Retirement News Highlights

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Public pension funds abandon 8% dreams

By Robert Steyer
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When it comes to public pension plans' assumed rates of return, what is rare today was quite common less than 10 years ago.

Only three of 129 public plans tracked by the National Association of State Retirement Administrators have assumed rates of return at 8%.

In 2010, by contrast, 59 plans had assumed rates of return of 8% and another 30 had rates higher than 8%, said Alex Brown, NASRA's research director. As recently as 2015, NASRA reported that 24 plans had rates of 8% and four had rates exceeding 8%.

A common theme for reducing the assumed rates of return has been the low-interest-rate environment, said Mr. Brown, referring to a February 2019 NASRA report that analyzed trends for assumed rates of return.

"The sustained period of low interest rates since 2009 has caused many public pension plans to re-evaluate their long-term expected returns, leading to an unprecedented number of reductions in plan investment return assumptions," the report said.

From February 2018 to February 2019, the report said 42 plans, or 33% in the NASRA database, reduced their return assumptions. Ninety percent have done so since 2010.

Among the plans tracked by NASRA, the median assumed rate dropped to 7.25% this year from 8% in 2010 and 7.5% in 2015.

"There's wide variations but there is a fair amount of clustering" among return assumptions in the NASRA database, Mr. Brown said. Three-fourths of the state plans have rates ranging from 7% to 7.5%.

8 is enough

The Ohio Police & Fire Pension Fund, Columbus, has had its 8% return rate assumption since Jan. 1, 2017, down from 8.25%. The change "was made as a part of a regularly scheduled five-year review of all actuarial assumptions," David Graham, the $15.5 billion fund's communications director, wrote in an email.

"In the review that resulted in our moving to an 8% assumed rate, our independent actuary and investment consultant agreed that over a 30-year period we would have a slightly better than 50% chance of meeting that return," Mr. Graham wrote.

"While returns in the short term (10 years) may be expected to be lower, the 30-year look provided a better probability," Mr. Graham added. "Our next study of assumptions will be in 2021 and we will take these findings into consideration when discussing a potential change at that time."

The pension fund had a funded status on an actuarial basis of 69.9% as of Jan. 1, 2018.

"We continue to meet the state of Ohio's requirement that all unfunded liabilities be paid within a 30-year time frame," Mr. Graham wrote. "We are currently at 28 years."

For the fiscal year ended Dec. 31, 2018, the pension fund had a net return of -2.4%, which was better than the benchmark of -2.67%.

Three-year annualized returns of 7.16% topped the benchmark of 6.83%. Five-year annualized returns of 5.53% exceeded the benchmark of 4.98%. Ten-year annualized returns of 9.54% outpaced the benchmark of 8.89%.

Reasons for 8%

Texas County & District Retirement System, Austin, has chosen an 8% rate for several reasons, such as investment style, said Kathy Thrift, chief customer officer, in an email.

"When compared to the average public pension plan, our asset mix is very different," Ms. Thrift wrote. "The major difference in our portfolio is that we have a very small percentage — 3% — allocated to investment-grade bonds."

She added that the pension system "has used other asset classes with better return characteristics to offset risk in the portfolio," including hedge funds and strategic credit.

Emphasizing that 8% "is a long-term target," Ms. Thrift wrote that market volatility means the pension system won't hit 8% every year.

The system "has other measures in place to manage risk, including a $1 billion reserve fund — as of Dec. 31, 2018 — that may be used to offset future adverse experience," she explained.

The retirement system's board "in good years," can "set aside earnings rather than pass them through to the individual employer plans," she explained. "The reserves are invested with the plan assets. This tool has helped us keep employer rates stable over time."

The $31.9 billion retirement system completed its most recent review in December 2017 to assess its economic and demographic assumptions.

"Two independent outside actuarial firms both concurred that the investment return assumption is reasonable," Ms. Thrift wrote. "We conduct a full review of our assumptions every four years."

