are justified, but many are not. In many instances, the current debate has generated much more heat than light. It is our hope that our testimony will shed much-needed light on the status of public pension plans and provide the subcommittee with up-to-date data on the health and sustainability of those plans. Given the contentious political climate that has put public pension plans under attack, it is crucial that policymakers at all levels of government are operating with full and accurate information and that they are evaluating that information in the proper context.

NCPERS is the largest trade association for public sector pension funds, representing more than 500 funds throughout the United States and Canada. It is a unique non-profit network of public trustees, administrators, public officials and investment professionals who collectively manage nearly $3 trillion in pension assets. Founded in 1941, NCPERS is the principal trade association working to promote and protect pensions by focusing on advocacy, research and education for the benefit of pubic sector pension stakeholders. Further, NCPERS promotes retirement security for *all* workers through access to defined benefit pension plans.

In addition to serving as Executive Director and Counsel for NCPERS, I currently serve as a Trustee on the Fairfax County Uniform Retirement System, $1 billion public employee retirement system providing pension coverage for the Fire & Rescue Department, Sheriff's Department, and certain other sworn employees of Fairfax, Virginia. I also served on the Morningstar Pension Endowments and Foundations Steering Committee and City of Virginia Beach Mayor's Committee on Employee Pensions. Before joining NCPERS I served for six years as a government representative for an international public sector union, working on benefits, appropriations, homeland security and health care issues. I helped draft and lobby for passage of the Staffing for Adequate Fire and Emergency Response

(SAFER) Act. I have served on several Federal Advisory Committee Act (FACA) committees and working groups. I began my career in the office of former Sen. Bill Bradley of New Jersey, where I worked on the Newborns' and Mothers' Health Protection Act.

The Health and Sustainability of Public Pension Plans

First and foremost, we would like to assure you that the vast majority of public pension plans are healthy, sustainable and more than adequately funded. There are a few, extremely well-publicized exceptions, but they are just that – exceptions, not the rule. And the few plans that are in trouble are in trouble for the same reason – failure by the government entities sponsoring them to live up to their legal and fiduciary responsibilities to regularly and adequately fund their plans.

Illinois is currently in the news for being in last place among the states when it comes to funding its pension systems. Illinois' repeated and prolonged failure to contribute what it owes stands in stark contrast to its employees' faithful contributions, paycheck after paycheck. The story of the tiny town of Prichard, Alabama has also been chronicled far and wide. Town officials failed to fund its plan, defied state law by cutting off all benefits to its 150 retirees nearly two years ago and has sought (unsuccessfully so far) bankruptcy protection to get out from under their obligation. At least 18 of Prichard's pensioners have died while waiting for the pension checks they were promised in return for their years of public service.

But as I said, these are the exceptions, not the rule. This spring, NCPERS and Cobalt Community Research conducted perhaps the most comprehensive study addressing retirement issues for state and local pension plans. In all, 216 public pension funds covering nearly 7.6 million active and retired public employees and with assets exceeding $900 billion were surveyed. The vast majority – 83 percent – were local pension funds, while 17 percent were state pension funds.

What we found was that public pension plans are experiencing a robust recovery from the Great Recession that adversely impacted all institutional investors. They report earning above-average returns. And they are more than adequately funded to meet their obligations.

Some recent studies of public pension funds paint an unrealistically bleak picture because they rely in the main on 2009 data – data from a low point in the Great Recession. NCPERS survey relies on up-to-date data and demonstrates convincingly that a lot has changed for the better over the past 18 months.

The NCPERS/Cobalt Community Research Survey's key findings

Despite weak short-term investment experience in 2008 and 2009, the long-term investment discipline of fund managers has produced an average one-year return of 13.5 percent, based on

the most recently reported data. Funds participating in the study reported a 20-year average return of 8.2 percent.
Investment returns are the single most significant source of plan funding, comprising about 66 percent of fund revenue. Individual plan members are a significant source of plan funding, contributing 10 percent of plan revenue. Employer contributions comprise only 24 percent of plan revenue.

Although media coverage has focused on a handful of troubled funds, the vast majority of plans are managed responsibly and maintain strong funding levels. On average, public pension plans are 75.7 percent funded and continue to work toward full funding. According to its February 2011 report *Enhancing the Analysis of U.S. State and Local Government Pension Obligations*, Fitch Ratings considers a funded ratio of 70 percent or above to be adequate.

The NCPERS/Cobalt Community Research study presents a far more accurate – and far less distressing – picture of the actual status of public pension plans today. And our findings do not stand alone. Reviews by the Economic Policy Institute as well as by the National Association of State Retirement Administrators and the National Council on Teacher Retirement have produced similar findings.

