# Retirement News Highlights

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## Looking to future, public plans cut assumed rates of return

By Robert Steyer

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Through good times and bad, public pension plans have been reducing their assumed rates of return for more than a decade, a recognition that they must be more conservative for the long term.

But the pace of rate-cutting has eased in recent months among the 131 public pension plans tracked by the National Association of State Retirement Administrators as plan executives evaluate the impact of inflation, said Keith Brainard, NASRA's Georgetown, Texas-based research director.

High inflation would have to be chronic before plan officials would consider raising rates, he said. "Public pension plans are waiting to see if inflation is transitory or secular," said Mr. Brainard, adding that he couldn't speculate on how long secular — or chronic — inflation would have to continue to prompt assumed rate of return revisions.

Even as inflation rose, some public pension plans reduced their assumed rates of return:

Jacksonville (Fla.) Fire Police & Fire Pension Fund announced in February it was cutting its rate to 6.5% from 6.9% based on a review of the $2.7 billion pension plan's investment policy statement. The $33.7 billion Pennsylvania State Employees' Retirement System, Harrisburg, announced in June 2022 a rate cut to 6.875% from 7%, which took effect Dec. 31.

Board members of the $3.7 billion North Dakota Public Employees Retirement System in October approved a rate reduction to 6.5% from 7%, according to the pension system website.

"The last 15 years have been extraordinary," said Mr. Brainard, referring to the rate-cutting trends. Since the 2018 fiscal year, 106 of the 131 plans tracked by NASRA have reduced their assumed rates, and some have done so more than once. Since the 2010 fiscal year, all plans in the NASRA universe have reduced their rate at least once.

Some plans have conducted systematic reductions. For example, the Nebraska School Retirement System, part of the Nebraska Public Employees Retirement System, Lincoln, is in the midst of a gradual, yearly assumed-rate reduction that will culminate in 7% for the 2024 fiscal year. The rate is 7.1% for current fiscal year that ends June 30.

The strategy was approved in December 2020 by the Public Employees Retirement Board. The rate was 7.5% when the board acted. The school pension system had assets of $14.1 billion as of June 30, 2022.

"The strategy of gradual rate reductions announced in advance is a way of enabling policymakers and employers to anticipate the effects, phasing them in over a period of several years," Mr. Brainard said.

The latest NASRA data show the average assumed rate of return for public plans is 6.93% as of Dec. 31, down from 8% for the 2001 fiscal year, with the sharpest decline coming after the 2008-2009 recession. During this period, the median rate dropped to 7% from 8%.

The pension fund rate cutting is based on internal and external forecasts usually extending 20 to 30 years, plus analyses of workforce demographic trends and plans' asset allocation strategies. The plans are pursuing a Goldilocks strategy in which the actuarial porridge has to be just right — neither too high nor too low.

"An investment return assumption that is set too low will overstate liabilities and costs, causing current taxpayers to be overcharged and future taxpayers to be undercharged," said a March NASRA report describing the rate-setting balancing act.

"A rate set too high will understate liabilities, undercharging current taxpayers at the expense of future taxpayers," the report said.

Most plans in the NASRA universe choose their assumed rates via a vote from a retirement board after having consulted with actuaries and other sources. A few rates are set by state legislatures. "Anything in the legislative realm is likely to be political," Mr. Brainard said. "The temptation is to keep the rate higher than it should be to lower the costs."

The lower the assumed return, the greater the contributions are needed by various employers — state, municipal, schools — to pay for benefits. If actual returns fall below assumed returns, employers must contribute more, too.

## Wide variation

Public pension plans may have a common goal, but there's a wide variation in their approach to achieving it.

Among NASRA-tracked plans, the most common assumed rate of return is 7%, which is used by 47 plans. Among the highest rates, one plan has a 7.55% rate. Seven are at 7.5%. Among the lowest, 12 have rates below 6.5%, including two under 6%.

That's a big difference from 20 years ago when a majority of the plans had rates of return of 8% or higher.

The biggest risk factor to pension rate-planning is a stock-market jolt, said Hank H. Kim, executive director and counsel for the National Conference on Public Employee Retirement Systems.

Demographic changes are less problematic. "It's fairly consistent," Mr. Kim said. "We can see it coming from miles away."

NCPERS conducted a survey from September 2022 to December 2022 covering 195 public pension plans — 56% were local plans and 44% were state plans.

