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# Retirement News Highlights
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## 10 Ways to Close Public Pension Funding Gaps

*NCPERS research identifies actions governments can take to close pension funding gaps without resorting to detrimental 'knee-jerk' reactions.*

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The best way to close public pension funding gaps, according to the National Conference on Public Employee Retirement Systems (NCPERS), is to reform state and local revenue systems and close tax loopholes.

"But that is a long road, and it is beyond the scope of responsibilities of pension trustees and administrators," NCPERS said in a recent research paper called "Ten Ways to Close Public Pension Funding Gaps." "However, we can help ensure that state and local governments are looking at the appropriate data when determining how to fund public services and programs, including pensions."

NCPERS notes that when state and local governments are faced with public pension funding gaps, they often default to "knee-jerk solutions" such as shutting down defined benefit (DB) plans in favor of defined contribution (DC) plans, or altering benefits and contribution formulas, "sometimes to a punishing degree," which it said can lead to serious unintended consequences.

As the title of the paper suggests, the organization identifies 10 policy options that can be adapted to a pension plan's specific circumstances and that it said neither undermine public pensions nor cause harmful economic consequences. However, NCPERS said the paper is not intended to offer recommendations, but ideas to consider and explore.

"Each pension system is unique and must explore, in consultation with experts and through a robust due diligence process, policy options that best fit its needs," said NCPERS.

**Option 1: Exploring a New Approach to Limited Pension Obligation Bonds**

NCPERS proposes considering a new approach to pension obligation bonds (POBs), which have been used by governments to improve funding levels of their pension plans, although with mixed results, says NCPERS. These bonds are taxable and the proceeds can be invested to earn returns that are higher than the cost of the bonds. The paper explains a new approach to POBs that it calls new limited pension obligation bonds, or NLPOBs, which are paid off from a designated revenue stream.

States would issue and guarantee 30-year NLPOBs, and NCPERS says it believes a 5% coupon would be feasible in the current economic environment. The paper said its analysis shows that a state guarantee would be "a safe bet" for the state instead of incurring additional costs to buy a hedge or insurance.

Option 2: Exploring Actions of the Federal Reserve System

The paper notes that while public pension trustees and managers do not deal with the Federal Reserve System on a day-to-day basis, they do monitor the Fed's actions as they affect their investment decisions.

"There are some actions that the Federal Reserve is now planning to take that pension funds may consider as they address funding issues," the paper said. "For example, in light of the COVID-19 economic downturn, the Federal Reserve has opened a new municipal discount window and is willing to buy municipal assets as well as exchange-traded funds [ETFs]."

**Option 3: Exploring Bridge Loans to Increase Liquidity**

Before the Federal Reserve opened the Municipal Liquidity Facility to help state and local governments better manage cash flow pressures, pension funds used short-term bridge loans to meet their liquidity needs.

"Now that the Federal Reserve Municipal Liquidity Facility and existing commercial bank municipal credit facility are available," the paper said, "pension funds may have more options to meet their liquidity needs."

**Option 4: Securitizing Public Assets**

In times of urgent need, governments can use securitization of public assets instead of dismantling pensions, the paper said. For example, they can use state and local assets that generate cash flow by turning them into a marketable security, such as mortgage-backed securities issued by Fannie Mae and Freddie Mac. These securities are underwritten by investment banks, traded on the stock exchange, and are backed by cash flow generated by underlying assets.

"Governments may lease these assets, which in turn can be securitized by the underwriter," said the paper. "In theory, cash flow from an asset may be dedicated directly to a pension fund without securitization."

**Option 5: Exploring a Dedicated Revenue Stream**

NCPERS notes that a state or local government in some cases can set aside an existing revenue stream to address pension funding needs, such as when the Pennsylvania state legislature authorized Philadelphia to collect an additional 1% sales tax for five years to offset increased pension contributions or when Kansas' state legislature passed a law in 2012 allowing gaming revenues from state-owned casinos to be directed to the state's public employee retirement system.

**Option 6: Establishing a Stabilization Fund**

According to the paper, a public pension stabilization fund can be a cushion for economic volatility and serve as a "rainy day fund" that can be tapped to correct imbalances in a pension system.

"When there is a shortfall, a stabilization fund provides a clear and legally mandated mechanism to cover it," the paper said. "Stabilization funds also can be used to prevent unfunded liabilities from growing beyond a certain level. We are aware of only a couple of states that have established stabilization funds."

**Option 7: Exploring Monthly Employer Contributions**

The paper says one of the characteristics of the Wisconsin Retirement System (WRS), which is among the best-funded systems in the US, is that employer and employee contributions are both part of payroll. NCPERS says this offers two advantages: It takes employer contributions out of "the political realm" where lump-sum payments may be made in full or in part through an appropriation process; and the money is available to pension funds for investment sooner and on a regular basis along with employee contributions.

**Option 8: Exploring Consolidation**

"Consolidation can provide economies of scale," said the paper, which cited as an example Wisconsin's Department of Employee Trust Funds, which in the 1970s consolidated most state and local retirement systems into a single organization. It also noted that last year Illinois consolidated its police and fire plans into statewide plans, and, a few years ago Nebraska consolidated the investment function of various local plans at the state level.

However, the paper cautions that despite the economic advantages of consolidation, it may take away local control of successful plans. "Therefore, consolidation should be carefully assessed, weighing the particular circumstances and needs of all stakeholders," said the paper.

**Option 9: Exploring Auto-Triggers**

According to the paper, many public pension plans in the US use so-called auto-triggers to determine cost-of-living adjustments (COLAs). Additionally, some have started using them to determine employer and employee contributions as well.

**Option 10: Reforming Revenue Systems and Closing Tax Loopholes**

"Tax reform is not something trustees and administrators of public pensions do on a day-to-day basis," said the paper. "But many pension plans have government relations representatives and other advocates who can lobby policymakers to protect and preserve public pensions."

NCPERS notes that a good tax system should "be in sync with the economy," meaning that it shouldn't be too high, but it shouldn't be too low. According to the paper, taxes should be broad based and progressive, and they should be able to provide stability during bad economic times and keep pace with the economy in good economic times.

"In the grand scheme of things, any one of these options may seem a small step, but in the long term, they may make a difference," the paper said. "They are more rational responses than is dismantling public pensions, which have been a model of how to provide a secure retirement for more than a century."

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