The Growing Net Pension Liability: The Cases of New Jersey, Illinois, and Rhode Island

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INTRODUCTION

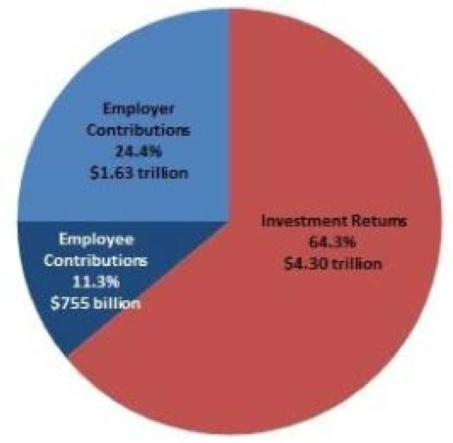
Pensions, which are form of deferred compensation, are regarded to be pivotal benefits needed to ensure that the most qualified candidates are hired to public positions and retained. Public employees who expect retirement benefits as compensation for forgoing working for higher wages in the private sector provide fundamental services for the community which include education, protective services, and transportation.

RECIPE FOR UNDERFUNDED PENSION

	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Accrued Actuarial Liability	GASB Ratio %	Market Value of Assets	Unfunded Market Value Liability
FY 1997	31,948	30,717	1,231	104.0%	32,922	2,205
FY 1998	35,513	33,768	1,745	105.2%	41,540	7,772
FY 1999	40,078	36,752	3,326	109.0%	47,537	10,784
FY 2000	44,023	39,534	4,489	111.4%	51,612	12,078
FY 2001	50,732	46,552	4,181	109.0%	45,279	(1,273)
FY 2002	50,531	50,130	401	100.8%	39,305	(10,825)
FY 2003	49,674	53,914	(4,241)	92.1%	38,340	(15,574)
FY 2004	49,574	58,018	(8,444)	85.4%	41,414	(16,604)
FY 2005	49,755	62,797	(13,041)	79.2%	42,918	(19,878)
FY 2006	50,659	67,266	(16,607)	75.3%	45,780	(21,486)
FY 2007	52,433	71,656	(19,222)	73.2%	50,720	(20,936)
FY 2008	52,718	75,763	(23,045)	69.6%	47,000	(28,763)
FY 2009	50,230	80,956	(30,727)	62.0%	36,540	(44,416)
FY 2010	48,079	73,714	(25,635)	65.2%	37,766	(35,948)
FY 2011	46,698	76,806	(30,108)	60.8%	40,795	(36,010)
FY 2012	45,064	79,434	(34,370)	56.7%	38,271	(41,163)
FY 2013	44,050	81,330	(37,279)	54.2%	39,487	(41,842)

The underfunded public pension is the result of underlying political, economic, and demographic factors that have contractually increased the public pension liability contingent upon the volatility of the market.

The 2007 recession entrenched a divide between assets and liabilities attributable to the pension fund. Pension payments slowly reduced the assets while the pressure of a balanced budget decreased and even eliminated governmental contribution into the public pension plans.