The average assumed rate of return was 6.86% vs. 7.07% for the previous year. Six plans had rates of 6% or less. None exceeded 8%.

## Texas Teachers trims

Texas Teacher Retirement System, Austin, reduced its assumed rate of return in July to 7% from 7.25%. The latter figure was in force since 2018, after having been lowered from 8%. For the latest rate cut, the

$179.7 billion pension fund reported that short-term and long-term investment returns were projecting lower.

The pension system's net five-year annualized return as of Dec. 31, 2022 was 6.1%, and the net 10-year annualized return was 7.6%.

The fund's board works with its actuarial consultant and investment consultant to prepare a forecast.

The assumed rate of return is based on many factors, "with the largest emphasis on expected rates of return, risk and potential for diversification," Mike Simmons, director of trust strategy, wrote in an email. "We work with many partners who use different approaches to develop this forward expectation."

When assessing a future return rate, the Texas pension fund looks at projected investment returns over a 10-year period and a 30-year period. This is incorporated into the liability funding period — a 22-year forecast around which the assumed rate of return is based.

Mr. Simmons acknowledged that high inflation might play a role in future rate considerations, but it would have to be high and chronic.

"Long-term inflation forecasts remain subdued, and with a funding period of 22 years, the long-term inflation projections carry more weight in the analysis," he wrote.

"Although high inflation rates have been observed recently, the long-term expectations of both the market and economists are near the Federal Reserve's target inflation," he added.

## Oregon has eye on inflation

At the $96 billion Oregon Public Employees Retirement System, Salem, executives are tracking inflation, but they don't forecast an immediate impact on rate-setting. "It's a bit more transitory now," said Director Kevin Olineck. "We don't see much change. We are looking long term."

Oregon PERS sets its rates every two years, and the next decision will come July 28. Any change will take effect in September.

It has been slowly reducing its assumed rate for return for nearly a decade. The rate was cut in 2014 to 7.75% from 8%; to 7.5% in 2016; to 7.2% in 2017; and to 6.9% in 2021.

The net five-year annualized return was 7.74% as of Dec. 31 and the net 10-year annualized return was 8.54%.

The pension system participates in a series of meetings leading up to its July decision: a joint meeting with the Oregon Investment Council and its consultant, Milliman; a June analysis of economic assumptions; and a July analysis of demographic assumptions.

Economic assumptions include assessments of inflation, wage growth, trends in government employment and investment return forecasts. Demographic assumptions include mortality, retirement, disability, salaries and information on how many employees leave before retirement age.

Oregon pension fund officials tell legislators what they plan to do 30 days before acting, but the Legislature isn't involved in rate-setting.

## Securing lawmakers' OK

By contrast, the public pension plans in Minnesota must secure legislative approval.

The plans' assumed rates are among the highest in the country at 7.5%, and bills were introduced in February to set a 7% rate for nine public plans, under the umbrellas of the Minnesota State Retirement System and the Public Employees Retirement Association, both based in St. Paul.

In November, the actuary consultant for the two St. Paul-based pension systems warned trustees in separate reports that a 7.5% assumed rate, in effect since the 2018 fiscal year, was unsustainable.

"In our professional judgment, the statutory investment return assumption of 7.5% ... deviates materially from the guidance set forth in Actuarial Standards of Practice No. 27," said a Nov. 8 report by Gabriel, Roeder & Smith Co. to the Minnesota State Retirement System. The firm was referring to a guidance document from the American Academy of Actuaries. A return assumption "in the range of 5.64% to 6.84% would be reasonable for this valuation," the report said.

The firm issued the same warning with the same recommendation in a Nov. 30 report to Public Employees Retirement Association of Minnesota.

A February report by Minnesota's Legislative Commission on Pensions and Retirement noted that the combined annualized net returns for all of the public pension plans, whose investments are managed by the State Board of Investment, were 8.4% for 10 years, 8.6% for 20 years and 8.3% for 30 years. All were measured for periods ended Sept. 30

The net return for the 12-month period ended Sept. 30 was -11.6%.

"The investment return assumption is a forward-looking assumption and past performance is only one factor of many to consider when changing the return assumption," the commission wrote.

Cutting the assumed rate of return for each plan would lead to "reducing the funded ratios, increasing required contributions and modifying downward the projected funded ratios," the commission wrote.

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