



Retirement News Highlights

Wednesday, March 31, 2021

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Study Suggests There Is No Imminent Public Pension Crisis

Reforms enacted by many plans will cause benefit cash flows to decline significantly, paper finds.

By Michael Katz

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March 31, 2021

Contrary to popular belief, a recent research paper from the Brookings Institution argues there is no imminent crisis for most public pension plans.

As the paper notes, much ado has been made in recent years about state and local pension plans' large unfunded liabilities, with one study estimating that public pension funds' obligations exceed their assets by nearly \$4 trillion. The paper focuses on whether state and local pension plans are fiscally sustainable over the medium- and long-term under current policies and funding levels, and what changes are needed if they aren't.

The paper projected the annual cash flows of state and local pension benefits and found that pension benefit payments in the US as a share of the economy are currently near their peak and will remain there for the next two decades. However, it also said the reforms enacted by many plans will gradually cause benefit cash flows to decline significantly.

"This is a new and important finding in terms of the fiscal stability of these plans as it indicates that the cash flow pressures they currently face will eventually recede," said the paper.

The paper acknowledged that under low or moderate real asset return assumptions of 0% to 2.5%, and a discount rate of 0%, state and local pensions are not currently sustainable because pension debt as a share of the economy would rise indefinitely. However, it added that pension debt can be stabilized with "relatively moderate fiscal adjustments," regardless of whether governments move to stabilize pension debt over the long-term, medium-term, or immediately.

The findings also suggest there's no need to rush to stabilize the pensions as there is only a slight benefit to starting a stabilization process now instead of a decade down the road. "Neither the level at which debt stabilizes as a share of the economy nor the contribution change needed to achieve stabilization increase significantly when the start of the stabilization process is pushed 10 years out," according to the paper.

The Brookings researchers said an unexpected discovery was that the plans in need of the largest adjustments to remain sustainable aren't the least-funded plans, but the plans that have not enacted many reforms.

"One might suspect that the least well-funded plans got that way by failing to make sufficient contributions and by ignoring looming imbalances," the report said. "But we find that many of the most poorly funded plans have in recent years undertaken the largest reforms and increased contribution rates the most."

By doing this, says the paper, many of the poorly funded plans have already made significant progress toward stabilizing their pension debt.

"Overall, while achieving fiscal stability will require adjustments, our results suggest there is no imminent 'crisis' for most public pension plans," the authors concluded.

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Funding ratio for state pension plans slips in 2020 – Wilshire

By ROB KOZLOWSKI

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March 30, 2021

U.S. state pension plans' estimated aggregate funding ratio at the end of fiscal year 2020 fell to 70% from 72.7% in the previous year, a report from Wilshire Associates shows.

Based on over 100 state plans' most recent annual reports, most of which provide data as of June 30, the aggregate funding ratio is based on \$3.253 trillion in aggregate assets and \$4.647 trillion in aggregate total pension liabilities, according to Wilshire's 2021 Report on State Retirement Systems.

Asset levels rose 0.5% from \$3.238 trillion at the end of fiscal year 2019, but aggregate total liabilities advanced 4.3% from \$4.456 trillion at the end of the prior fiscal year.

Wilshire attributed the rise in assets to positive investment returns and contributions. The report said about 30% of contributions came from plan participants.

Contributions increased the asset value by almost 5%, while returns increased the asset value by 3.2% for the year. Benet payments are estimated to have decreased asset values by 7.8%. "Other" items increased asset values by 0.1%, according to the report.

On the liability side, the estimated increase due to interest cost (approximately equal to discount rate as a percentage of the beginning-of-year total liabilities) was 7%, annual benefit accruals increased liabilities by 1.9% and actuarial losses and "other" increased the liability by 1.1%. Benet payments are estimated to have lowered liability values by 5.7%.

The median discount rate was 7.1% at the end of fiscal year, down 0.15 percentage points from a year earlier. The range of discount rates was 2.87% to 7.75% for fiscal year 2020.

The aggregate asset allocation of the universe was 30.3% domestic equities, 21.7% total fixed income, 17.7% international equities, 12% real assets, 9.6% private equity and 8.7% other.

According to the report, the aggregate asset allocation to domestic and international equities remained relatively unchanged in the last decade. For fiscal year 2010, the aggregate asset allocations to domestic and international equities were 31.1% and 17.6%, respectively.

Total fixed income fell to 21.7% from 28.1% and total real assets doubled to 12% from 6% in that time period.

Private equity increased slightly to 9.6% from 9% in the past 10 years, while "other" increased to 8.7% from 8.2%.

Other assets can include any other asset class, including hedge funds and commodities.

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