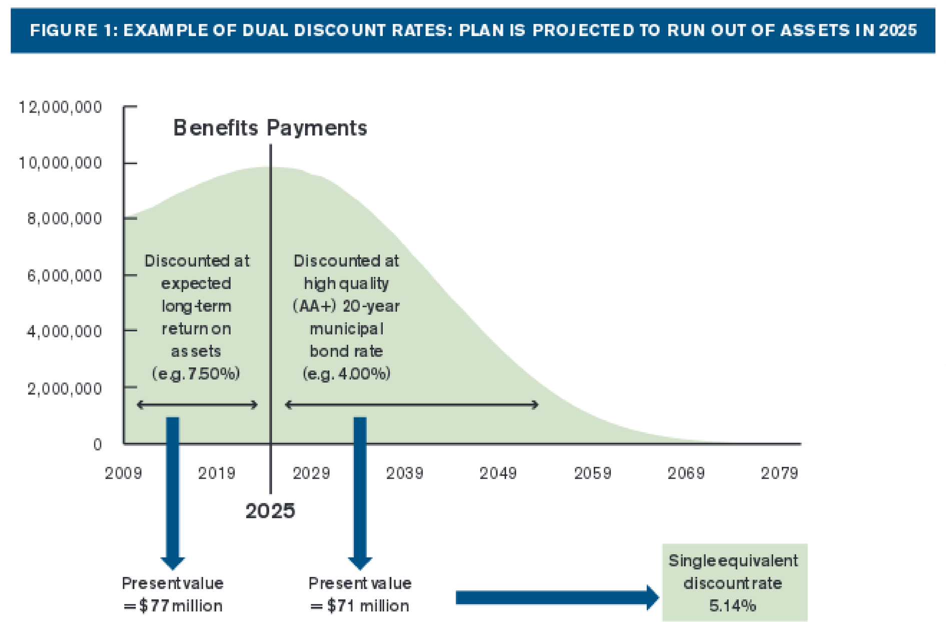


Source: Compiled by NASRA based on U.S. Census Bureau data

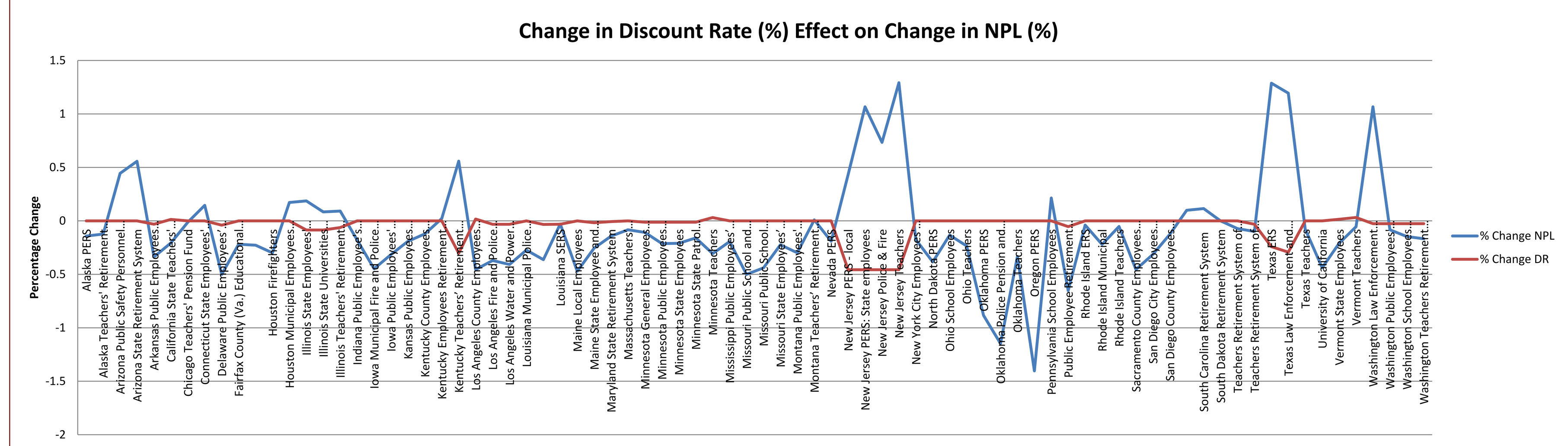
GASB 67 AND 68

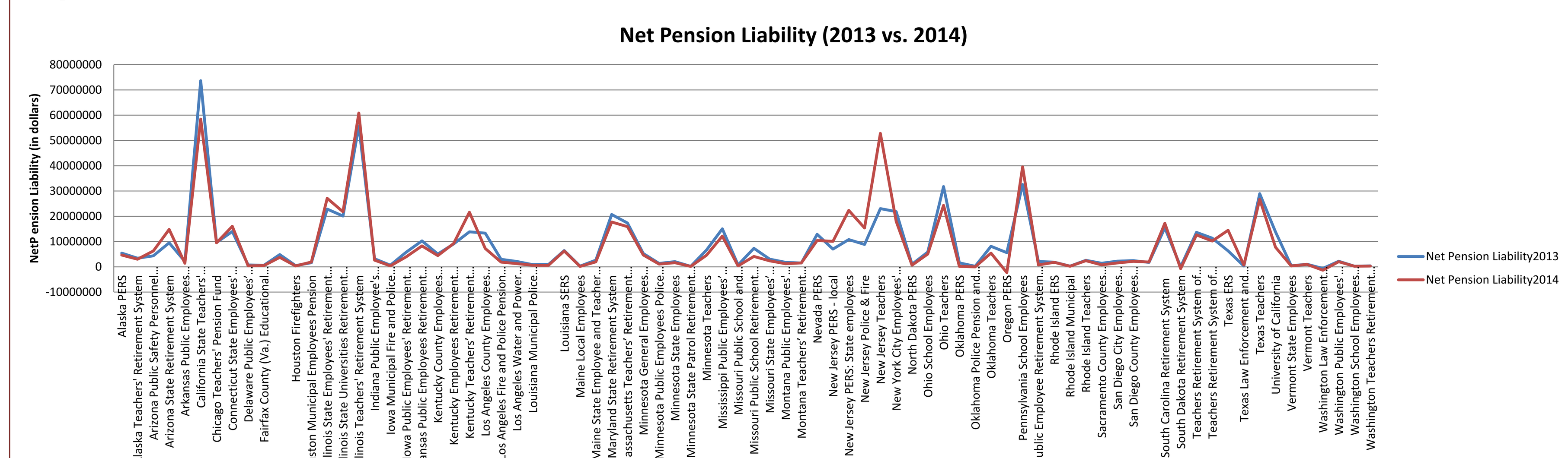
GASB statements No. 67 and 68 governing public pension plans, are amendments to GASB statements No. 25 and 27, respectively, and were issued in 2012. These amendments were included to ensure transparency, consistency, and comparability, key pillars in accounting as well as to allow for better decision making and more accountability for state and local government defined benefit plans. The most fundamental change that