# PAPERS 9th Annual Fall Workshop

*Public Pension Plans: A Panel of Fiduciaries Share Their Insights*
*(What Changes I Have Seen/What Changes I Hope to See)*

Moderator, Timothy H. Johnson
Executive Director, Allegheny County Employees' Retirement System

The Sheraton Station Square Pittsburgh
Wednesday, November 18, 2015

# Basic pension funding equation:

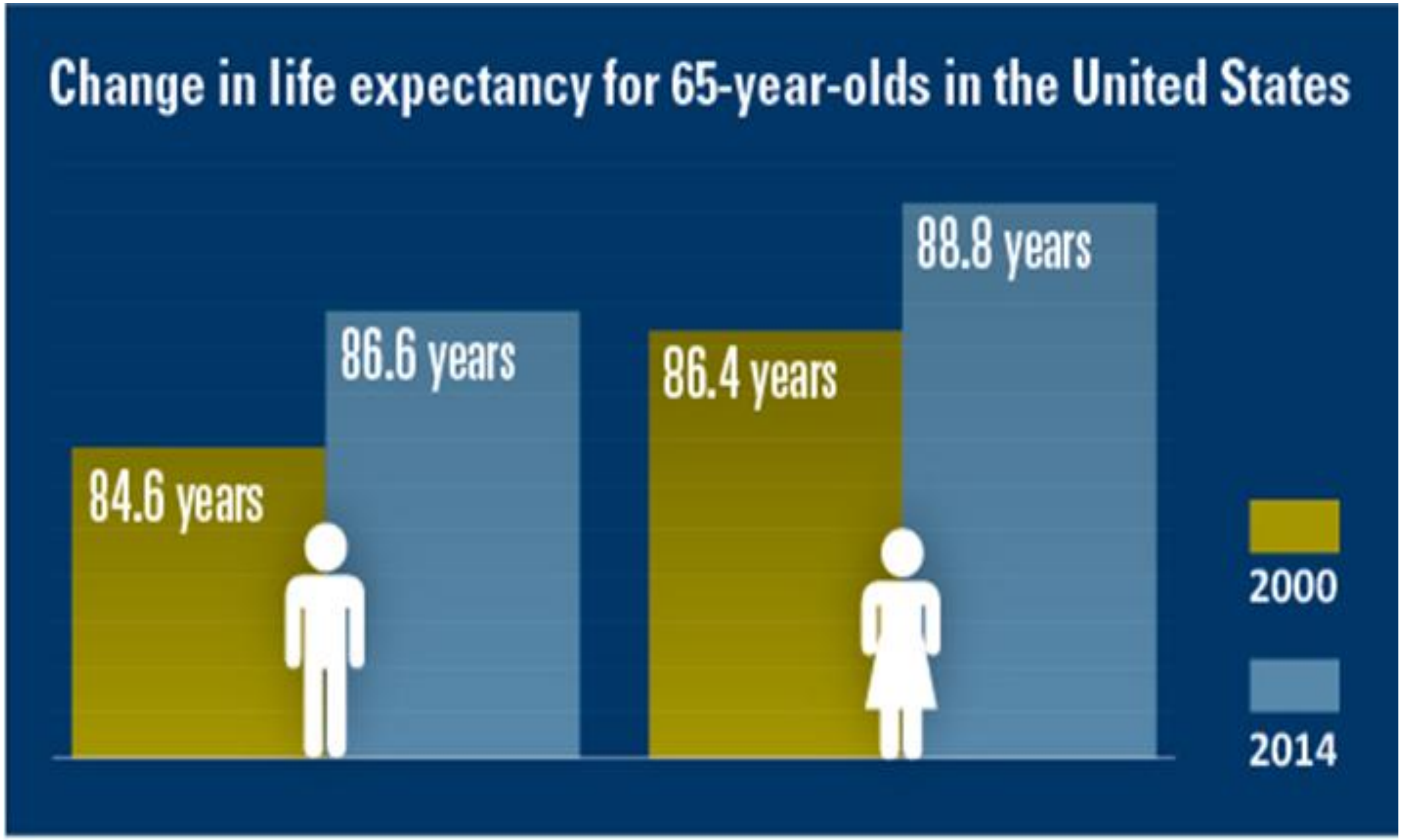
*Contributions + Investment Income =*

*Benefit Payments + Expenses*

Today, the assets of many pension funds have tripled in size to about 150 percent of their sponsors' budgets, and pensions hold roughly three-quarters of their assets in risky investments such as stocks, private equity and hedge funds.

