

Future of Retirement Plan Design for Public Employees

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Market Losses

**Aging Workforce, Negative Publicity and
Budget Constraints**

How to Address Funding Issues

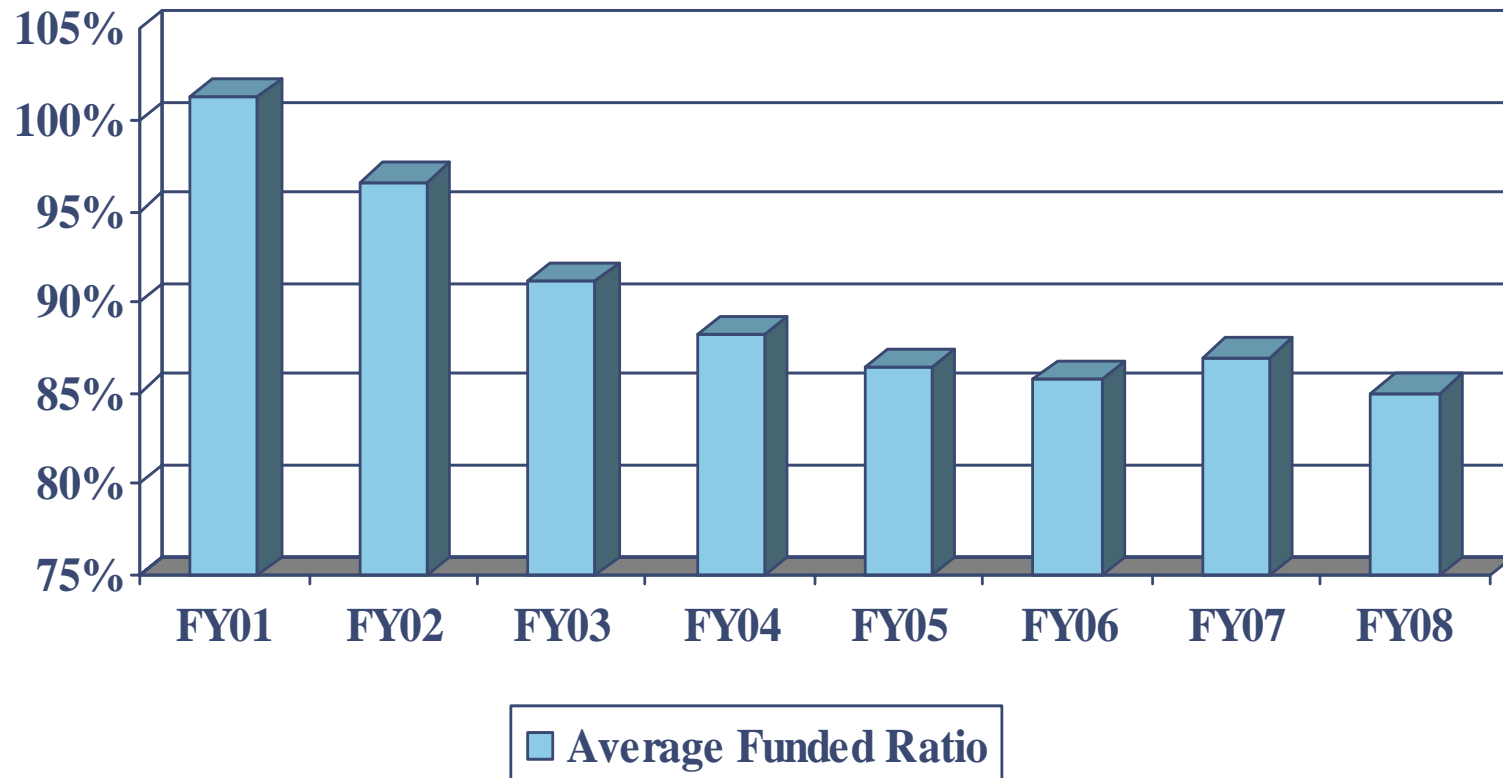
Future Plan Design

Where are we now?