came with the amendments was the use of a new discount rate for accounting purposes which represents a blended rate equivalent to the combination of: "long-term expected rate of return on assets (to the extent plan assets are projected to be sufficient to meet benefit payments) and a 20-year tax-exempt municipal bond yield or index rate (applied after projected crossover point where plan assets don't cover benefit payments)" (GASB 67 and 68: Accounting and Reporting for Pensions, 2016).

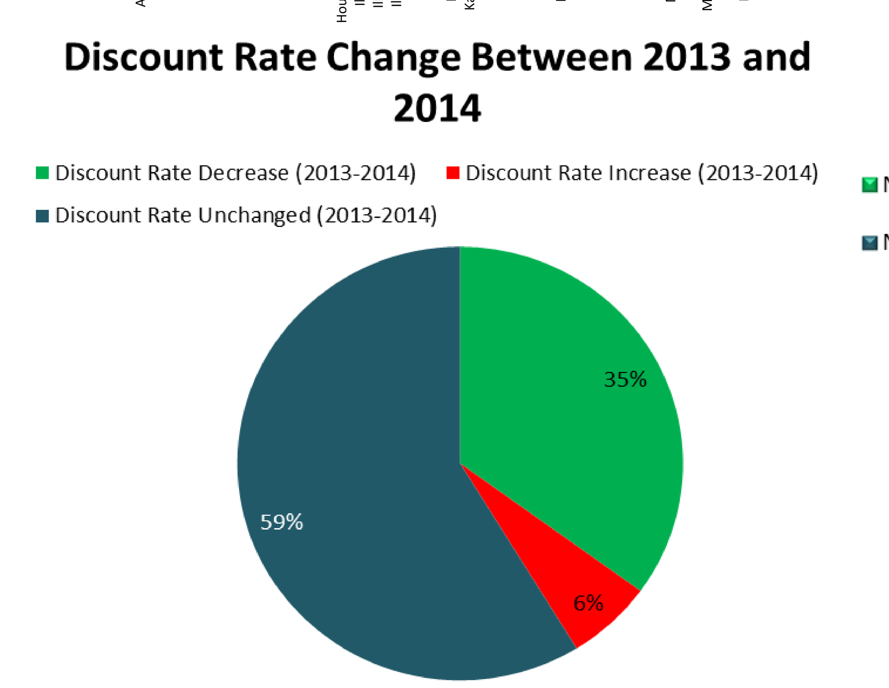
FIGURE 1: EXAMPLE OF DUAL DISCOUNT RATES: PLAN IS PROJECTED TO RUN OUT OF ASSETS IN 2025

