Financial Status of State/Local Retirement Plans

Implications of the Changes and Challenges Facing State Retirement Systems

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State/local pensions, assets as percent of liabilities, discounted at expected return and 10-year U.S. Treasury yield.

Assumed return
10-year Treasury yield
Author's calculations using Public Plans Database
State and local pension assets as percent of state and local government budgets

Source: Federal Reserve
Employer Normal Cost as Percent of Employee Payroll, Missouri State Employees Retirement System, at different discount rates

- 22.9% (U.S. Treasury yield)
- 17.8% (Corporate bond yield)
- 12.6% (Financial advisors' estimated return, from Aubry et al., 2017)
- 7.2% (Assumed return on portfolio holding ~75% risky assets)

Discount rate:
- 2.00%
- 3.00%
- 4.00%
- 5.00%
- 6.00%
- 7.00%
- 8.00%
- 9.00%

Employer Normal Cost:
- 35%
- 30%
- 25%
- 20%
- 15%
- 10%
- 5%
- 0%
Pension Insolvency in Puerto Rico

• Background
  • No debt paid in past two years; pension plan assets practically exhausted
  • Federal oversight board appointed by President Obama, 2016

• Main DB pensions insolvent
  • Multiple actuarial warnings to increase contributions; contributions remained low and benefits enhanced
  • Teachers and police have no Social Security

• Oversight Board proposal
  • Hard freeze all benefit accruals
  • Shift all employees to DC plan, w/10% employee contribution (no match), plus Social Security enrollment
  • Reduce current retiree benefits by 10%, progressively
    • No cut on first $1,000 in monthly benefits; 25% marginal cut on benefits > $1,000
    • Median *household* retiree income in Puerto Rico is about $17,500.
    • Detroit cut benefits ~20%; but San Bernardino had no cuts.

• Relevant factors
  • Benefit cuts on the table when whole entity is bankrupt, not merely the pension
    • Creates multiple stakeholders; in Puerto Rico, education, healthcare, employee headcount, etc. all being cut
  • Federal pseudo-bankruptcy *probably* will allow cuts despite state legal protections
    • Governor refuses to implement pension cuts; creditors may sue for larger cuts. Will be settled in court.
  • Pension cuts can affect economy; macro issues matter
    • Bankruptcy mostly about debt restructuring; money available to pay debt depends on health of economy.