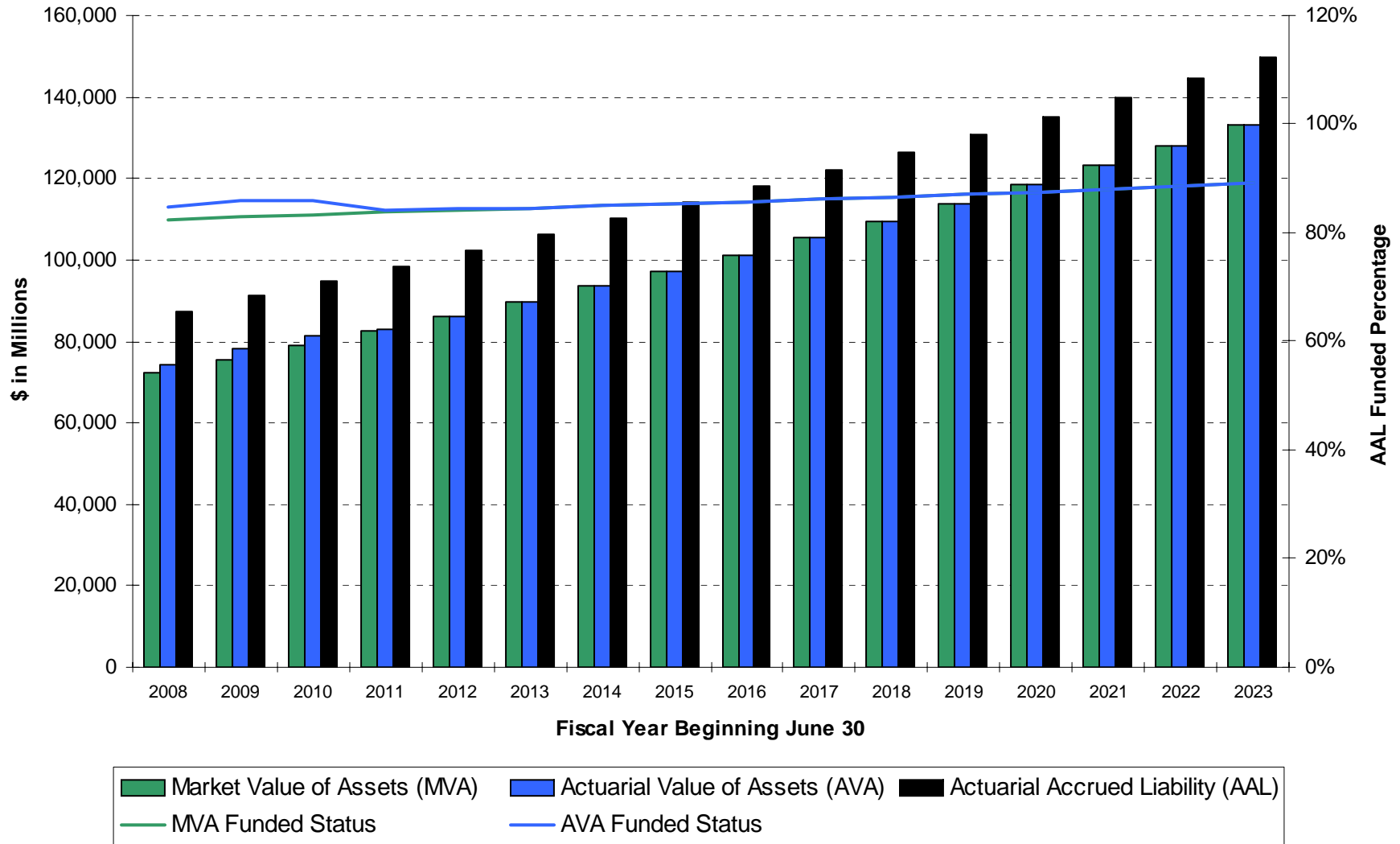
- Good asset returns in the 1990s resulted in significant improvement in plans' funded ratios
- For many plans, benefit enhancements were granted “paid for” with investment returns
- Markets crashed FY 2002 and FY 2003
- Markets boomed FY 2004 to 2007
- Then bottom fell out of the market
 - Downturn in global financial markets is deeper and faster than ever projected
 - Impact on all retirement systems has been exponential
 - Market recovery expected to be long and gradual