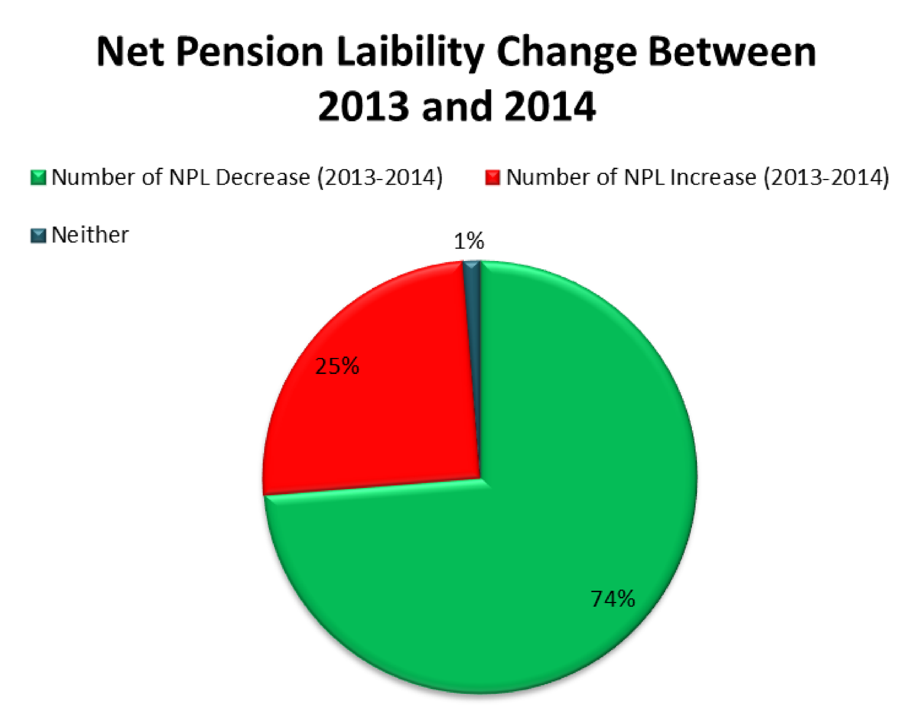


GASB 67 AND 68 EFFECT ON PENSION PLANS



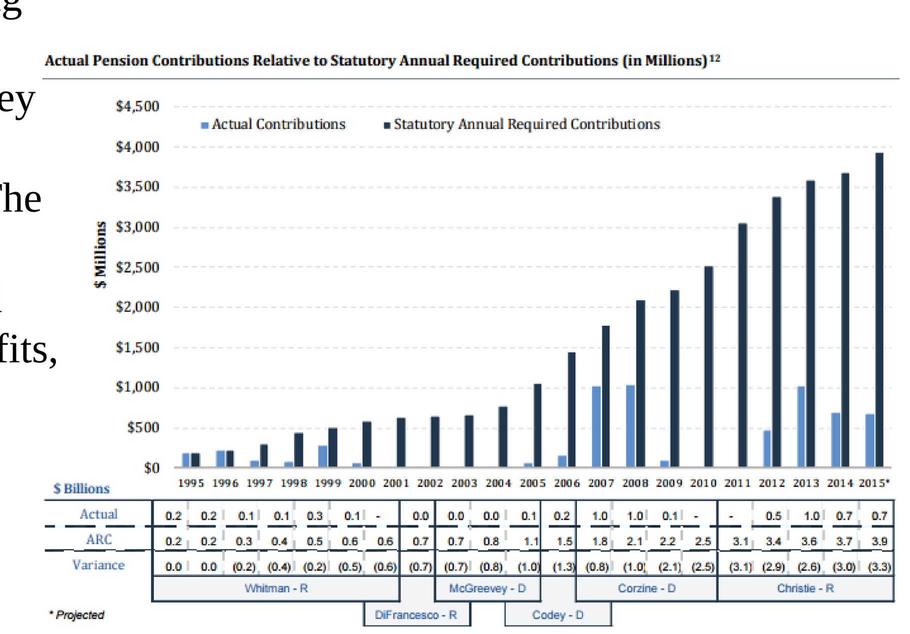






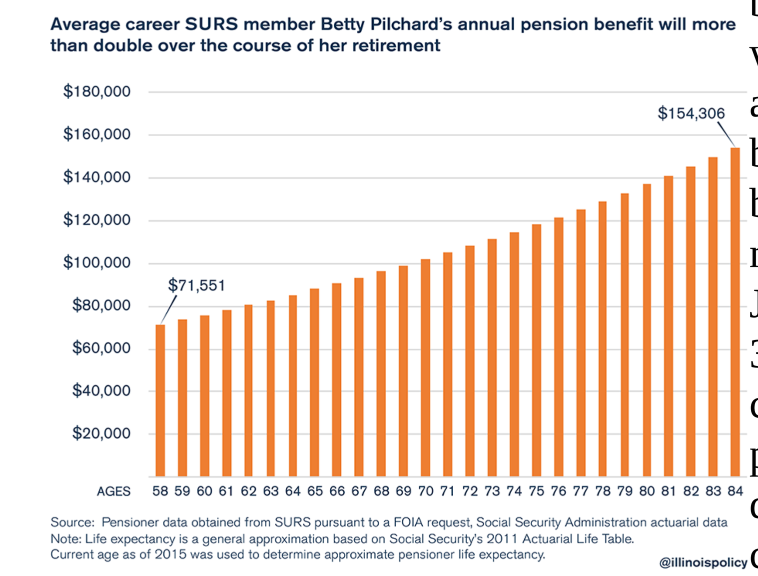
CASE STUDY ONE: NEW JERSEY

In the 2014 fiscal year, New Jersey's net pension liability for all pension plans was $83 billion with an aggregate funded ratio of 48.6 percent (Russ, 2016). New Jersey's growing net pension liability can be traced back to Governor Jim Florio's administration and its successors. The same trend was seen: more money was tied to the market, higher estimates of return were assumed, little to no contribution was made to the pension fund, increase in benefits to public workers, tax cuts to New Jersey citizens, and veiled in-balance budget. In 2011, Governor Chris Christie signed Chapter 78 which eliminated cost-of-living adjustments (COLAs) and was an attempt to deal with the growing net pension liability. However, Governor Christie did not keep up with the funding requirements of the legislation. Later, in 2014, Governor Christie created a nonpartisan New Jersey Pension and Health and Benefit Commission to address New Jersey's net pension liability crisis. The recommendations of the commission included the freezing of the current pension plans which would entitle all public workers to currently earned benefits, and the replacing the current plans with a "cash balance plan" which is a hybrid plan containing elements of both defined benefit and defined contribution plans. This will share the burden of investment return between the employer and the employee.



CASE STUDY TWO: ILLINOIS

