Center for State & Local Government Excellence

SUCCESS STRATEGIES

for Well-Funded Pension Plans

February 2015

Why are some pension plans better funded than others? While some plans are more than 100 percent advance-funded, the average funded ratio of the largest 150 plans in 2012 was 72 percent, according to our 2014 issue brief, *The Funding of State and Local Pensions: 2013-2017*. http://slge.org/publications/the-funding-of-state-and-local-pensions-2013-2017

The Center for State and Local Government Excellence examined four defined benefit pension systems that have a long tradition of being well-funded: Delaware Public Employees' Retirement System, Illinois Municipal Retirement Fund, Iowa Public Employees' Retirement System, and North Carolina Retirement Systems.

While each pension plan has a unique history, there are certain characteristics common to all five plans, particularly the employer's commitment to fund the annual required contribution. The systems have all lowered their annual investment assumption to 7.5 percent or less in recent years and have adjusted employer and employee contributions as needed to meet funding requirements.

Even as the public focuses on the new accounting standards issued by the Governmental Accounting Standards Board, the most important issue for taxpayers, employees, and employers alike is that there is a clear plan to fund the government's pension obligations. In 2013, 11 national associations issued *Pension Funding: A Guide for Elected Officials.*" http://slge.org/publications/pension-funding-a-guide-for-elected-officials

The *Guide* stresses the importance of basing a government's pension funding policy on an actuarially determined contribution, being disciplined about making required contributions, and clearly reporting how and when pension plans will be funded.

These case studies illustrate how those principles have been applied and underscore the importance of fiscally responsible solutions that provide retirement security for public workers.

For more research and information about promising benefit and compensation practices, pension funding, and workforce trends and issues, visit slge.org.

Elizabeth K Kellar

Elizabeth K. Kellar
President and CEO
Center for State and Local Government Excellence

Center for State & Local Government Excellence

DELAWARE
Public Employees' Retirement System
2015

The Plan

The Delaware Public Employees' Retirement System (DPERS) administers retirement benefits for nearly all public employees in the state. Today, DPERS administers nine different pension plans covering 72,600 state and local employees, including 43,061 contributing members, 26,180 retired members, and 3,359 inactive vested members. It has net assets of $8.1 billion restricted for pension benefits.[1]

Commitment to Funding

DPERS has been well funded throughout its 44-year history, driven by full funding of the state's annual required contribution (ARC) and an investment philosophy that focuses on controlling downside risks. Funding for the plan comes from a combination of investment returns (80 percent in fiscal year 2014), employer contributions (15 percent in fiscal year 2014), and employee contributions (3.7 percent in fiscal year 2014).[2]

Challenges

- Continuing to increase funded ratio of assets to liabilities following stock market losses in 2008 and 2009.

Changes to Plan Design

Bipartisan legislation signed into law in May 2011 made adjustments to the state pension plan that were designed to reduce the cost of funding pension and health benefits for future state and local employees covered by DPERS. The law made three changes to the plan for employees hired after January 1, 2012:

1. Increased the employee contribution from 3 percent to 6 percent of salary over $6,000;
2. Increased the normal retirement age from 62 with five years of service or 60 with 15 years of service to a new normal retirement age of 65 with 10 years of service or 60 with 20 years of service; and
3. Increased the vesting period from five years to 10 years of service.[3]

Strategies for Success

Following four years of improved investment returns and adjustments to the benefits structure going forward, pension officials have reaffirmed the strategies for success that have guided the plan since its creation:

- Sustained commitment to fully funding the annual required contribution in good and bad financial times.
- Ad-hoc cost-of-living adjustment (COLA) increases that are not embedded in the pension statute are considered annually by the legislature based on fund performance, and are funded over five years when granted. (Employees have received two cost-of-living adjustments recently – 2 percent in July 2011 and 1 percent in January 2012.)
- A continuing partnership between the executive and legislative branches on pension issues.
- A generally good understanding of pension

Funded Ratios for the Delaware Public Employees' Retirement System

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
101.6	101.7	103.7	103.1	98.8	96.0	94.0	91.5	91.1	95.8

Sources: DPERS Forty-Third Comprehensive Annual Financial Report issues in the General Assembly, supplemented by regular outreach to new legislators to increase understanding of issues, roles, responsibilities, and challenges.[4]

More

- The Board of Pension Trustees adopts the new annual required contribution (ARC) in October for the new budget cycle based on the annual actuarial valuation.
- The director of the state Office of Management and Budget is an ex-officio member of the Board of Pension Trustees, which ensures a close connection between pension funding requirements and the state budget process.[5]
- Assuming the plan earns 7.5 percent on its invested assets, the state contribution is projected to decrease gradually over the next 10 years. Over the same period, the plan's funded status is projected to grow slowly to an estimated 93 percent.[6]
- Pension officials credit the recovery from the 2008-2009 recession, in part due to a solid and consistent investment strategy that does not change when markets are volatile. No additional changes in plan policies or employee benefits are anticipated in the near future.[7]

Endnotes

1 Delaware Public Employees' Retirement System, Forty-Third Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2014, pages 27 and 29.

