Consent

Agenda Item 4c

April 16, 2013

ITEM NAME: Survey of Retirement Systems with Funded Status Below 40%

PROGRAM: Pension

ITEM TYPE: Information Consent

EXECUTIVE SUMMARY

This is an information item providing information regarding retirement systems that experienced financial issues and fell below a 40 percent funded status since 2000.

There is not a lot of experience of public plans, especially of state-wide plans, falling below 40 percent funded. The state systems reviewed provide an indication that a pension system can recover from falling below a 40 percent funded status. However, all three of the state-wide systems examined and the one local system examined in detail have considered or have actually implemented benefit reductions for current and/or future system participants.

STRATEGIC PLAN

This item supports the Strategic Plan Goal A: Improve long-term pension and health benefit sustainability.

BACKGROUND

During the discussion on pension funding risk tolerances at the January Board of Administration (Board) offsite, Board members asked staff if retirement systems in the United States had ever fallen below a 40 percent funded status, and what actions had been taken (if any) to address the situation.

ANALYSIS

Staff identified three separate state retirement systems that had financial issues and that had fallen below a 40 percent funded status since 2000, they are:

- Illinois State Employees' Retirement System
- Kentucky State Employees' Retirement System
- West Virginia Teachers' Retirement System

Through our review of the three state pension systems, we identified that:

- The Illinois State Employees' Retirement System has yet to effectively address their low funded status.

- The Kentucky State Employees' Retirement System may be impacted by two bills that Legislature passed but the funded status has not yet improved.
- The West Virginia Teachers' Retirement System is in a much better situation today than it was 10 years ago.

Illinois State Employees' Retirement System
The Illinois State Employees' Retirement System remains below a 40 percent funded status. The funded status of this system has trended downward for several years. Chronic failure to pay the annual required contributions is the main funding issue, but the system hasn't established a plan to correct the problem.

Kentucky State Employees' Retirement System
The Kentucky State Employees' Retirement System fell below a 40 percent funded status, primarily due to failure to pay the plan's annual required contributions. Kentucky lawmakers passed Senate Bill 2 (SB2) and House Bill 440 (HB440) on March 27, 2013, and there are reports that the Governor of Kentucky signed the bills. SB2 directly impacts the pension system by:

- Mandating that employers pay full Annually Required Contributions (ARC)
- Closing the defined benefit plan to new employees that start after January 1, 2014. Those employees will participate in a defined contribution plan.
- Adding criteria to reduce the potential for "pension spiking"
- Making payments of cost of living adjustments subject to strict eligibility requirements
- Allowing the Legislature to eliminate, suspend or reduce benefits for employees that start after January 1, 2014, but the member is entitled to the accumulated account balance accrued at time of elimination, suspension or reduction
- Increasing Board membership from 9 to 13 members
- Establishing a "Public Pension Oversight Board" comprised of 13 members to provide oversight to the States' Assembly with respect to benefits, administration, investments, funding and laws and regulations pertaining to the Kentucky Retirement Systems

HB440 involves eliminating an income tax credit and offering a car trade-in credit as part of a package to generate nearly $96 million in new revenue for pensions by 2015, and $99.9 million a year later. The following articles provide more information on:

- The bills the Kentucky Legislature passed
- A report the Kentucky Governor signed the bills
- Details about how SB2 changes the pension law in Kentucky

http://www.courier-journal.com/article/20130326/NEWS0101/303260064/Pension-reform-passes-Kentucky-legislature http://www.kentucky.com/2013/04/04/2586721/gov-beshear-signs-pension-reform.html

https://kyret.ky.gov/images/uploads/news/Summary_of_Senate_Bill_2_changes.pdf

West Virginia Teachers' Retirement System

The West Virginia Teachers' Retirement System had an 18 percent funded status in 2003. Until 1991, this system was funded on a pay-as-you-go basis. This approach did not adequately fund the benefits promised to past employees. To address the funding issue, the Governor gained consensus among the legislature, unions, system participants and taxpayers to fund past promises. As part of this agreement, the system closed the defined benefit plan to new members and offered them a defined contribution plan; however, the system reverted back to a defined benefit plan in 2005 once determining a defined benefit plan was a better and more cost effective solution. The following article provides more information:

http://www.plansponsor.com/MagazineArticle.aspx?id=4294990027

Municipal Pension Plans

In addition to the State pension plans that fell below a 40 percent funded status, there are a number of municipal pension plans that have fallen below a 40 percent funded status. The following is a link to a study conducted by Boston College on Locally Administered Pension Plans. An appendix lists a number of locally administered plans with their funded status. Some are less than 40 percent funded.

http://crr.bc.edu/briefs/locally-administered-pension-plans/

Staff looked at one municipal plan in particular: the Prichard Pension Plan for the City of Prichard, Alabama. This plan received a considerable amount of attention because it stopped making payments to retirees in 2009. The pension plan for the employees and retirees of the City of Prichard, Alabama, had to take extreme steps as a result of inadequate funding. The system is funded through fixed member and employer contributions. This system provided benefit enhancements to members for years without ever increasing the contributions to the retirement system. Effectively, this meant that the city was not paying its ARC. In 2009 with only $26,809 in assets, the city filed for bankruptcy and the system stopped all benefit payments to retirees. Partial benefit payments (about one third of the promised benefit) resumed in June 2011. The funding situation for the retirees is still precarious. The following article provides more information on the Prichard Pension Plan:

http://media.al.com/live/other/Prichard%20Pension%20Article%20Semoon%20Chang.PDF

An interesting common element in the four systems examined is that, in each case, the employer contributions were less than the actuarially required contributions for a significant period. While funding failures are a common element in the systems getting into difficulty, funding discipline was a key factor in the recovery of the West Virginia Teachers' Retirement System.

ALAN MILLIGAN
Chief Actuary

ANN BOYNTON
Deputy Executive Officer
Benefit Programs Policy and Planning