

## March/April 2010

The following news summaries were developed by Gabriel, Roeder, Smith & Company to inform clients and other benefit professionals of news in the benefits industry. Our thanks to Mary Ann Vitale for her diligent work on this issue. To receive this publication electronically, send an email to [web.admin@gabrielroeder.com](mailto:web.admin@gabrielroeder.com) with “SUBSCRIBE NEWS SCAN” in the subject line. To stop receiving this publication electronically, send “UNSUBSCRIBE NEWS SCAN” in the same manner. Copies of this and other benefit-related publications are available on the GRS website at [www.gabrielroeder.com](http://www.gabrielroeder.com).

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### **NASRA Research Director Keith Brainard Discusses the Economy’s Impact on State Pension Funds**

On March 30, 2010, Keith Brainard, research director for the National Association of State Retirement Administrators (NASRA), was interviewed on C-SPAN’s Washington Journal program. During the 40-minute interview, he discussed a wide range of topics, including the economy’s impact on state pension plans as well as how states are responding. Currently, public pension plans distribute benefits to 7.5 million Americans totaling over \$175 billion annually. Mr. Brainard also spoke about the recently published NASRA issue brief *Public Pension Plan Investment Return Assumptions*, discussed below.

The C-SPAN video is available at: <http://www.c-spanarchives.org/program/292786-5>

### **NASRA Releases Issue Brief on Public Pension Plan Investment Return Assumptions**

On March 16, 2010, NASRA released its issue brief *Public Pension Plan Investment Return Assumptions*. Recent media reports have suggested that the investment return assumptions of public retirement systems are unrealistically high. In response, NASRA examined public pension investment return data and found that, on average over the past 25 years, public pension funds have exceeded their assumed rates of investment return. Prepared by Keith Brainard, research director for NASRA, the brief finds that the median actual investment return for the 25-year period ending December 31, 2009 was 9.25%, exceeding the period’s median 8% assumed rate of return.

In addition to presenting data related to public plans’ actual investment experience, the brief is intended to clarify how the investment return assumption is established and how it should be evaluated. Additionally, the brief identifies various factors that are considered by actuaries and plan fiduciaries when establishing and evaluating the investment return assumption. These factors include, but are not limited to:

- Expected rates of return by asset classes;
- The plan’s historical investment performance;
- The plan’s investment policy;
- Current government and corporate bond yields;
- Expected portfolio volatility;

- Performance of investment managers;
- Expected rates of inflation, and
- Projected cash flow timing and volatility.

The issue brief emphasizes that a governmental plan's investment return assumption is focused on the long-term, typically an investment horizon of 30 to 50 years. Investment returns are important because investment earnings account for a majority of the revenues for most public pension plans. According to the brief, since 1982, public pension funds have accrued an estimated \$4.4 trillion in revenue. Of that amount, investment earnings account for \$2.64 trillion (60% of the total), employer contributions account for \$1.2 trillion (27%), and employee contributions account for \$578 billion (13%).

The brief is accessible at: [http://www.nasra.org/resources/InvReturnAssumption\\_Final.pdf](http://www.nasra.org/resources/InvReturnAssumption_Final.pdf)

### **EBRI Survey Finds Workers' Retirement Confidence Stabilizing as Economic Recession Slows**

In March 2010, the Employee Benefit Research Institute (EBRI) released its issue brief: *The 2010 Retirement Confidence Survey: Confidence Stabilizing, But Preparations Continue to Erode*. The survey found that retirement confidence levels, which fell to record lows during 2008 and 2009, have stabilized as the economic downturn subsided. The percent of active workers who are very confident about having enough money for a comfortable retirement has increased slightly to 16% in 2010 compared to 13% in 2009. In addition, the percent of retirees who are very confident about having a financially secure retirement stabilized at 19% in 2010 compared to 20% in 2009.