2 Author's calculation from Forty-Third Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2014, page 22.

3 DPERS Annual Valuation Report as of June 30, 2013, pages 47-49 and interview with David C. Craik, State Pension Administrator, January 17, 2014.

4 Interview with David C. Craik, January 17, 2014.

5 Ibid.

6 Delaware State Pension Plan, Actuarial Valuation as of June 30, 2013, page 4.

7 Interview with David C. Craik, January 17, 2014.

ILLINOIS
Municipal Retirement Fund
2015

The Plan

The Illinois Municipal Retirement Fund (IMRF) is an agent, multiple-employer defined benefit pension plan which covers 2,977 local government and public school district employers. It has 173,826 contributing active members, 107,732 current benefit recipients, and 12,717 inactive vested members. Today, it manages nearly $28 billion in assets.[1]

Commitment to Funding

IMRF is committed to being 100 percent funded and has a strong track record in moving toward that formally-adopted strategic goal. Funding for the plan comes from a combination of investment income (81 percent in 2013), employer contributions (14 percent in 2013), and employee contributions (5 percent in 2013).[2]

Challenges

- Implementing the new Governmental Accounting Standards Board (GASB) reporting standards for pensions and ensuring public understanding of the new accounting data regarding IMRF's financial status; and
- Managing any political changes and actions related to funding of other pension plans in the state and their impact on IMRF.[3]

Changes to Plan Design

In April 2010, the Governor signed a bill that changed the benefit packages for nearly all the state's pension programs, including IMRF. The changes, which apply to employees who enroll in IMRF from January 1, 2011, forward included:

- Lengthening the vesting period from eight to 10 years;
- Increasing the normal retirement age for full pension benefits from 60 to 67 years with 10 years of service;
- Increasing the earliest retirement age for a reduced pension from 55 to 62 years with 10 years of service;
- Increasing the number of years used to calculate the final average salary from four to eight;
- Increasing the early retirement pension reduction from 0.25 percent for each month under the normal retirement age (60) to 0.5 percent for each month under the new normal retirement age (67);
- Capping eligible wages for retirement benefits at $106,800 adjusted for inflation ($109,971 in 2013); and
- Setting the non-compounding cost-of-living increase at one-half of the Consumer Price Index (CPI) or three percent, whichever is less.[4]

Strategies for Success

The IMRF board has authority to enforce collection of the annual required contribution (ARC) from all participating units of government, including the ability to sue participating governments for failure to pay or asking the state to withhold other funding to that government until its ARC is paid. This, along with its formal commitment to achieve

Funded Ratios for the Illinois Municipal Retirement Fund

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
94.3	94.6	95.3	96.1	84.3	83.2	83.3	83.0	84.3	87.6

Sources: Illinois Municipal Retirement Fund, Comprehensive Annual Financial Report for the years ended December 31, 2013 and December 31, 2012

100 percent funding of pension benefits, is the key factor in its continuing financial success.[5] Other factors that contribute to the fund's success include:

- A conservative, consistent, long-term approach to estimating investment returns that does not change with market swings and achieves the greatest return with an acceptable amount of risk;
- Annual required contribution rates (ARC) that float based on current demographic and investment returns;
- Annual review of the annuitant financial reserve to ensure that the fund has 100 percent of the assets needed to pay benefits for those specific retirees; and
- Maintaining fully funded reserves for employees and retirees.[6]

More

- Each of IMRF's member jurisdictions has a unique employer contribution rate and is responsible for funding benefits only for its employees.
- The IMRF Board of Trustees sets the annual contribution rates for each local government based on current actuarial assumptions with the 100 percent funded goal in mind.[7]

Endnotes

1 Illinois Municipal Retirement Fund Comprehensive Annual Financial Report for the year ending December 31, 2013, and *Pension Plan Health: What Accounts for Differences*, presentation by Louis W. Kosiba to the Center for State and Local Government Excellence's Future of Retirement Summit, April 2013.

2 Author calculation from the Illinois Municipal Retirement Fund Comprehensive Annual Financial Report for the year ending December 31, 2013, page 13.

3 Interview with IMRF Executive Director Louis W. Kosiba, January 5, 2011.

4 Interview with IMRF Executive Director Louis W. Kosiba, January 20, 2014, and *Pension Plan Health: What Accounts for Differences*, presentation by Louis W. Kosiba to the Center for State and Local Government Excellence's Future of Retirement Summit, April 2013.