| Municipality | Pension fund balances as % of budget | Pension contribution as % of total payroll | Allocation to stocks |
|---|---|---|---|
| A | 300% | 43% | 65% |
| B | 173% | 28% | 55% |
| C | 245% | 14% | 70% |

The average pension plan's annual required contribution from the government rose from 8.6 percent of employee wages in 2001 to 27.2 percent in 2013. But fewer than six in ten governments actually made their full pension contribution.




Source: *Society of Actuaries (www.soa.org, October 27, 2014)*

# Panel Guests

*Butler County Treasurer*
*Trustee of the Butler County Employees' Retirement System*

## Diane Marburger

*City of Pittsburgh Controller*
*Trustee of Pittsburgh's Police, Fire and Municipal Pension Funds*

## Michael Lamb

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Introduction:

"Thank you for staying with us this hour. My guests and I were tasked with discussing the changes we have seen and hope to see in regards to our fiduciary duties.

One thing about pensions that has not changed is the basic pension funding equation:

*Contributions + Investment Income = Benefit Payments + Expenses.*

It seems simple. You don't need an algebra vocabulary to understand that C + I = B + E. But it sure has become harder than it looks as the values of these terms have been changing very dramatically over the years."

Let me illustrate.

According to the National Association of State Retirement Administrators, virtually all public pension funds are in what is called a "cash-flow negative" state. That means that every year, they pay more in benefits to retirees than they receive in contributions. And that signals, at least for some, an urgent need to reconsider traditional investment strategies.

At the same time fewer governments are making the full pension contributions, while they rely on riskier investments to make up the difference, which is a volatile combination for state and local government finances.

You see in the past, public employee pensions were not a major factor for state and local governments, as public pension funds were small relative to the budgets of the governments that sponsored them, and pension investments were mostly low-risk. In 1975, for instance, a typical public plan had an investment portfolio equal in size to about 50 percent of the government's overall budget, and it held about one-quarter of its assets in equities or other risky investments. Thus, significant investment losses were unlikely and those losses, when they did occur, were small relative to overall public budgets that had to cover those losses. [1]

Today, the assets of many pension funds have tripled in size to about 150 percent of their sponsors' budgets, and pensions hold roughly three-quarters of their assets in risky investments such as stocks, private equity and hedge funds.

| *Municipality* | *Pension fund balances as % of budget* | *Pension contribution as % of total payroll* | *Allocation to stocks* |
|---|---|---|---|
| A | 300% | 43% | 65% |
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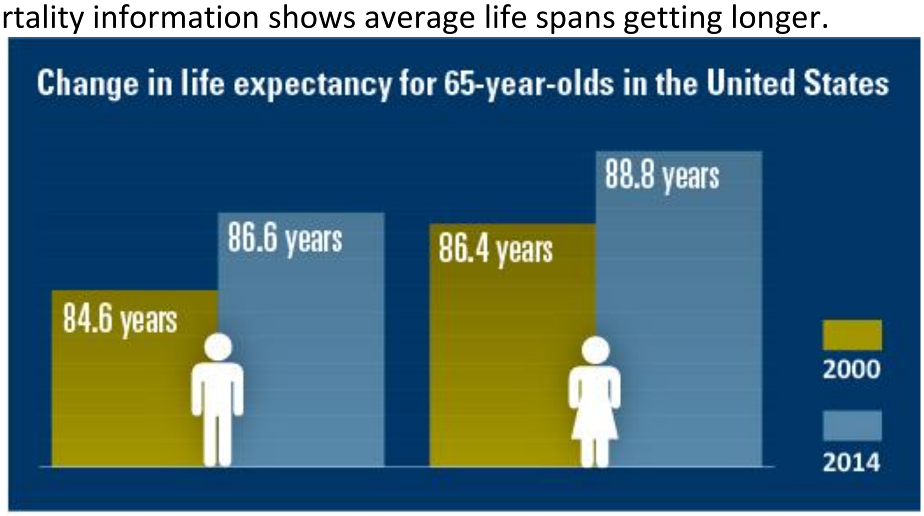
The growing size of pension funds relative to government budgets makes any percentage loss in the fund more costly for governments to make up, and the increasing risk of pension investments makes those losses more likely. While government budget planners crave stability and predictability in their annual pension contributions, the increasing size and risk taking of U.S. public plans makes this goal impossible, even using actuarial methods such as smoothing investment losses over long time periods. [1]

