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Public Sector Retirement Systems

Steps to Providing Support and Technical Assistance

Overview

Using our research expertise, we provide technical assistance to policymakers considering ways to ensure that their public sector retirement systems are affordable and sustainable and put workers on the path to a secure retirement. At the invitation of cities and states across the country, we undertake an objective and datadriven process to analyze public retirement systems and to develop and examine options for improvements. That process seeks to answer eight key questions:

1. What is the current fiscal status of the state's or city's retirement plan or plans?
2. What are the historical factors that have contributed to any unfunded retirement liabilities?
3. What are the expected results of any past reforms?
4. What is the fiscal outlook for the system over the next 10 to 30 years?
5. How are current retirement benefits structured?
6. What are the retirement system's current investment policies and practices?
7. What are the risks that the state or city faces under different economic scenarios?
8. How would any proposed solutions affect fiscal sustainability for government and taxpayers, and retirement security for workers?

Below we provide greater details on these questions:

1. What is the current fiscal status of the state's or city's public sector retirement system?

We begin our assessment by reviewing state or city actuarial valuations and financial reports to evaluate the current health of the jurisdiction's pension plans. Our work involves an extensive review of comprehensive annual financial reports, actuarial reports and valuations, and other documents that disclose financial details about the pension systems, concentrating on central data points.

Among the key data points:

- Funding data. Assets, liabilities, and the unfunded actuarial accrued liability (UAAL).
- Funding contribution data. Funding requirement as determined by the plan's actuary, broken out by normal cost and the cost of amortizing the unfunded liability; analysis of how the funding policy is projected to reduce pension debt over time; and review of whether plan sponsors have fully paid the actuarial required contributions.
- Budgetary impact. Required contributions as a share of payroll, total spending, revenue, and other measures.

2. What are the historical factors that have contributed to any unfunded retirement liabilities?

Using actuarial analyses produced by the state's or city's pension plans as the primary resource, we provide policymakers with an examination of the historic sources of any existing unfunded liabilities—comparing the relative magnitude and impact of unpaid contributions and the difference between actual and expected investment returns, as well as changes to benefits or actuarial assumptions.

Among the key data points:

- 10-year history of unfunded liability, broken out by the main causes, including contribution shortfalls, investment returns, and changes to assumptions and benefits.

3. What are the expected results of any past reforms?

The vast majority of states and many cities have taken action to resolve pension challenges, and some also have taken steps to address retiree health benefit liabilities. We examine past reforms to determine their long-term effects on the retirement plan, such as how well they will mitigate future economic downturns and what changes to the benefit plans mean for workers' retirement security.

Among the key data points:

- Long-term contribution and funding projections with and without reforms.
- Analysis of benefits based on plan changes for short-term, medium-term, and career workers.

4. What is the fiscal outlook for the system over the next 10 to 30 years?

Policymakers need to know what the existing system means not just for the present but for the future as well. We work with an actuarial partner to develop long-term projections of assets, liabilities, and contributions so that policymakers will obtain an accurate picture of how their pension plans will affect their state's or city's fiscal situation. When appropriate, we include deeper reviews of the budgetary consequences of projected costs and describe them in context.

Among the key data points:

- Funding data. Assets, liabilities, the UAAL, and funded ratio projections.
- Contribution data. Projected funding requirements, broken out by normal cost and the cost of amortizing the unfunded liability.
- Budgetary context. Contributions as a share of payroll over the next 30 years.

5. How are current retirement benefits structured?

We assess the plan's benefit design by analyzing different retirement savings and replacement rate outcomes and provide projections of the accrual of benefits over time for short- and long-term employees as well as employees hired during their early, middle, or late working years. These analyses are designed to show expected savings and benefit levels for career workers, along with younger and midcareer workers who may change jobs. Our effort to assess retirement benefits for any individual also includes whether an employee is eligible to participate in Social Security, as it increases the individual's replacement income and offers protection against inflation during retirement.

Among the key data points:

- Savings accrual over time for a worker entering at actuarially determined ages for early, middle, and late career joiners (presented graphically).
- Points in the savings accrual where changes in benefits increase and/or decrease in comparison with expected rates of attrition for the average worker.
- Income replacement rates for workers in retirement after leaving public service at various lengths of service.
- Vesting periods, attrition rates, and interest on employee contributions.
- Participation in Social Security.
- The effect of projected inflation on retirement benefits.

6. What are the retirement system's current investment policies and practices?

We evaluate the investment policies and practices in the context of investment policy, historic performance and benchmarks, and fees. The assessment includes a review of asset allocation as well as payments for expenses and fees in comparison with peers and national averages.

Among the key data points:

- 10-year return rate, compared with relevant benchmarking (by asset class, if available).
- Current asset allocation, including the proportion in riskier assets and alternatives.
- Fee and expense rates.

7. What are the risks that the state or city faces under different economic scenarios?

We summarize the risks and unpredictability of costs under the current plan design and funding policy. This work includes providing long-term projections of costs and liabilities under plan assumptions as well as alternative investment return scenarios. We examine how well the retirement plans may fare if the investments perform at the 10th, 25th, and 75th percentiles compared with the overall market or a similar mix of stocks and bonds.

Among the key data points:

The 10- to 30-year projections under different investment return scenarios include:

- Normal cost, funding status, and the UAAL.
- Contributions from employees and government sponsor.

8. How would any proposed solutions affect fiscal sustainability for government and taxpayers, and retirement security for workers?

As policymakers consider these issues, our analysis is designed to ensure that they have accurate assessments of the effects, strengths, and weaknesses of various proposals. We model the results of proposed solutions on budgets and workers' retirement savings and share suggestions with policymakers on best practices.

Among the key data points:

- Evaluation of how proposed plan changes would affect the fiscal sustainability of the retirement system.
- Demonstration of how various plan proposals would affect different groups of workers, depending on age, type of service, length of public employment, and other factors.

Glossary

Actuarial report. A document outlining the calculations made to assess the current and future costs of pension plans and retiree health plans.

Amortize. Make scheduled payments to eliminate pension liabilities over a period of time.

Asset allocation. The distribution of assets under management and typically invested by designated asset classes, such as equities, fixed income, or alternatives (which include private equity, real estate, and other complex financial instruments).

Comprehensive annual financial report. An annual disclosure produced by a state or pension system detailing key financial data.

Funded ratio. The level of assets on hand in proportion to pension costs.

Normal cost. The cost of benefits earned by employees in any given year.

Replacement rate. The percentage of pre-retirement income.

Unfunded actuarial accrued liability. The difference between the total value of pension benefits owed to current and retired employees or dependents and the plan assets on hand. This is an unfunded obligation for past service.

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