<u>Public Pension Plans Adapting to New Economic Realities</u>

Public pension plans are not relying solely on strong investment returns to ensure their sustainability. Plans are already undertaking a wide range of structural changes to adapt responsibly to current economic realities and to guarantee their long-term health.

In 2010, more changes were enacted by state and local governments across the country than in any year in recent history. More modifications are in the works – to benefits, plan design, operational practices, oversight practices and more. This continuing restructuring should guarantee not only that public pensions remain the most efficient means of delivering retirement benefits, but also the least costly – at least to states and localities that have kept up with their required contributions to those plans. Jurisdictions that have shown less funding discipline may face greater challenges.

NCPERS and Cobalt Community Research are currently conducting a comprehensive review of the changes public pension fund have made or plan to make in the near future. The full report will be completed in late Spring 2011 and will be shared with members of the subcommittee.

<u>America's Retirement Crisis</u>

While budget and revenue shortfalls have prompted officials at all levels of government to take a close look at public pensions systems, we believe that their focus is too narrow. The fact is that while the vast majority of public pension plans are healthy and sustainable, they provide retirement benefits to only a fraction of American workers.

The U.S. is facing an overall retirement crisis. Our ability as a nation to sustain our economy at a time when a record number of workers are entering their retirement years should be an important part of our national debate. Retirement security for *all* Americans – whether the work in the public or private sector – must become a national priority.

The truth is that for more than 100 years, public pension plans have been the most economically efficient means of delivering retirement benefits. Another inescapable truth is that until the 1980s – when defined contribution plans like the 401(k) were introduced – defined benefit pensions were common in the private sector. Workers knew that with their pensions, Social Security and their own savings, they could retire with dignity.

Today, there's a $6.6 trillion deficit between what 401k account holders should have and what they actually have. And the 80 million baby-boomers who are nearing retirement may not have enough time left in the workforce to earn back what they have lost in retirement assets.

It is our hope that as they look at the functioning of state and local pension funds, members of Congress and other policymakers will see that public pension plans provide ample evidence of how effective retirement systems can and do work – and that they provide a strong model for addressing America's retirement crisis and providing retirement security for all.

NCPERS stands ready to assist federal and state policymakers with facts, research, and expertise as they delve into policy discussions on retirement security. We invite this committee to contact us should you need additional information.

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2011 NCPERS
Public Fund Study

Preliminary Results
April 2011

Study conducted by
National Conference on Public Employee Retirement Systems
and Cobalt Community Research

2011 NCPERS Public Fund Study Preliminary Results

Compiled by Cobalt Community Research

This study reviews funds' current fiscal condition and steps they are taking to ensure fiscal and operational integrity

Executive Summary

In March and April 2011, the National Conference on Public Employee Retirement Systems (NCPERS) began a study to collect the most recently available data on member funds' fiscal condition and steps they are taking to ensure fiscal and operational integrity.

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The 2011 NCPERS Public Fund Study includes responses from 216 member funds with a total number active and retired memberships surpassing 7,599,000 and assets exceeding $900 billion. It is the most comprehensive study addressing retirement issues for this segment of the public sector.