The survey also found that worker confidence regarding their ability to pay for basic expenses in retirement has recovered slightly. In 2010, 29% of workers reported being very confident about having enough money to pay for basic expenses in retirement, up from 25% in 2009, but down from 34% in 2008. However, the percent of workers who are not confident about their ability to pay for medical expenses increased from 44% in 2009 to 51% in 2010. Moreover, the percent of workers who are not confident about their ability of pay for long-term care increased from 56% in 2009 to 61% in 2010.

The expected retirement age of workers in 2010 remains relatively unchanged from 2009. However, long-term trends indicate that expected retirement age has increased over the past two decades. Specifically, the percent of workers who expect to retire after age 65 has significantly increased from 11% in 1991 to 19% in 2000 to 33% in 2010. Moreover, during the past year, 24% of workers have delayed their retirement plans for a variety of reasons, including: the poor economy, a change in their employment situation, insufficient finances, and stock market losses.

Furthermore, the percentage of workers (and/or their spouses) that saved money for retirement over the past year declined from 75% in 2009 to 69% in 2010. In addition, only 60% of workers (and/or their spouses) are currently saving for retirement, down from 65% in 2009. Notably, an increasing percent of workers report having no savings and investments. The percent of workers with less than \$1,000 in savings has increased from 20% in 2009 to 27% in 2010. The percent with less than \$25,000 in savings (excluding the value of their primary home and defined benefit plans) has increased from 52% in 2009 to 54% in 2010. Additionally, many workers continue to be unaware of how much savings they will need for a comfortable retirement. Of the respondents, only 46% have attempted to calculate their retirement savings needs.

The 2010 Retirement Confidence Survey is available at:  
[http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_03-2010\\_No340\\_RCS.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-2010_No340_RCS.pdf)

## **GAO Projects Rising Health Costs Will Prolong Fiscal Challenges for State and Local Governments**

On March 2, 2010, the Government Accountability Office (GAO) released its report *State and Local Governments' Fiscal Outlook: March 2010*, updating its long-term fiscal projections for state and local governments. According to the GAO, absent any policy changes, rising health care costs will continue to cause fiscal challenges for state and local governments through 2060. The GAO projects that, in the absence of future policy changes, the aggregate fiscal position of state and local governments will decline from a deficit of -0.3% of GDP in 2010 to -5.0% of GDP by 2060.

According to the report, the financial decline is driven, in part, by reductions in state and local government tax revenues due to the current recession. Total state and local government tax receipts (which comprise 68% of total state and local government revenues and include sales, income, and property taxes) fell from 9.25% of GDP in 2008 to 8.80% in 2009. Tax revenues are projected to rise slightly to 8.82% of GDP in 2010 and remain relatively level thereafter. In the near term, increases in federal grants-in-aid due to the American Recovery and Reinvestment Act of 2009 have helped to alleviate some of the pressure. However, even with these increases, the GAO estimates the aggregate operating deficits of state and local governments will be about \$39 billion in 2010 and \$124 billion in 2011.

The GAO report predicts that future long-term state and local government fiscal pressures will largely be driven by increasing health care costs. According to the report, state and local government health care expenditures (including Medicaid and the cost of health insurance for employees and retirees) are projected to grow from 3.5% of GDP in 2010 to 3.8% in 2011 – and ultimately much higher. By contrast, other types of expenditures, including wages and salaries are expected to grow at a rate slightly less than GDP.