5 *100% Funding at a glance…*, Illinois Municipal Retirement Fund fact sheet, January 2012.

6 Interview with IMRF Executive Director Louis W. Kosiba, January 5, 2011.

7 Illinois Municipal Retirement Fund Annual Actuarial Valuation Report, December 31, 2012, page A-8.

Center for State & Local Government Excellence

IOWA
Public Employees' Retirement System
2015

The Plan

The Iowa Public Employees' Retirement System (IPERS) is a contributory defined benefit plan that uses years of service, a multi-year average covered wage, and a multiplier to determine annual pensions. IPERS covers 346,413 members who work for public schools, state agencies, counties, cities, townships, and other public entities. At the end of fiscal year 2014, IPERS had 165,913 active contributing members, 108,233 retired members, 72,267 inactive members, and managed nearly $28 billion in net assets restricted for pension benefits.[1]

IPERS has three membership classes with different contribution requirements and benefits - regular members who make up about 95 percent of the participants and two special service member classes made up of sheriffs, deputies, and other law enforcement and protection occupations.

Commitment to Funding

Pension plans are funded by a combination of investment gains and government employer and employee contributions. IPERS has maintained a fairly solid ratio of assets to liabilities despite more than ten years of underfunding the annual required contribution for regular members. In fiscal year 2014, for example, IPERS gained $4.99 billion in the fund, of which 78 percent came from investment income, 13 percent from employer contributions, and 8.6 percent from employee contributions.[2]

Challenges

- Historically, IPERS has relied heavily on investment returns to maintain financial stability. IPERS suffered significant investment losses in the 2001-2002 and 2008-2009 recessions.[3]
- IPERS' combined government employer-employee contribution rate had been fixed at 9.45 percent of payroll by state statute. That fixed rate was frequently lower than the annual required contribution (ARC). Over the years, this failure to pay the ARC was a major factor in the plan's growing unfunded actuarial liability (UAL).
- Between 2008 and 2012, the IPERS unfunded actuarial liability grew from 43.5 percent of covered payroll to 87.2 percent.[4]

Changes to Plan Design

- In 2010, the General Assembly increased the combined required employer-employee contribution to 13.45 percent as part of a comprehensive plan to improve IPERS' fiscal health. This rate was still below the ARC for that year.
- Legislation, which became effective July 1, 2012, authorized IPERS to adjust the contribution rates up or down each year by up to one percentage point to bring them closer to the ARC beginning in fiscal year 2013. Pension officials say this transition from a "hardwired" statutory contribution rate to an annually adjusted rate with a cap moves the plan toward long-term financial stability and reduces the unfunded liability.[5]
- The 2010 legislation also made the following

Funded Ratios for the Iowa Public Employees' Retirement System

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
88.7	88.4	90.2	89.1	81.2	81.4	79.9	79.9	81.0	82.7

Source: Iowa Public Employees' Retirement System Comprehensive Annual Financial Report, Fiscal Year 2014.

changes to IPERS member benefits:

1. increased the vesting period from four to seven years for nonvested employees;
2. increased the early retirement reduction in benefits for all IPERS members from three percent to six percent for each year before reaching the normal retirement age; and
3. increased the number of years used in calculating the average salary for benefits for all employees from three to five years.[6]

Strategies for Success

- Recognizing that investment performance alone will not guarantee financial security;
- Regularly adjusting the employer-employee contribution rates to meet actuarially required levels;
- Sustaining the annual required contribution and benefit adjustments even if the financial picture looks better in the short-run; and
- Taking incremental actions to reduce the unfunded liability to maintain the plan's long-term fiscal health.[7]

More

- Even factoring in investment losses in the 2001-2002 and 2008-2009 recessions, investment earnings contributed more than 65 percent of benefits paid over the past several decades.[8]
- In fiscal year 2014, investments gained 15.88 percent. This was a substantial increase from the previous year's investment returns of 10.12 percent.[9]
- IPERS officials continue to explore the benefits, opportunities, and challenges of adding a defined contribution option for its members. Historically, there has been a lack of support for action, particularly because of the burden it places on employees to manage their retirement investments and concerns that employees lack disposable income to contribute to a new plan.[10]

Endnotes

1 Iowa Public Employees' Retirement System Comprehensive Annual Financial Report, Fiscal Year 2014, pages ii, 4, and 33.

2 Author calculations from IPERS Comprehensive Annual Financial Report, Fiscal Year 2014, page 22.

3 FY 2012 Annual Summary, Iowa Public Employees' Retirement System, page 3.

4 IPERS Comprehensive Annual Financial Report, Fiscal Year 2013, pages 5 and 36.

5 IPERS Comprehensive Annual Financial Report, Fiscal Year 2013, page 6, and interview with IPERS CEO Donna Mueller, January 17, 2014.