Key Findings

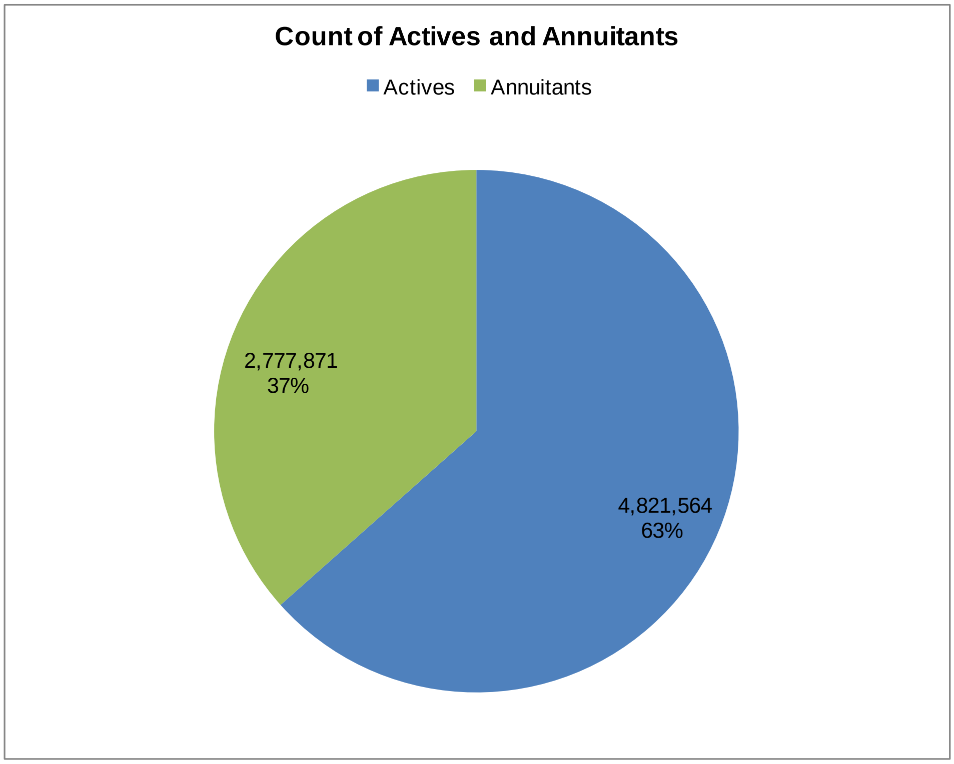
1. Despite weak short-term investment experience in 2008 and 2009, the long-term investment discipline of fund managers has produced an average 1-year return of 13.5 percent based on most recently reported data. Funds participating in the study reported a 20-year average of 8.2 percent. The average return that respondents use to calculate assets is 7.7 percent with an assumed rate of inflation of 3.5 percent.
2. Investment returns are the single most significant source of plan funding, comprising about 66 percent of fund revenue. Members are a significant source of plan funding and contributed 10 percent of plan revenue. Employer contributions comprise only 24 percent of plan revenue.
3. Although media coverage has focused on a handful of troubled funds, most funds are managed responsibly and maintain strong funding levels. On average, funds are 75.7 percent funded and continue to work toward full funding. According to its February 2011 report *Enhancing the Analysis of U.S. State and Local Government Pension Obligations*, Fitch Ratings considers a funded ratio of 70 percent or above to be adequate. As with a home mortgage, funding levels are designed to slowly be funded over many years. The average amortization period for respondents is 25.8 years.

About Cobalt Community Research

Cobalt Community Research is a nonprofit research coalition created to help governments, local schools and other nonprofit organizations measure, benchmark, and manage their efforts through high-quality affordable surveys, focus groups and facilitated meetings. Cobalt is headquartered in Lansing, Michigan.

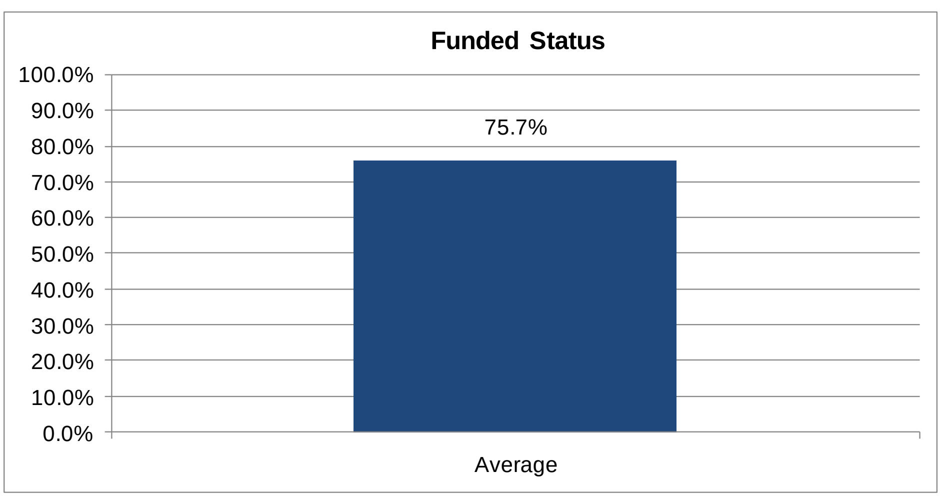
2011 NCPERS Public Fund Study: Preliminary Results

For the 2011 study, 216 respondents provided feedback to NCPERS using the most recent data they have available. Approximately 83 percent of respondents represented local government pension funds and 17 percent represented statewide retirement systems. The graph below shows the number of active members and retiree/beneficiaries represented by these funds. This totals more than 7,599,000 covered lives.