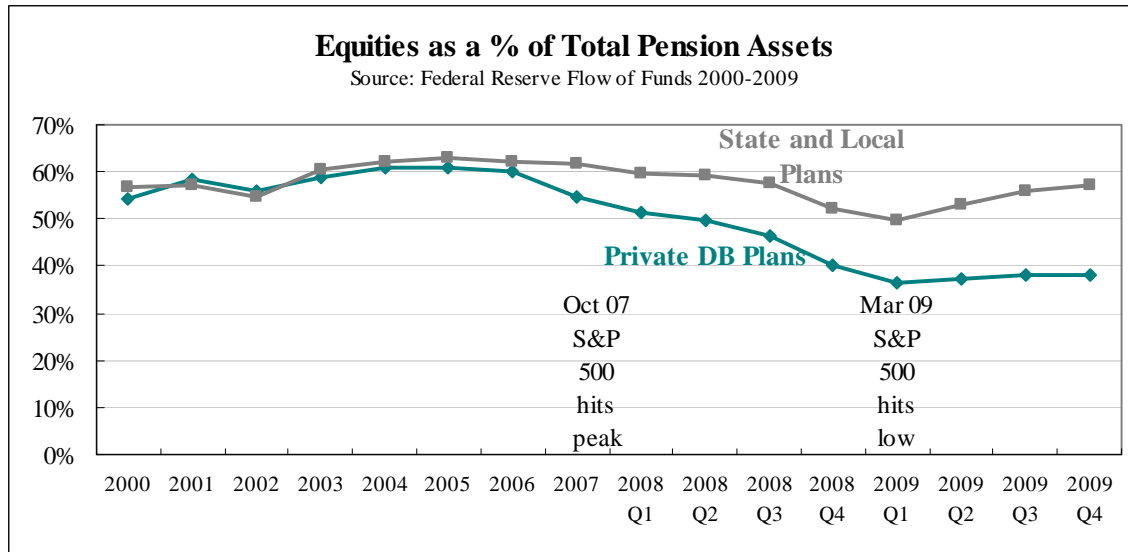
The report also discusses the decline in state and local pension assets resulting from the decline in the financial markets. According to the report, state and local pension plan assets fell 26.7% from \$3.2 trillion at the end of 2007 to \$2.3 trillion at the end of 2008. The GAO estimated that the sector's required contribution rate was 9.9% of wages in 2009, compared with actual contributions of 8.3% in 2008. The report notes: "While governments can postpone increasing the annual contribution rate, postponing could increase the rate needed to fully fund pensions." In addition, the report notes that governments are also facing challenges in funding retiree health care benefits.

The GAO report is available at: <http://www.gao.gov/new.items/d10358.pdf>

## **NIRS Reports Public Pension Plans Have Benefited from Investments in Equities**

On March 15, 2010, the National Institute on Retirement Security (NIRS) reported that the investment returns of state and local pension plans outperformed their private sector counterparts in 2009. Based on data from the U.S. Federal Reserve Board's *Flow of Funds* report for the fourth quarter of 2009, state and local government pension plans gained 16% compared to 13% for private sector pension plans. These differences are due, in part, to differences in equity allocations between the two groups of plans. According to the report, despite the recent recession, public plans have maintained a balanced, long-term investment approach and hold about 57% of their assets in equities. By contrast, private plans hold about 38% of their assets in equities. As a result, the strong stock market recovery in 2009 yielded greater gains for public plans.

The following graph illustrates the U.S. Federal Reserve's *Flow of Funds* report data for equity allocations of public and private defined benefit pension plans from 2000 through 2009. As shown, after the stock market reached its peak in October 2007, the equity holdings of both public and private plans fell and continued falling until the stock market hit bottom in the first quarter of 2009. However, while both types of plans experienced significant equity declines, private-sector equity holdings fell more rapidly than those of public-sector plans.



Source: National Institute on Retirement Security. Used with permission.

The NIRS report explains much of the difference in equity allocations is due to changes in federal pension laws and threatened changes in accounting standards applicable to private-sector plans. Prior to 2006, pension plans in both sectors invested similarly, allocating about 60% of investments to equities. In 2006, the Pension Protection Act changed many of the funding rules for private-sector plans, including a requirement to amortize investment losses over seven years or less. In addition, private-sector accounting standards threatened to value plan assets and liabilities as if the plan was terminating. As a result, private plans have attempted to reduce investment volatility by steadily moving investments out of the stock market and into fixed-income securities, which generally earn lower returns. The NIRS report concludes that this policy shift imposed a significant cost on private-sector employers since greater returns could have been earned in 2009 with a more balanced portfolio.

