

## Strong Investment Gains and Legislative Changes Speeding Public Pension Recovery

April 2011



*At the end of calendar year 2010, aggregate state and local government retirement system assets totaled \$2.93 trillion, a 35 percent increase from their quarterly low point during the market collapse. These asset levels are also nearly 25 percent higher than they were on June 30, 2009 – a date on which many recent studies on the financial condition of state and local pension trusts are based. Since then, not only have investment returns rebounded sharply, but many states have adopted changes to benefit levels and financing structures that have positively impacted pension trusts.*

### **Asset values in state and local pension trusts have increased sharply**

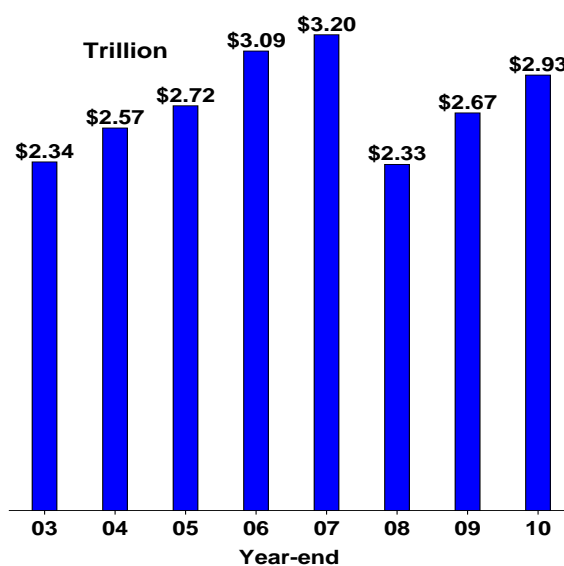
Most state and local government employee retirement systems have substantial assets set aside for current and future retirees. State and local government pensions are not paid from general operating revenues, but rather, from trusts to which retirees and their employers contributed. These trusts are funded during employees' working years and paid out over decades. Most public employees are required to contribute a portion of their wages—typically five to ten percent—and these contributions, plus earnings on trust fund investments, account for approximately 75 percent of public pension revenue over the past 30 years. The remainder comes from employer contributions, which, on a national basis, represent about three percent of all state and local government spending.

As shown in Figure A, state and local government pension trusts have regained much of the asset value lost during the 2008-2009 market downturn. While trust values even at the depths of the market decline remained above \$2 trillion, at the end of 2010, aggregate public pension asset values were \$2.93 trillion – a 35 percent increase from their March 31, 2009 quarterly low point.

### **Studies based on mid-2009 data miss significant asset growth**

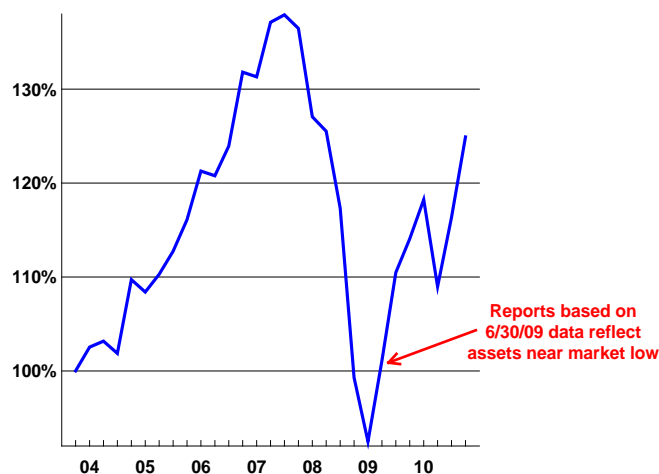
Some studies published since the market decline do not include the sharp increase in public pension asset values since June 30, 2009, the fiscal year-end date for most public pension plans. In fact, market values have grown since by nearly 25 percent. Reports that overlook these gains in state and local government pension trust assets since mid-2009 can be misleading.

**Figure A. Combined assets of state and local government pension plans**



Federal Reserve Flow of Funds

**Figure B. Change in combined assets of state and local government pension plans, 12/03 to 12/10 (12/03 = 100%)**

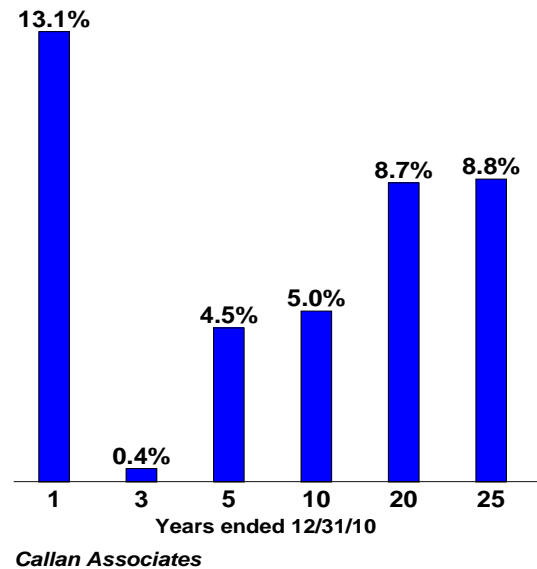


Federal Reserve Flow of Funds

## Long-term public pension fund investment returns continue to exceed assumptions

State and local retirement trusts accumulate and pay out assets over decades, and as such, have an extended investment horizon. While the recent rebound in asset values is noteworthy, long-term investment return performance is most critical. Figure C, showing median public pension fund investment returns for periods ended 12/31/10, indicates that over longer periods (20 and 25 years) public pension funds have met or exceeded their investment return assumptions (typically 7.5 percent to 8.5 percent).

Figure C. Median annualized public pension fund investment returns for periods ended 12/31/10



## Adjustments to pension benefits and financing arrangements

In the past few years, nearly two-thirds of states have made changes to pension benefit levels, contribution rate structures, or both to improve the long-term sustainability of their retirement plans. According to the National Conference of State Legislatures (NCSL), over 20 states—an “unprecedented” number—made such changes in 2010. Many local governments have made similar fixes to their plans, and other state and local governments are expected to consider similar modifications in 2011.

Changes enacted in recent years include raising the age, years of service, or both, required to qualify for a retirement benefit; reducing rates of benefit accrual; increasing employee contribution rates; and reducing future cost-of-living adjustments for existing retirees, among others. These will positively impact the financial condition of state and local retirement systems.

## Conclusion

Pension trusts have fluctuated dramatically in recent years. Just as the unprecedented market decline in 2008-2009 eroded asset values, notable changes and developments have occurred since that largely restored trust fund levels. Rising capital markets, strong long-term investment returns, and actions by many states to preserve or restore the affordability and sustainability of their pension plans have all played a role. The use of point-in-time measures, particularly at the low-point of the market recovery, can present a distorted or misleading picture of the condition of public pensions. The use of such measures also underscores the need for policymakers to closely analyze long-term programs such as state and local government retirement systems in order to avoid making major policy decisions based on short-term and outdated information.

## Resources

- Board of Governors of the Federal Reserve System: *Flow of Funds Accounts of the United States, Fourth Quarter 2010*
- *State and Local Government Spending on Public Employee Retirement Systems*, National Association of State Retirement Administrators, January 2011 <http://nasra.org/resources/ERContributions.pdf>
- *Selected Approved Changes to State Public Pensions to Restore or Preserve Plan Sustainability*, National Association of State Retirement Administrators <http://www.nasra.org/resources/SustainabilityChanges.pdf>

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