Retirement News Highlights

Thursday, September 19, 2021

US stock market rally bolsters state pension plans

Recovery spreads across $3.9tn American public retirement system

By Chris Flood

Financial Times

September 19, 2021

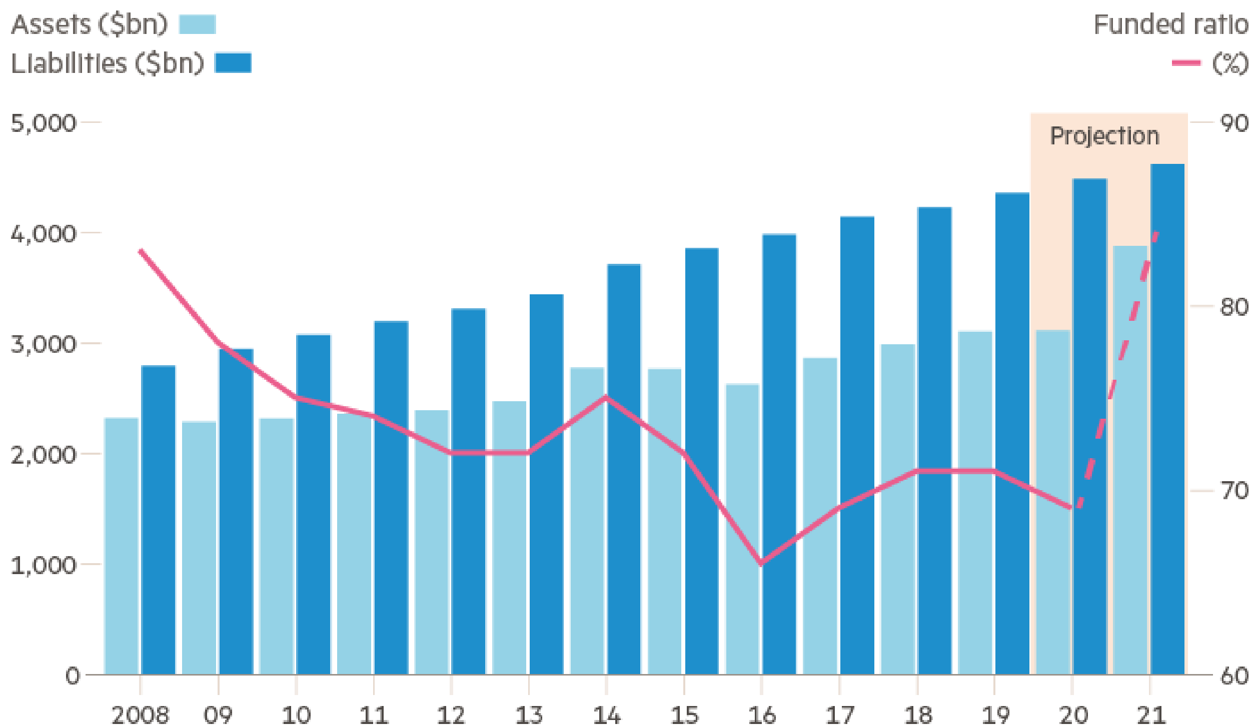
A record-breaking rally for US stocks has powered the strongest annual investment returns for state pension plans in more than three decades, easing funding strains across America's public retirement system.

State pension plans on average earned investment returns of 25 per cent in the year ending 30 June, boosting assets across the US public retirement system by more than $0.5tn to $3.87tn, according to Pew Charitable Trusts, a Washington-based think-tank.

Greg Mennis, a director at Pew, said "once in a generation" returns had lifted the aggregate funded position — assets as a share of liabilities — for US state pension plans to 84 per cent, its highest level since the end of the 2007/08 financial crisis.

The gap between the assets held by US state pension plans and their liabilities is projected to have shrunk to $740bn at the end of June, the first time it has dropped below the $1tn mark since 2014.

Pension funding gap projected to reach lowest level in over a decade



Source: Pew Charitable Trusts

Yet Anthony Randazzo, executive director at Equable Institute, a New York-based non-profit think-tank, said the funded position of US state pension plans was “still well below” where they should be aiming for.

“Getting up to 80 per cent funded is great relative to recent history but there are plenty of clouds ahead,” said Randazzo. “No one thinks that state pension plans will earn such high returns consistently which means there is a warning here. States can’t invest their way out of this mess.”

“Returns for state pension funds have been exceptional with some seeing their best ever annual performance,” noted Thomas Aaron, a senior credit officer at rating agency Moody’s, “but we still see pretty widespread risks.”

Moody’s uses a discount rate — based on high-quality corporate bond yields — of under 3 per cent to value the liabilities of state pension funds, suggesting the funding gap still exceeds $4tn.

State pension funds use their own measures of expected annual returns averaging about 7 per cent as a discount rate, significantly reducing the value of future liabilities.

“Most state pension funds still have heavy allocations to equities and bonds to meet their 7 per cent average return requirements,” said Aaron. “The high return seeking nature of public pension investments carries significant volatility risk and it would not take a repeat of the 2007/08 financial crisis to wipe out a good part of the returns that have been achieved.”

Pew collected data from 230 state pension plans accounting for about four-fifths of assets in the public retirement system. Only partial data was available for 2020, which Pew used for its projections for state retirement systems. These estimates were reviewed by officials working at the plans.

An average annual increase in contributions of 8 per cent over the past decade has also helped improve the state pension system's funded position. Yet most state plans are paying out more in benefits than they receive.

To gauge the risk of a state pension fund running out of money, Pew measures operating cash flows as a percentage of assets. Public pension plans in Colorado, Ohio, Oregon, New Jersey and Rhode Island were paying out 5 per cent of their assets as recently as 2017. Pew views this threshold as a warning sign about a plan's future financial sustainability.

But increased contributions and other policy changes meant all 50 states paid out less than 5 per cent of assets in the latest year.

The coronavirus pandemic has highlighted the "volatility and uncertainty" facing US state retirement schemes, said Mennis, adding it was essential to introduce stress tests and arrangements to share losses between workers and retirees to ensure future pension promises could be met.

Back to top