History of funded ratio

- The average funded ratio of public pension plans has declined since 2001



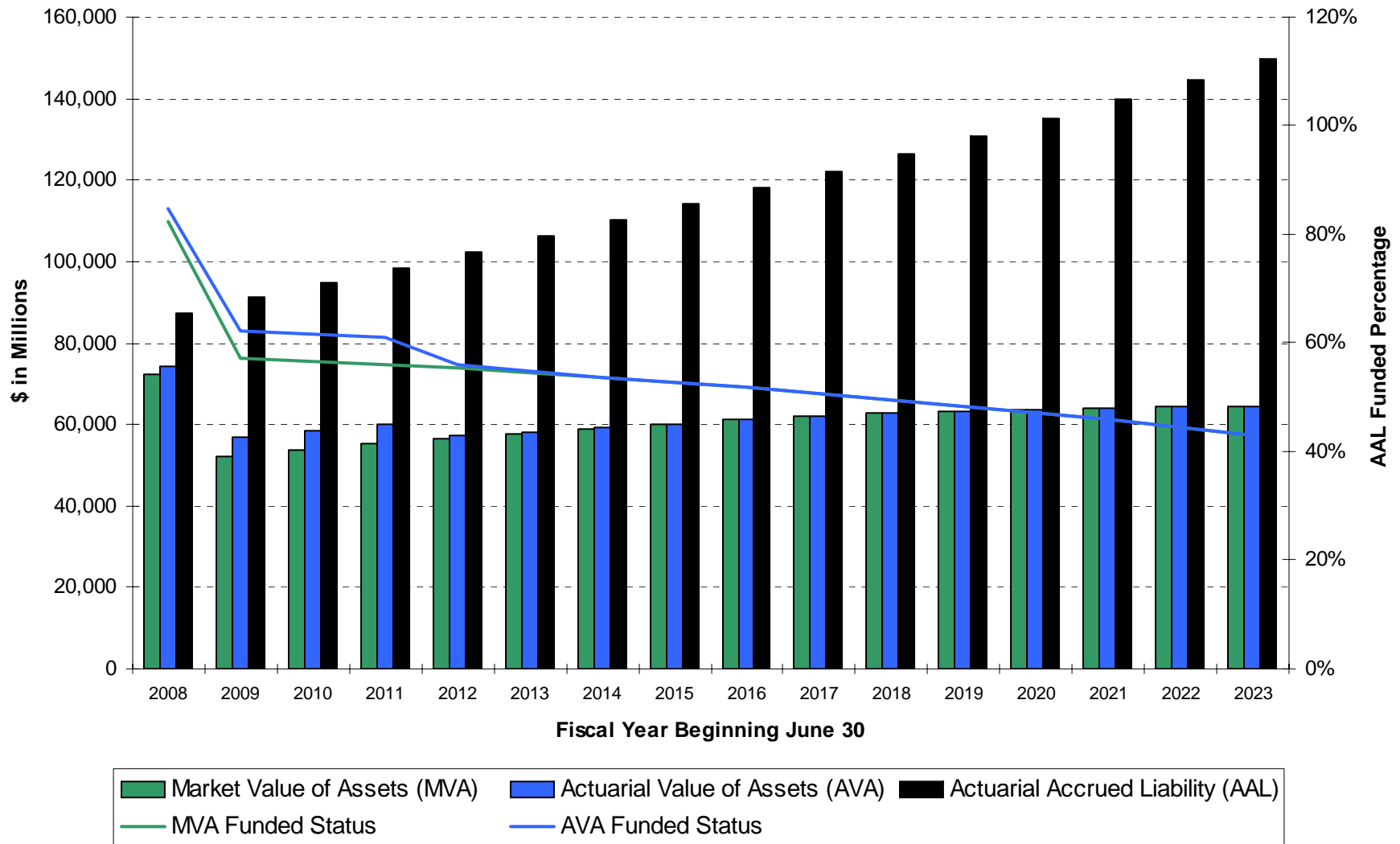
Typical plan — projection of funded status based on 8% return for all years (no market crash)



Where are we now?

- The average funded ratio at June 30 2008 was approximately 85%
- For plans invested 70% in equities, the loss on the market value of assets is – 20% to – 25%
 - As of June 30, 2009, the average funded ratio based on **actuarial assets** is roughly **75% to 80%**
 - If funded ratio is based on **market value of assets**, the average funded ratio is roughly **60% to 65%**
- State and local pension systems have lost over \$1.2 trillion

Typical plan — projection of funded status based on -25% return in FY 2009, 8% thereafter



Summary of where we are now

- Market crash
 - Funded status projected to decline to 45%
 - Contributions rates projected to double or triple
- Aging workforce
 - Population is getting older impacting plan demographics
- Mortality improvements
 - Longer life expectancies contribute to increasing pension and health care costs
- Negative publicity and budget constraints
 - Public employee pension plans are under attack