Ms. Thrift illustrated the system's long-term investment strategy by noting that members work an average of 18 years and are retired for 20 years or more. The 30-year return is 8% and the benchmark is 6.9% as of the fiscal year ended Dec. 31.

"Every year, we update our capital market assumptions, which are forward-looking expectations of the return, risk and correlation of each of our asset classes," she wrote.

"We then model a portfolio targeted to meet our long-term expected return goal with an acceptable level of risk," she added. "If we do not think our portfolio can be constructed to achieve our goal with an acceptable level of risk, we will adjust our expectations."

The system has a funded status of 88.5% on an actuarial value basis, or 91% when reserves are included, as of Dec. 31.

The return, net of fees, for the fiscal year ended Dec. 31 was -1.86%, but still better than the benchmark of -3.31%. The three-year annualized return was 6.57%, topping the benchmark of 6.16%. The five-year annualized return of 5.13% surpassed the benchmark of 4.1%. The 10-year annualized return was 9.02%, exceeding the benchmark of 8.06%.

The other plan in the NASRA database with an 8% assumed rate of return is the Arkansas State Highway Employees' Retirement System, Little Rock. The plan had $1.5 billion in assets and a funding ratio of 83.51% as of June 30, 2018, according to the latest actuarial valuation report

Additional details were not available. Robyn Smith, executive director, didn't respond to requests for information.

‘Unrealistically high'

The latest plan to leave the 8% club is the Connecticut Teachers' Retirement Fund, Hartford. Thanks to a law signed in late June by Gov. Ned Lamont, the plan's assumed rate dropped to 6.9% effective July 1, the beginning of its fiscal year, as part of a major restructuring.

"Eight percent was unrealistically high," Shawn T. Wooden, the state treasurer, said in an interview. He is the principal fiduciary of the $36 billion Connecticut Retirement Plans & Trust Funds, Hartford, of which the teachers' pension fund is the largest component at $18.4 billion as of June 30.

The lower assumed rate and the restructuring "will move the plan to something that is more realistic and sustainable," Mr. Wooden said. "We will move the fund on a long-term path to fiscal responsibility. Inflated assumptions distort unfunded liabilities."

The restructuring includes a special capital reserve fund "to serve as adequate provision for bondholders, to meet the requirements of the bond covenant, which allowed for the re-amortization of the Teachers' Retirement unfunded pension liability over 30 years," said an email from the treasurer's office.

The teacher's retirement fund had a funded ratio of 51.7% on an actuarial valuation basis as of June 30, 2018.

For the fiscal year ended June 30, 2019, the pension fund had a net return of 5.85% vs. a benchmark of 6.84%.

Annualized returns over three years were 9.03%, just below the 9.23% benchmark. The annualized five-year return of 5.96% lagged the benchmark of 6.09%. The 10-year annualized return of 8.84% trailed the benchmark of 9.01%.

Alaska Public Employees' Retirement System, with $16.9 billion in defined benefit assets, and the Teachers' Retirement System, with $8.3 billion in defined benefit assets, both cut their assumed rates of return this year to 7.38% from 8%. Both are managed by the Alaska Retirement Management Board, Juneau.

The board and its actuaries "review actuarial assumptions annually and the investment return assumption was reduced to 7.38% in 2019 to reflect lower prospective investment returns," Stephanie Alexander, the board's liaison officer, wrote in an email.

The board approved the rate change on Jan. 11.

The board "has adopted an asset allocation consistent with this long-term return assumption," she said.

For the 12 months ended March 31, the public employees' pension system had a net return of 5.25%. Three-year annualized returns were 9.34% and five-year annualized returns were 6.58%, according to the website of the Alaska Retirement Management Board, which uses the new 7.38% assumed rate of return as a comparison. The Alaska Public Employees' Retirement System had a funding ratio of 64.6% on an actuarial valuation basis as of June 30, 2018, according to a June 2019 report to the trustees of the Alaska Retirement Management Board.

The teachers' pension fund had the same returns over the same three periods using the same assumed rate as a benchmark. It had a funding ratio of 76.2% on an actuarial basis as of June 30, 2018, the report to the trustees said.

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