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If you drove your car from New York to Chicago at 20 mph instead of 60 mph, it would take three days instead of one to get there. That’s the simple formula opponents of public pension plans are using to produce ever-larger estimates of unfunded pension liabilities. Armed with calculators and political agendas, they lower the projected rates of return on pension assets to come up with reduced asset growth over 30 long years, which, to no one’s surprise, creates a funding gap. Their goal is to discredit more than 100 years of success by public pension plans in providing a secure retirement for workers. So they punch all the buttons until they come up with a dire estimated shortfall that sounds even more alarming than their previous ones.

The problem is, the low rates of return that produce such big scary shortfall estimates are not grounded in reality. Projections are forecasts that are based on past and present experience and refined over time. Past and present experience tell us that the current conservative average estimate developed by actuaries—a 7.62 percent annualized rate of return on pension assets over 30 years—is well within the realistic range, and it may be too low. It is almost certainly not too high. Thirty years is a very long time, and the view from the aftermath of a financial crisis tends to be clouded by pessimism. As the National Association of State Retirement Administrators, recently noted, “Over the last 25 years, a period that has included three economic recessions and four years when median public pension fund investment returns were negative, public pension funds have exceeded their assumed rates of investment return.”

Critics arrive at huge cuts in the estimated returns by imposing a theoretical market price on the future pension obligations. Measuring public-sector pension plans by this what-if measure—known as the market value of liabilities—is misguided, according to actuaries, yet this is the approach the Hoover Institute embraced in its latest research. In a scholarly article recently published by the American Enterprise Institute, Paul Angelo, senior vice president of the actuarial firm Segal Consultants, demonstrated that the market value approach is “far less useful” for public plans because it is not designed to estimate the expected cost of current and future benefit obligations, rather a measure of the immediate cost of shutting down a plan, something rarely done in the public sector. He defended the validity of the time-tested measure that pension plans actually use: actuarial accrued liabilities.

The minority of states that have significantly underfunded their public pensions do, of course, face the possibility of wide funding gaps. They broke their promises to make timely payments to pension funds—even though public employees made their payments on time—and there will be a cost for that decision. We all pay penalties when we decide not to pay our bills on time, making the costs larger than they would have been had we budgeted correctly. Just because they deferred payment does not mean they should be allowed to walk away from the obligation.
Most states and municipalities are solidly on track with their funding. Constantly fiddling with the numbers, as opponents seem intent upon doing, is a tactic aimed at making the real issue of pension underfunding seem impossibly large and unsolvable. It is neither. Requiring state and municipal governments to meet their funding obligations on time, without exception, would go a long way. States that don’t do this should pay a price in their cost of borrowing, as New Jersey has through many successive ratings cuts.

It’s time to put away the crystal balls and focus on the spreadsheets. States and municipalities can help pension plan managers do their jobs by meeting quarterly and annual funding obligations. Managers, in turn, will fine-tune their strategies as new information — actual, verifiable performance data instead of politically driven estimates -- becomes available, just as they have always done.

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