6 Summary of 2010-2012 IPERS Changes, Iowa Public Employees' Retirement System, pages 2-3.

7 Interview with IPERS CEO Donna Mueller, January 17, 2014.

8 FY 2012 Annual Summary, Iowa Public Employees' Retirement System, page 3.

9 IPERS Comprehensive Annual Financial Report, Fiscal Year 2014, page 5.

10 Interview with IPERS CEO Donna Mueller, January 17, 2014.

NORTH CAROLINA
Retirement Systems 2015

Center for State & Local Government Excellence

The Plan

The North Carolina Retirement Systems (NCRS) serves 875,000 current and former state and local employees and manages $74.5 billion in total assets. NCRS administers seven defined benefit pension plans, the largest of which are the Teachers' and State Employees' Retirement System (TSERS), which provides benefits to all state employees and full-time teachers; and the Local Governmental Employees' Retirement System (LGERS), which provides benefits for employees of cities, towns, counties, boards, commissions, and local government entities.[1]

Commitment to Funding

NCRS has a long history of being well funded. Its aggregate ratio of assets to liabilities across all plans is 93.9 percent. The pension plans are funded by a combination of investment gains and employer and employee contributions.[2]

Challenges

- The interest rate environment for investment returns and the prospect for national economic growth could affect the plan, since it depends on investment income and economic growth for fiscal stability.
- The inability of national leaders to work out a long-term debt reduction policy and agree on good fiscal policy is the biggest challenge to long-term growth of the pension plan.[3]

Changes to Plan Design

- In 2010, the General Assembly increased the vesting period for employees hired after August 1, 2011, from five years to ten years. This change was repealed in 2014, and the vesting period for all employees was returned to five years.[4]
- In 2012, the legislature authorized a 1 percent increase in benefits to retirees who were on the roll as of July 1, 2011, and a prorated portion of a 1 percent increase for employees who retired after July 1, 2011, but before June 30, 2012. The cost of the amendment was .33 percent of payroll, which was reflected in the annual required contribution beginning in 2013.[5]

Strategies for Success

- Consistent use of conservative actuarial assumptions. The fund assumes a 7.25 percent return on investments to minimize risk and recognizes all promised benefits in actuarial liabilities;
- Full funding of the annual required contribution to meet the plan's financial needs; and
- Prudent financing, such as requiring a full

Funded Ratios for the North Carolina Retirement Systems

Teachers' and State Employees' Retirement System

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
106.5	106.1	104.7	99.3	95.9	95.4	94.0	94.0	94.2	94.8

Local Governmental Employees' Retirement System

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
99.4	99.5	99.5	99.6	99.5	99.6	99.8	99.8	99.8	99.8

Sources: 2011-2012 North Carolina State Treasurer's Annual Report and State of North Carolina Comprehensive Annual Financial Reports for the years ending June 30, 2014 and June 30, 2013 actuarial analysis to assess the long-term price tag of any proposal that will affect benefits or costs.[6]

More

- Participating local governments are required to pay 100 percent of the ARC to fund LGERS. Employees contribute six percent of their salaries.
- Pension officials forecast that funded ratios for both TSERS and LGERS will remain flat for the next two years before inching back upward.[7]
- The fund offers only ad-hoc cost-of-living adjustment (COLA) increases that are tied to investment performance.[8]
- North Carolina offers two centrally operated supplemental defined contribution plans - the NC 401(k) and NC 457 - as well as a new 403(b) option for public school employees that was authorized by the General Assembly in 2012 and implemented in 2014. These plans are designed to provide easy access to savings/investment options to supplement members' retirement income.[9]

Endnotes

1 The North Carolina State Treasurer's Annual Report, FY 2011-2012, page 24.

2 *The State of State Pension Plans 2013: A Deep Dive into Shortfalls and Surpluses*, Morningstar, September 2013, page 2.

3 Input from Schorr Johnson, Communications Manager, Office of the North Carolina State Treasurer, February 10, 2014.

4 North Carolina General Assembly, Session Law 2014-88 – House Bill 1195, adopted July 30, 2014.

5 TSERS Actuarial Valuation Report prepared as of December 31, 2011, transmittal letter and page 1.

6 The State Treasurer's Annual Report, Fiscal Year 2011-2012, and interview with Schorr Johnson, February 10, 2014.

7 Input from Schorr Johnson, February 10, 2014.

8 The State Treasurer's Annual Report, Fiscal Year 2011-2012, and interview with Schorr Johnson, February 10, 2014.

9 Input from Schorr Johnson, February 10, 2014, and interview with Dr. Robert Clark, Chair, North Carolina Future of Retirement Study Commission, January 13, 2014; and *Pathways: A Newsletter for Active Government Employees in North Carolina*, Fall 2013.