Investment volatility has pushed annual contribution rates to levels that are harder for governments to pay. The average pension plan's annual required contribution from the government rose from 8.6 percent of employee wages in 2001 to 27.2 percent in 2013. But fewer than six in ten governments actually made their full pension contribution. [1]

We've looked at the left side of the equation, now what about the right side?

Current mortality information shows average life spans getting longer.




**Source:** *Society of Actuaries (www.soa.org, October 27, 2014)*

The belief is that this trend will continue in the future. As a result, computed retirement obligations will increase.

Finally, turning to fees and expenses, a recent Maryland Public Policy Institute study concludes that pension funds with the highest fees, as a percent of assets, recorded inferior investment returns, on average, versus those in states with the lowest fees. Basically, more fees equal lower returns [4].

Because of the multiple providers involved and the various ways fees are assessed, it can be difficult to determine who is receiving how much, and for which services. Nevertheless, fiduciaries are being reminded of their responsibility to accurately determine and evaluate their plan fees.

As you can see, pension funding seems simple, but managing the relationship between the two sides of the equation is serious business with significant implications.

So how are two western PA public plans meeting these challenges?

My goal was to bring a group of experienced fiduciaries together who had years of "change" under their belt who could share their wisdom regarding where they started in the world of pension responsibilities and where they have seen things progress over the years.

We were not able to draw on a fiduciary from a state plan due in large measure to two problems – 1) conflicting schedules (the General Assembly is in session today  and 2) state officials have been put under a travel restriction due to the failure of there being an adopted state budget.

Nevertheless, joining me are two individuals with the experience to speak with authority on the issues of fiduciary responsibility and pension funding.

Three term City of Pittsburgh Controller and Trustee for Pittsburgh's Police, Fire and Municipal Pension Funds- Michael Lamb.

Butler County Treasurer and Trustee of the Butler County Employees' Retirement System - Diane Marburger - just re-elected to serve her fifth term as county treasurer.

Certainly these two elected officials have seen some of these changes we are going to discuss today.

Sources:

[1] Biggs, A. (2015) Local-Government Worker Pensions Hang in the Balance. Retrieved from http://www.nationalinterest.org/feature/local-government-worker-pensions-hang-the-balance-14227?page=2

[2]Editorial Board. (2015). Fix pensions: The Democratic mayors are right — it's a crisis. Retrieved from http://www.post-gazette.com/opinion/editorials/2015/04/15/Fix-pensions-The-Democratic-mayors-are-right-it-s-a-crisis/stories/201504300014

[3]Hoffman H. (2015) New Mortality Tables Will Affect Defined Benefit Pension Plan Sponsors. Retrieved from http://www.claconnect.com/Employee-Benefit-Plans/New-Mortality-Tables-Will-Affect-Defined-Benefit-Pension-Plan-Sponsors.aspx

[4]Hooke J., Walters J. MARYLAND POLICY REPORT: Economic & Fiscal Policy, Public Pensions. Wall Street Fees and Investment Returns for 33 State Pension Funds. Retrieved from https://www.mdpolicy.org/research/detail/wall-street-fees-and-investment-returns-for-33-state-pension-funds