



NIRS FACT CHECK
State Pension Funds Fall Off a Cliff
January 20, 2010

A recent report by the American Legislative Exchange Council on state pension funds contains serious factual errors and omits relevant contextual information. As a result, it reaches inaccurate and alarmist conclusions. Its primary recommendation—to dismantle efficient group-based pension plans in favor of individual 401(k)-style accounts—misses the mark, as it would do nothing to improve state pension funding, and it could ultimately prove to be a significant waste of taxpayer dollars.

This document highlights a few of the more serious misstatements in the report and provides research citations that correct the record.

Page 3 and 29:

“These plans should consider replacing their defined-benefit plans with defined-contribution plans for new employees.”

- [NIRS research shows](#) that “freezing” the DB plan does nothing to reduce the plan’s unfunded liability; in fact, in the short term, the cost to pay down the unfunded liability can actually accelerate in the wake of a freeze.
- [Other NIRS research](#) shows that DB pension plans are an economically efficient way to fund retirement, because a DB pension can deliver the same retirement income at 46% lower cost than individual defined contribution (DC) accounts. Therefore DB plans are a more efficient use of taxpayer funds when offering retirement benefits to public employees.
- Further, [the experience of Nebraska and West Virginia](#) suggest that DC plans as a primary source of retirement income are insufficient. Both states offered DC plans to some public employees but abandoned the programs when it was revealed that the benefits provided did not allow employees to retire with an adequate income.

Page 4:

“Little progress has been made in providing current financial information for state and local pension plans, despite new GASB protocols that require state and local jurisdictions to provide this information in their financial statements. Many state and local jurisdictions have yet to meet the GASB reporting standards, and for those that do, they often provide data that is so out of date, it is of little use.”

- The GFOA annually awards [Certificates of Achievement for Excellence in Financial Reporting](#) to state and local governments that “go beyond the minimum requirements of generally accepted accounting principles to prepare comprehensive annual financial reports that evidence the spirit of transparency and full disclosure.”

- According to just this one source, [in 2006 over 150 public employee retirement systems had won this award](#)—again, not only meeting, but also exceeding, GASB reporting standards.
- Upon cross-referencing this list with the [Public Fund Survey](#), it can be determined that these 150 retirement systems represent more than 71% of the total assets managed by state and local retirement systems in the United States. Yet, undoubtedly, even more systems that abide by GASB and GFOA standards do not apply for this award, and thus are not included in this total.

Page 12:

“A better measure of the burden of unfunded liabilities in state pension systems, from a taxpayer’s perspective, is to compare unfunded liabilities per capita and as a share of per capita income.”

- This is a false measure, as taxpayers do not, and have never, paid the entire cost of public sector pension plans. State and local DB pension plans are usually funded by employer contributions and [contributions from employees themselves](#), who make regular payments to the fund directly out of their paychecks. On average, [public employees contribute 5% of pay](#) to finance their pensions, with employers contributing an additional 7% of pay.
- According to the [Public Fund Survey](#), most employees within Colorado PERA contribute 8.0% of pay, with an employer contribution of 11.15% of pay. In Kansas PERS, employees contribute 4.0% of pay, and employer contributions are 5.93%, 7.37%, and 8.84% of pay, depending on the occupation.

Page 22:

“Actuaries generally recommend an assumed rate of return on assets substantially below eight percent. For example, ERISA recommends that private employers assume a 6.1 percent return on assets in private pension plans.”

- ERISA makes no such recommendation on the investment assumptions of private plans. ERISA’s minimum funding requirements include a provision for the benchmark interest rate to be on par with a high quality corporate bond rate. However, this rate is used for funding purposes only; it does not serve as an investment return assumption.
- In fact, DB pension plans in the private sector assume an even higher rate of return, on average, than public sector plans, at [8.25%](#), versus [8.0%](#) for public plans.

Page 3 and 22:

“Because these pension systems assume a high return on assets, they must invest in a diversified portfolio of assets including equities as well as fixed income assets.”

- The cause and effect here is backward. [Public pensions invest in a diversified portfolio, consistent with modern portfolio theory](#). The expected rate of return stems from the portfolio of investments, not the other way around.
- [Federal reserve data](#) show that public sector plans invest quite similarly to private sector DB plans.

Page 3 and 28:

“Everything should be on the table, including changes in benefits and increased employee contribution rates, as well as employer contribution rates.”

- [NCSL data](#) show that public plans across the country are indeed putting ‘everything on the table’ in order to ensure long-term sustainability.
- Additional [NCSL data](#) further show that state budgets have challenges beyond public pension plans. According to NCSL, “States are taking a variety of approaches to close their budget gaps and the approaches include both cutting budgets and generating new revenues.”

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