



A TIME OF UNCERTAINTY

BY JIM MOSMAN, NCTR EXECUTIVE DIRECTOR



The depth of the economic downturn we are experiencing is something most of us have not experienced in a lifetime. For many pension funds, it is also the most significant decline in history for their investment portfolios. Only in the last twenty years have many funds had the ability to invest freely without statutory constraints; and thus, this is the first time that such a steep decline in the equity markets has affected them so profoundly.

Before the significant market decline of last fall, the public pension fund industry was actually quite well

funded. The Public Fund Survey, which is annually conducted by NASRA and NCTR, includes 101 pension funds representing 85% of all government pension assets. The last edition of the survey showed an average actuarial funding ratio of 86.4 % for the funds covered in the survey. You do not need to have a high level mathematics ability to understand that the current market decline is going to result in a significant average decline in funding ratios for most plans in the survey. Individual plans will experience this impact as they go through their next actuarial review. Market smoothing will help to a degree, but ultimately the full impact will be factored into funding ratios. There will no doubt be a need to ask for employer and employee rate increases to keep funds healthy for the long term. Funds with poor funding levels going into this market decline are probably going to feel the pain to an

even greater degree.

The only major significant silver lining to all of this is that participants in defined benefit plans are far better off than those in defined contribution plans. This is particularly true if a person is in retirement or at or near his or her desired retirement date. Defined benefits plans—because of their long-term horizon—have the ability to spread investment declines over long periods and market cycles. A defined contribution plan cannot spread the impact of the decline in account value and the participant feels the immediate impact to his or her account balance. In many cases, participants must alter retirement plans because of the reality that they no longer have sufficient funds to retire. Persons already retired in defined contribution plans feel their retirement security melting away at a rapid pace. As a matter of fact, the

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CAPITOL COMMENTARY

HEALTHCARE REFORM: MAYBE THIS TIME?

By Leigh Snell, NCTR Federal Governmental Relations Representative



The impact of recent dramatic market declines on public pension plan funding levels will inevitably place increased pressure on governmental employers' future contribution rates. However, the cost of unfunded retiree healthcare continues to be the 800-pound gorilla in the room.

According to the U.S. Government Accountability Office (GAO), if left unfunded (i.e., if public sector employers continue to pay for these benefits on a pay-as-you-go basis), the cost of retiree health plans will likely amount to 5 percent of payroll by 2050. Furthermore, according to the Centers for Medicare and Medicaid Services (CMS), total healthcare spending grew to \$2.2 trillion in 2007, or

\$7,421 per person.

Rising healthcare costs are therefore not only creating serious financial liabilities for many States and municipalities, but they also threaten the security of more and more retired Americans and are causing many to delay retirement. Is it any wonder, then, that President Obama has said healthcare reform is "not something that we can sort of put off because we're in an emergency. This is part of the emergency."

But with so many other pressing economic issues, is healthcare reform possible in 2009? The early signs are encouraging. On Capitol Hill, the chairmen of the three House committees with jurisdiction over the issue have pledged to "work closely together to pass national health reform." They have agreed to coordinate their efforts and have set a goal of having a final proposal ready for consideration by the full House before the August re-

cess. Senator Max Baucus (D-MT), chairman of the Finance Committee, has set a similar goal for the Senate.

Another hopeful sign is that a diverse coalition representing 30 organizations—including the Chamber of Commerce, the Pharmaceutical Research and Manufacturers of America, AARP, and the AFL-CIO—has recently written both House and Senate leaders, urging them to suspend pay-as-you-go rules for healthcare reform. These organizations believe that much of the savings from such reform would be long-term, and that requiring spending or revenue offsets for the entire cost of the effort within a 10-year budget window "will significantly reduce the likelihood" of enacting comprehensive healthcare reform.

In the meantime, President Obama has set aside \$634 billion for healthcare reform in his 10-year budget outline, which his Office of Management and Budget (OMB) Di-

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dramatic impact on defined contribution plans is causing some retirement experts and members of Congress to question the viability of 401(k) type plans in their current form as core retirement vehicles.

Without any doubt, defined benefit plans are also facing serious challenges. Once investment markets move upward again, it is going to take many months or years for some funds to return to funding levels of only a year ago. In the interim, state legislatures and other governmental bodies are going to be reluctant to supplement cash flows into these plans. Opponents of defined benefit plans will argue that taxpayers should not be expected to offset investment losses with

additional contributions. At the same time, the public sector workforce is aging rapidly and more are becoming eligible to receive retirement benefits. This is a dilemma that many public fund executives and trustees are facing at this moment and for some it seems like a dark tunnel with no light in sight.

Despite all of this negativity in the markets, I would argue that it is hardly the time to panic. I attended a recent pension conference that included a dialogue among several public fund chief investment officers as to whether strict rebalancing of pension fund portfolios is warranted in this type of economic environment. Some argued that strict application of rebalancing concepts should be tem-

pered by a current assessment of risk in the market. A well-known CIO from a large public fund countered something to this effect: For years we have argued that we are long-term investors and that we do not react to specific market conditions in our investment discipline. Why in the world should we depart from this discipline at this time when we have confidence that over time the markets will improve and our discipline will serve us well?

I think this is sage advice even though painful at the moment. The fact of the matter is that if the markets do not improve, then pension funds of all types and size have a serious problem of sustainability.



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HEALTHCARE REFORM

rector, Peter Orszag, described as putting "a significant down payment on the table."

So what will healthcare reform look like? President Obama will not be offering a definitive plan of his own, preferring to set broad principles and let Congress hammer out the details. As Orszag explained, "On exactly what the administration does and does not favor on the benefits and coverage side, you should not expect and you will not be receiving definitive answers from me."

This is certainly a major departure from earlier failed healthcare reform efforts. Taking "PAYGO" off the table would also remove a major barrier. Will this approach work? Only time will tell. But if not, it won't be for lack of seriously trying.





On the move SHIFTS IN SYSTEM DIRECTORS



In February, Washington Governor Chris Gregoire named **STEVE HILL**, Administrator of the Health Care Authority, as Director of the **WASHINGTON STATE** Department of Retirement Systems. He now leads both agencies. Prior to his 2005 appointment as head of the Health Care Authority, Hill retired from a long career in senior management with Weyerhaeuser Co.



On April 1, **SANDRA J. MATHESON** begins her duties as Executive Director of the **MAINE PUBLIC EMPLOYEES RETIREMENT SYSTEM**. Matheson had been Director of Washington State Department of Retirement Systems since 2005. Prior to joining the Washington System, she served in various executive capacities, including eight years as CEO of Hanford Environmental Health Foundation.

PENSIONOMICS: PENSIONS GREATLY BENEFIT MORE THAN RETIREES

An economic impact analysis finds state and local government pension benefits have a significant impact that ripples through every state and industry across the nation. The report, *Pensionomics: Measuring the Economic Impact of State and Local Pension Plans*, was released in February by the National Institute on Retirement Security (NIRS). What role does your state play in this encouraging study? Read and download the full report, plus individual state fact sheets, at the NIRS website, www.nirsonline.org.



2009 Events

**22nd Annual
System Directors' Meeting
June 18-20**

Hyatt Regency Newport
Newport, Rhode Island
REGISTRATION UNDERWAY

**9th Annual
Trustee Workshop
Institute: July 27
Workshop: July 28-29**

Hyatt Regency Newport
Newport, Rhode Island
REGISTRATION BEGINS IN MAY

**87th Annual Convention
October 10-15**

Renaissance Esmeralda
Indian Wells, California
REGISTRATION BEGINS IN JUNE

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