Underfunded employee pensions are among the biggest problems facing most governments in the United States, with state unfunded obligations estimated as high as $833 billion. In general, public employees view the benefits as an unassailable right and taxpayers find this to be an unaffordable burden. Compounding the issue is the fact that most Americans, whether public or private sector employees, have savings that are insufficient to sustain their lifestyles in retirement. So we have a problem that exists for everyone — employees and taxpayers — and has the potential to severely affect each of these constituencies in the years ahead.

The current pension funding crisis is not a new event; it has a history and causality stretching back over more than a decade. Whether driven by unwise benefits increases, poor funding practices or both, the problem is only getting worse. Starting in 2016, 10,000 baby boomers a day will reach retirement age. They face daunting income replacement ratios, currently insolvent or underfunded pension plans — if they have a traditional pension plan at all — and a skeptical taxpayer base unwilling to ride to the rescue.

This discouraging status quo is compounded by the fact that by 2033, 30 million additional individuals will have turned 65, leaving both Medicare and Social Security unable to pay their bills from current revenues. The pension crisis, whether among public or private employees, also affects the broader economy, because most Americans have simply not saved enough to sustain a dignified retirement. Today, retiree spending accounts for 5.3% of our Gross National Product (GNP) and employs millions of workers directly and tens of millions indirectly.

The retirement funding crisis is not an easy problem to solve, but the economic and social health of our society demands a solution. This begins by recognizing that pension shortfalls and lack of retirement income are not math problems, but are complex challenges requiring thoughtful solutions, politically challenging to implement. There are remedies, but they, too, involve shared sacrifice. Any solution must provide workers sufficient income guarantees, be affordable to taxpayers, and sustainable far into the future.

At the PFM Group, we work at the nexus of government and finance, and we believe solutions to the nettlesome pension-related issues must be found at this junction. Only a multi-faceted solution is truly viable, and we propose a number of potential policy considerations in framing one, including:

- Retirement benefit redesign
- Renegotiation strategies and tactics centered on cost sharing
- Monetizing assets and closing plans where appropriate
- Full recognition that pensions, where offered, are part of compensation
- An ongoing commitment to funding in good times and bad

We are confident that with motivation, collaborative negotiation, shared sacrifice, and an understanding of all the factors involved, sufficient, affordable, and sustainable solutions to the challenge of retirement finance will be developed and implemented for the good of all.
There has been some progress in the last five years:

- 30 states increased employee contributions
- 31 states increased age or service requirements for new hires
- 21 states made changes to post-retirement COLAs
- 15 states reduced benefit multipliers
- As of July 1, 2013, 11 states offer a hybrid DB/DC plan to large groups of public employees

Strategies and Tactics

- Holistic view of total compensation
- Higher employee contribution
- Mandatory Annual Required Contribution (ARC) funding
- Caps on benefits
- Funding underfunded systems
- Adjust minimum retirement age
- Elimination of retroactive increases
- Development of hybrid systems
- Create contribution certainty and risk parity
- Monitor with vigilance and engage employees

2010 STATE PENSION OVERVIEW

<table>
<thead>
<tr>
<th>State</th>
<th>Number of State Plan Participants</th>
<th>UAAL (Millions)</th>
<th>Recent State ARC Contribution (Millions)</th>
<th>Funding Surplus (Deficit)</th>
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Source: Boston College Database, National Association of State Budget Officers 2010-2012 State Expenditure Report, Census Bureau

CONSISTENT PENSION FUNDING RESULTS IN MORE STABLE PLANS

Assembled from multiple sources by the PFM Group.

For further information about PFM’s Center for Retirement Finance or a copy of our full report, contact Jim Link, Managing Director, at 215.557.1222 or linkj@pfm.com or Michael Nadol, Managing Director, at 215.557.1433 or nadolm@pfm.com.

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