Closing the Funding Gap without Dismantling Public Pensions #1

Addressing Pension Funding Challenges

NCPERS Public Pension Funding Forum

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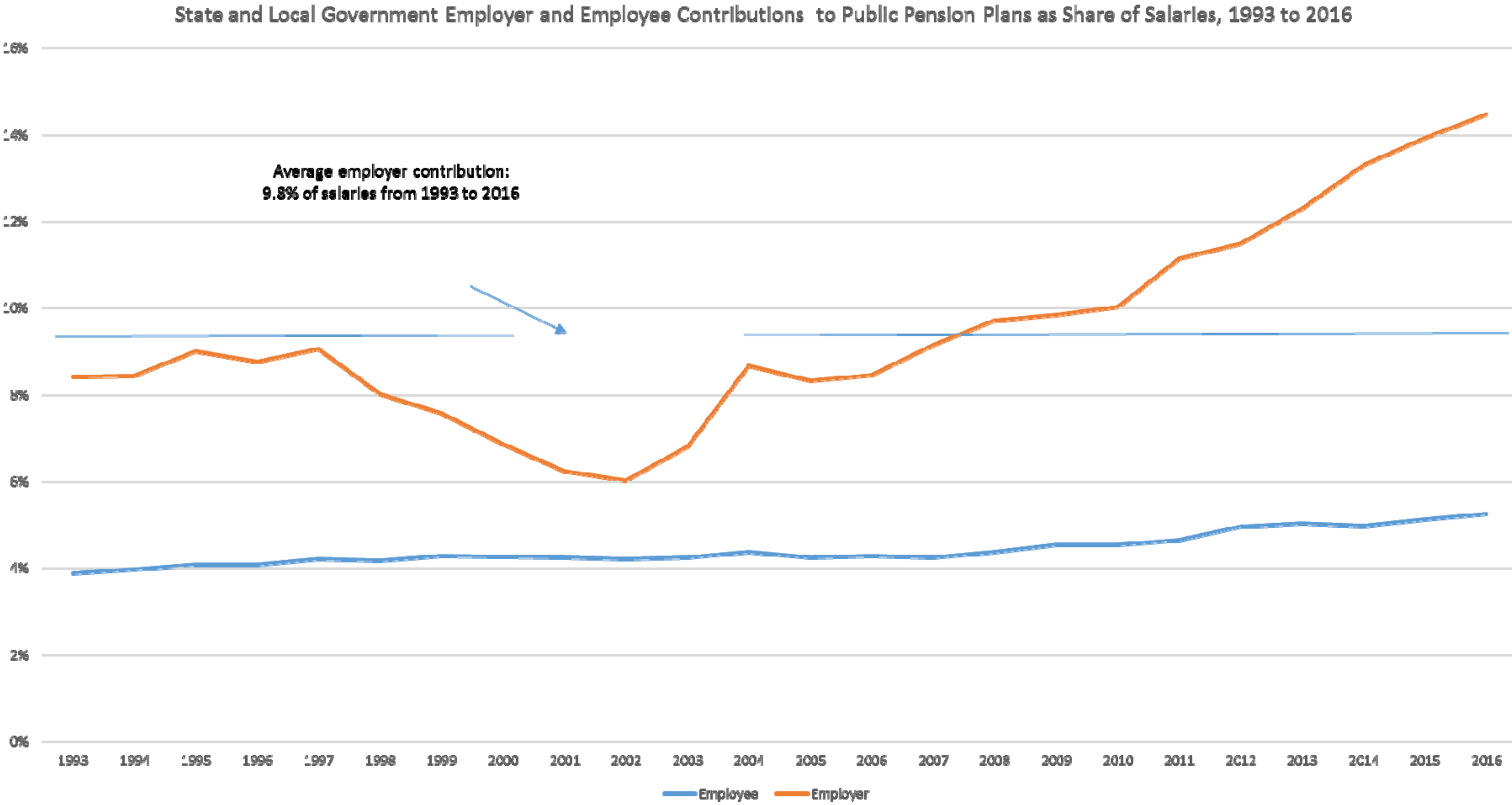
State and Local Government Employer and Employee Contributions to Public Pension Plans as Share of Salaries, 1993 to 2016
Average employer contribution:
9.8% of salaries from 1993 to 2016
16%
14%
12%
10%
8%
6%
4%
2%
0%
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
Employee
Employer

Three Ways to Steady Employer Contributions

1) Accounting rules to reflect long-term commitment, e.g. by allowing for twenty year smoothing of asset and liability values (Weller and Baker, 2006).

2) Legal requirements of employers to make regular payments, e.g. as share of payroll, or to use dedicated taxes to pay for pension contributions.

3) Bond issues to make future funding commitments explicit and to give pension funds more predictable flows of income.

Each approach has its own challenges

1) Accounting standards:

- GASB has been moving away from smoothing.
- Smoothing needs to happen for both assets and liabilities to work.
- Stakeholders would need to be comfortable with low and high funding ratios.

2) Legal requirements:

- Can be inflexible to meet changing economic environment and plan specifics.
- Time inconsistency problem: future legislative changes are not precluded.
- Faces political obstacles when funding ratios are high.

3) Bond issues:

- Temptation to saddle future governments with balloon payments.
- Making costs explicit could result in ratings changes and thus cost increases.

Summary and conclusion

- Public pension funds face financial challenges because employers in the past contributed less than necessary.
- Addressing financial challenges requires stabilizing employer contributions for the future.
- This can happen through accounting rule changes, legislative changes and bond issues.
- It cannot happen through investment allocation changes or lower fees.
- The political and economic environment will determine the best approach to addressing future financial challenges.