Fundamental actuarial equation of balance

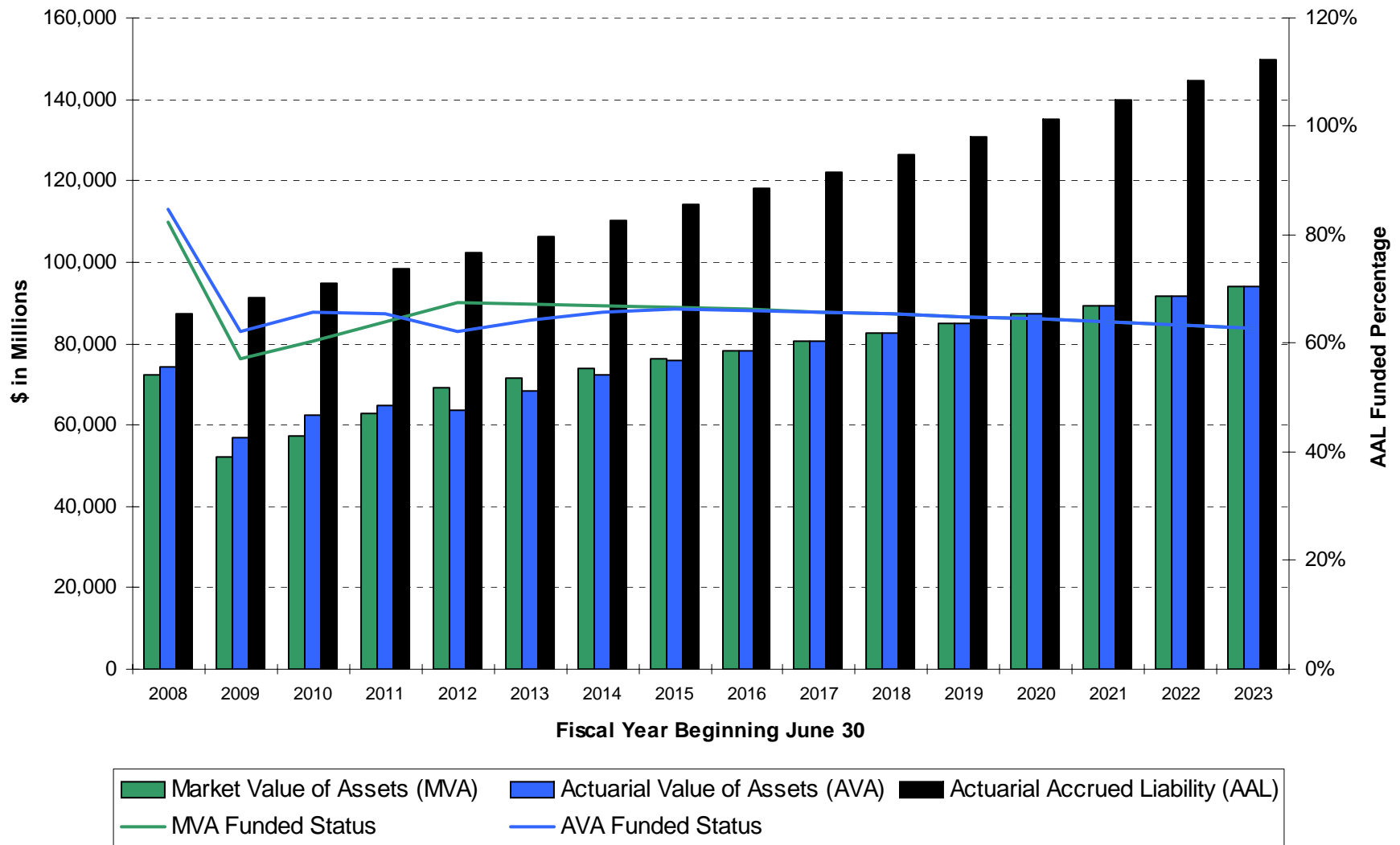
Contributions + Investment Earnings

=

Benefits + Expenses

- Means that there are three levers to keep the equation in balance (expenses relatively fixed and minor when compared to the others)
 - Contributions
 - Investment earnings
 - Benefits

Projection of funded status based on -25% return in FY 2009, 15% for next 3 years and 8% thereafter



Can we rely on investment returns to address funding issues?

- Unable to predict, but many believe that economic conditions likely to remain flat for a number of months or even years
- The likelihood of investment returns resolving the funding issue is remote
- That leaves changes in benefits as the remaining lever available to resolve the funding issue

Benefits – Changes to consider

- COLA
- Retirement age
- Benefit multiplier
- Final average salary period and other changes

COLA

- Lower the annual COLA percentage
- Change a compound COLA to a simple COLA
- Delay the COLA start date to age 65
- Freeze the COLA for a number of years
- Base the annual COLA on funded status of the system
- Eliminate the COLA

COLA change is often the only practical alternative that impacts both active and retired employees

Retirement Age

- Eliminate “service and out” benefits
 - 25 and out
 - 30 and out
 - Providing a benefit without a minimum age is expensive
- Implement minimum age for all retirement benefits

Benefit Multiplier

- Basing future accruals on lower multiplier
 - Will not have significant impact on funded status of the system
- Lowering the multiplier for all years of service
 - Could have significant impact on addressing funding
 - Difficult message to deliver to employees

Other Benefit Changes

- Examples
 - Eliminate the lump sum death benefits
 - Eliminate interest on member accounts
 - Charge more for purchase of service benefits
 - Change final average salary period (e.g., from 3 to 5)
- These changes would have minimal impact on funding
 - Do not cost much, so eliminating these types of benefits would not produce savings

Summary

- Market downturn is the worst since the Great Depression
- Private sector taxpayers have seen their retirement benefits slashed
- Negative articles on public employee benefit plans have become the norm as opposed to the exception
- Benefit concessions will be necessary to keep many plans solvent
- Disclaimer – this presentation reflects actuarial analysis and not support for cutting benefits. Benefit changes for public safety employees should reflect their job duties.

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