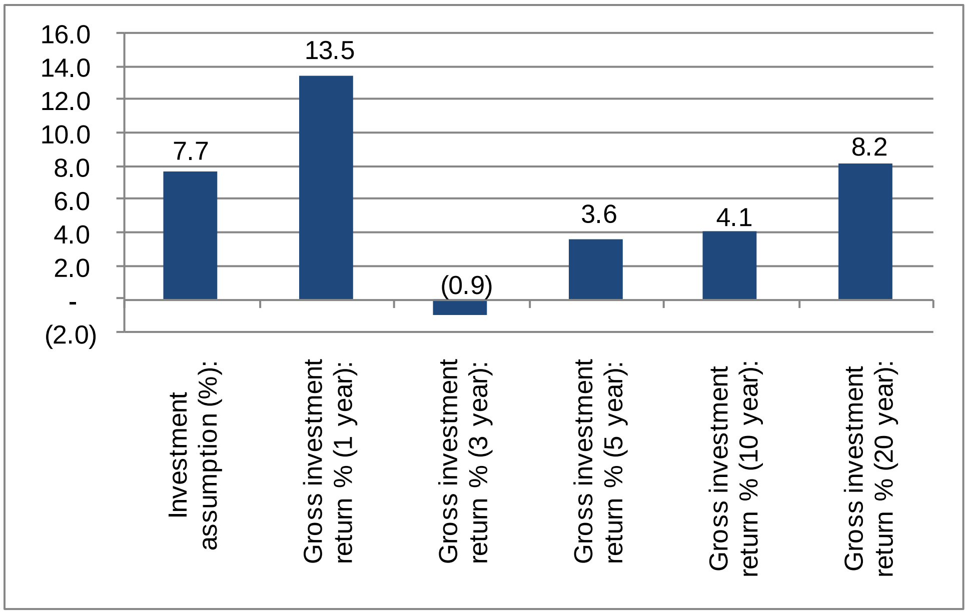


Funding Level and Returns

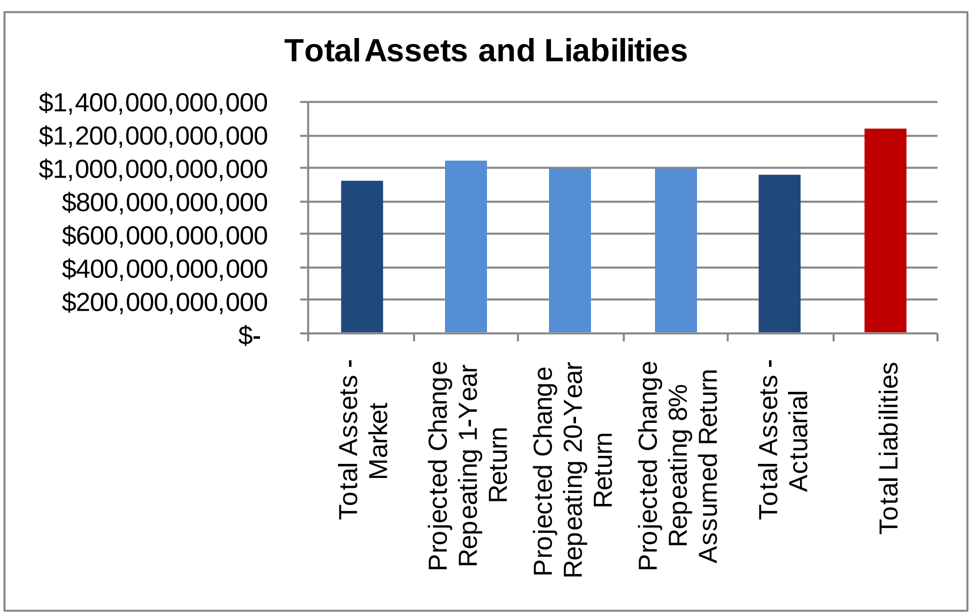
On average, the funded level of responding funds is a solid 75.7 percent. When comparing the total actuarial assets of all respondents to the total liabilities, there is an overall funded status of 77.4 percent. Pension funds are designed to pay off liabilities over a period of time to ensure long-term stability and to make annual budgeting easier through more predictable contribution levels. For responding funds, that period of time averages to 25.8 years.



Funding level is affected by the average investment returns a fund experiences over a set number of years. For respondents, the average number of years used in the calculation is 5 years. This is done to keep employer contribution rates more stable, as annual market return fluctuations would create significant volatility in the budgeting process. With the market declines in 2008 and 2009, the market and actuarial value of fund assets has declined; however, both 1-year and 20-year returns reported by participating funds points to continuing long-term improvement in funded status. The graph below shows average returns for responding funds.