Illinois' pension is 40.9 percent funded, making Illinois' State public pension the worst funded across the U.S. Like in New Jersey, Illinois' unions have been able to increase benefits without the government ensuring adequate funding for those benefits with the assets of the fund being tied to the volatile stock market. Further, unlike New Jersey, Illinois has maintained the 3 percent automatic COLAs which causes pension payments for 60 percent of public workers to double in 25 years due to the compounding effect of the COLAs. However, Illinois has effectively implemented reform to the growing net pension liability for members who have enrolled in the public pension system after January 1, 2011. While employee contribution rates remain the same, benefits realized by new members decrease. This entrenches a divide between newly hired public workers and those who have been grandfathered in.



CASE STUDY THREE: RHODE ISLAND

Rhode Island pension reform which took place in 2011 has been consistently cited as the epitome of effective pension reform. The pension reform took place under independent Governor Lincoln Chafee with State Treasurer Gina M. Raimondo spearheading the reform. When Raimondo took office, she decreased the rate of return from the previous 8.25 percent to 7.5 percent and increased the life expectancy which increased net pension liability from $4.7 to $7 billion. The Rhode Island Retirement Security Act reformed the pension plans by suspending COLAs for both current and future retirees, increasing the retirement age to 67, and creating hybrid DB-DC plan which all employees would have both a defined contribution plan, similar to a 401(k), and a defined benefit plan which guarantees a much smaller pension.

CONCLUSION

Pensions are a vital financial resource for public workers and have a severe impact on the economy. Approximately 16 million workers across the United States are dependent on pensions. Mitigating the net pension liability is of utmost importance in order to ensure solvency, economic growth, and the stability of the public sector.

REFERENCES

Please see attached pages.