The NIRS report is available at: <http://www.nirsonline.org/index.php?option=content&task=view&id=373>

### U.S. Census Bureau Releases 2008 Survey of State and Local Government Retirement Systems

On March 25, 2010, the U.S. Census Bureau released its *2008 State and Local Government Employee Retirement Systems Survey*. The annual survey provides information on revenues, expenditures, financial assets, and membership for public employee retirement systems. The 2008 survey covered fiscal years that ended between July 1, 2007 and June 30, 2008 and included 2,550 public retirement systems.

At the end of fiscal year 2008, state government employee retirement plans had 13.1 million active members and local government plans had 1.6 million active members. In fiscal year 2008, total payments were \$193.8 billion with \$175.4 billion paid in retirement benefits and other payments of \$18.4 billion. Total receipts amounted to \$79.6 billion in 2008, compared with \$577.6 billion in 2007. Government employer contributions were \$82.0 billion and employee contributions were \$36.9 billion in 2008. However, investment earnings were (\$39.3) billion in 2008, compared to an increase of \$471.0 billion in 2007.

Assets of state and local government employee retirement systems totaled \$3.2 trillion in 2008, down \$179 billion from 2007. The loss was largely due to declines in the values of corporate stocks, bonds, mortgages, and short-term securities, which fell \$254 billion overall. However, the loss was partially offset by a \$76 billion increase in real property and other investments.

On March 30, 2010, Beth Almeida, executive director of the National Institute on Retirement Security (NIRS), was quoted by the Bureau of National Affairs' *Pension and Benefits Reporter* as saying: "The Census data is not

surprising, and reflects the extremely difficult environment all investors faced in 2008 at the height of the financial crisis.” She added, “Pension funds have rebounded as the market has recovered.”

The national census tables are available at: <http://www.census.gov/govs/retire>

Data are aggregated at the state and local levels, but may also be downloaded for retirement systems individually.

### **BLS Reports on Employer Costs for Employee Compensation**

On March 10, 2010, the U.S. Department of Labor’s Bureau of Labor Statistics (BLS) issued its report: *Employer Costs for Employee Compensation – December 2009*. According to the BLS, at the end of 2009, employers in private industry paid employees total compensation averaging \$27.42 per hour worked, consisting of \$19.41 in wages and salaries (71% of the total) and \$8.00 in benefits (29% of the total). By comparison, the total compensation costs for state and local government employees averaged \$39.60 per hour, consisting of \$26.11 in wages and salaries (66%) and \$13.49 in benefits (34%).

However, the report warns that the compensation costs of state and local governments should not be directly compared with the costs in private industry due to differences in the occupational structures between the sectors. The report notes that professional and administrative support occupations account for two-thirds of the state and local government workforce, compared with one-half of the workforce in private industry.

Moreover, if average compensation costs for the “management, professional, and related” occupational group (which includes teachers) are compared, total compensation is similar for private industry and state and local governments, as shown in the following table:

**Employer Costs per Hour Worked  
Management, Professional and Related Occupational Group  
December 2009**

	<b>Private Industry</b>		<b>State &amp; Local Governments</b>	
	<b>Avg. \$/hour</b>	<b>% Total</b>	<b>Avg. \$/hour</b>	<b>% Total</b>
<b>Wages and salary</b>	\$34.12	71%	\$32.96	68%
<b>Benefits</b>	14.07	29%	\$15.19	32%
<b>Total compensation</b>	\$48.19	100%	\$48.15	100%
<i>Source: U.S. Bureau of Labor Statistics, Employer Costs for Employee Compensation – December 2009. Data compiled by author from Tables 4 and 9.</i>				

The BLS report is available at: <http://op.bna.com/dlrcases.nsf/r?Open=lswr-83elqz>