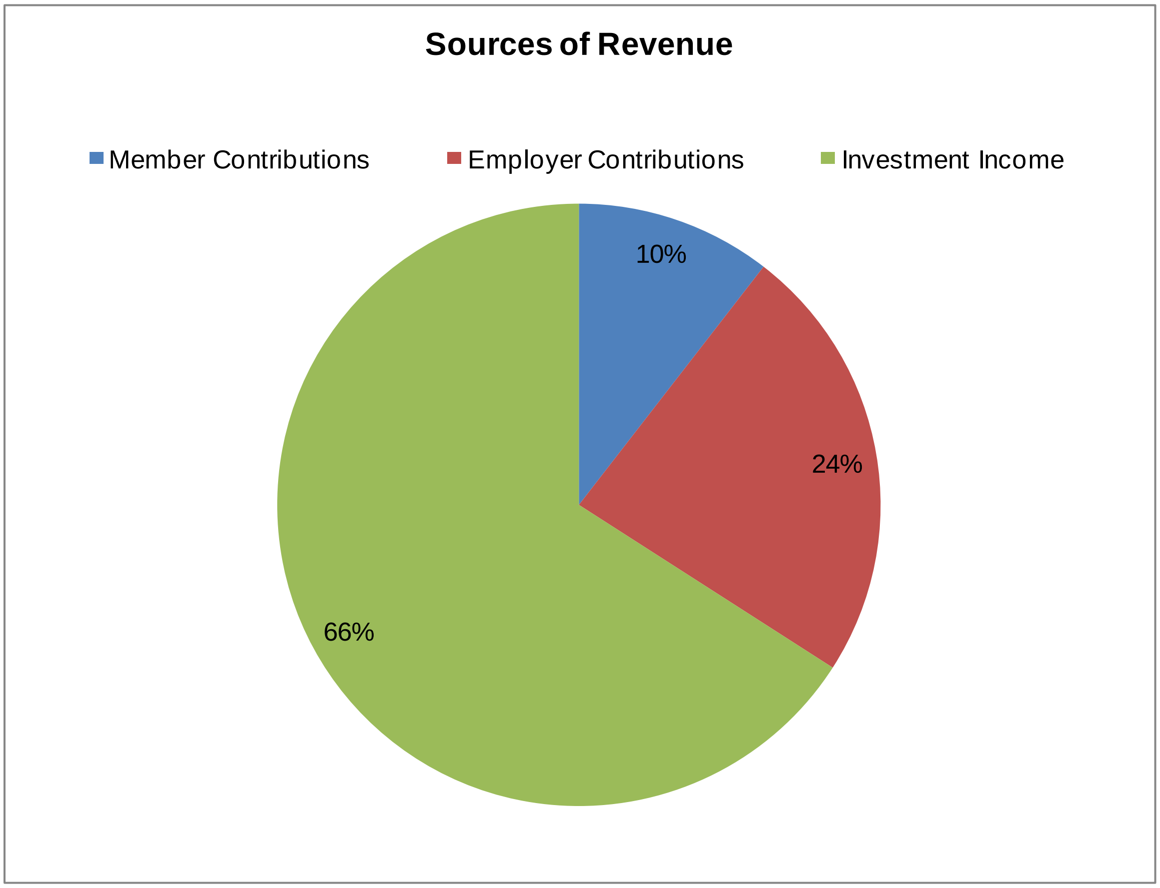


The following graph shows the market value and actuarial value of assets (dark blue columns). The red column shows actuarial liability that pension plans are designed to meet over time. The light blue columns project the improvement in market assets in one year using three scenarios: repeat of the 1-year return (13.5 percent), returns that equal the reported 20-year return (8.2 percent), and returns that equal the average reported actuarially assumed rate of return (7.7 percent). Essentially, this graph shows that despite short-term market declines, funds will continue to make progress toward funding liabilities.



Sources of Funding

Income used to fund pension programs generally comes from three sources: member contributions, employer contributions and investment returns. The chart below shows the proportion of funding provided through each of these sources. By far, investment returns are the most significant source (66 percent). Member contributions make up 10 percent of fund income. Employer contributions equal about 24 percent. These findings are consistent with other credible industry studies. Both this study and other industry studies show that annual fund expenditures and economic impact significantly exceed the annual contributions made by the employers.



Next Steps

This preliminary data represents only a portion of findings in the 2011 study. Other areas to be reviewed include changes funds have made or plan to make in the following areas:

- Benefit changes
- Design changes
- Operational practices
- Communication and member engagement practices
- Oversight practices.

The full report will be completed in late Spring 2011.