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Subject: Pension Reform Newsletter, January 2014

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This newsletter seeks to shine a light on articles, research, opinion, reformers and other information related to pub
state and municipal levels. As we continually strive to improve the publication, please feel free to send your questi
christensen@reason.org. You can also follow the discussion on pensions and other governmental reforms at Reas
@ReasonReform.

In This Issue...

Articles

The Hidden Danger in Public Pension Funds
By Truong Bui, Reason Foundation

Public pension expert Andrew G. Biggs, a resident scholar at the American Enterprise Institute, offers a great i
public pensions in a recent study, "The Multiplying Risks of Public Employee Pensions to
Budgets," which he summarizes in an article at the *Wall Street Journal*. According to his
"pose roughly 10 times more risk to taxpayers and government budgets than in 1975." W
increases in pension sizes and flawed assumptions about risk and returns are the culprit
long shift from safe bonds to risky stocks, along with the recent growth of 'alternative inve
private equity."

Basic finance dictates that an asset's volatility is correlated with its risk. More volatile assets can generate higher r chances of incurring losses. In the past, public pensions could achieve 8% expected returns with relatively low vol returns). In particular, a portfolio in 1975 could earn an annual expected return of 8% with a standard deviation of 65 years. By contrast, a portfolio today must have a standard deviation of 14% to get the same expected return, su

As many public pensions still assume an 8% rate of return, this implies that pension managers must invest more ir substantial threat to state and local budgets. To show how big the threat is, Biggs indicates that the standard devi amounted to 1.8% of state and local budgets in 1975, while it reached a whopping 19.8% today due to the dramati risk imposed by public pensions on state and local budgets has increased tenfold over the past four decades.

The implications of Biggs' analysis are two-fold: 1) public pensions' sizes need to be reduced, and 2) pension man properly match assets with liabilities.

To read Biggs' study, "The Multiplying Risks of Public Employee Pensions to State and Local Government Budget

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Oregon's Tepid Pension Reforms Still Leave $11 Billion Unfunded Liability

By Sal Rodriguez, Reason Foundation

Last year, Oregon's Public Employee Retirement System (PERS), which provides retirement benefits to all public liability of nearly $14 billion. Unlike most other pension systems, only 30% of public employees actually contribute public employees enrolled in PERS receive a perk known as a "pension pickup," whereby taxpayers make contrib annual contribution the state of Oregon and local government agencies must contribute towards PERS. As a resul detriment of spending on services taxpayers think they're paying for.

Read the full column here.

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Pennsylvania Enacts Anti-Pension Spiking Provisions

By Sal Rodriguez, Reason Foundation

On December 23rd, Pennsylvania Governor Tom Corbett signed legislation reigning in the costly practice of pensi billion over the next fifty years ($22 million annually). Pension spiking, also known as pension padding, is the pract the factors used in pension calculations. Typically, it results in more pension benefits than the contributions made cover, thereby contributing to the pension plan's system-wide unfunded liability.

Read the full column here.

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Research

Pension Reform Case Study: Rhode Island

By Anthony Randazzo, Reason Foundation

In 2011, Rhode Island State Treasurer Gina Raimondo commissioned an independent actuarial assessment of the to the state's finances. This assessment showed an unfunded pension liability of $6.8 billion, implying that the syst its obligations.

Rhode Island Governor Lincoln Chafee and Treasurer Raimondo engaged the state's various communities and ke proposed reforms and then worked with leaders in the state legislature to highlight the problem and make the case Retirement Security Act of 2011 (RIRSA) combined conventional methods for adjusting labor contracts with some of cost-of-living-adjustments for retirees, increasing the retirement age and introducing a hybrid defined-benefit/de

While Rhode Island still faces challenges in the wake of its historic reform effort, the reform effort offers lessons fo

significant unfunded pension liabilities, such as:
• Policymakers must be determined to drive reform.
• Policymakers must realistically assess liabilities.
• Coalitions can reduce the complexity of legislative debate.
• Educating the public matters.
• There are many roads to $0 unfunded liability.
• Pension reform is more than defined-benefit reform.

Though it remains to be seen whether the reform effort will achieve the full savings projected under the RIRSA pla
some benefits from its significant reforms as long as its future leaders do not return to past practices. Read the stu

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Public Pension Reform: Benefit Design as the Key to Sustainability
By Truong Bui, Reason Foundation

A recent paper released by Carl A. Hess, Thomas J. Healey and Kevin Nicholson at Manhattan Institute describes
cost reduction. Using a sensitivity analysis based on a hypothetical worker model, the paper indicates that annual
compared to a baseline model if the following measures are adopted: 1) an increased retirement age, 2) a broade
living adjustment. Implementing even only one of the three measures can save anywhere from 23.5% to 32.8% of
compensation adjustment bringing the most impact.

The paper also proposes other design modifications and reforms, which most notably include increasing employee
padding, matching assets and liabilities with appropriate discount rates, making the annual required contribution a
ratio with stress-testing in actuarial valuations. While the paper acknowledges the great difficulty in persuading juri
emphasizes that these changes will not only benefit only taxpayers and future generations, but also the public em

To read more of the paper, go here.

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Pension Reform Glossary

To aid those who engage in discussions and negotiations on pension reform, "and to offer a level of transparency
Government has put together a plain language glossary to better understand public pension systems. This glossa
glossary can be found here.

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Quotes

"While the California Rule protects pension benefits in perpetuity, it doesn't protect the employee's salary, health c
than to change her pension formula."
- Chad Aldeman, associate partner at Bellwether Education Partners

"The pension moves on the part of the state of Illinois (are) a positive after many years of gridlock. It's a first step.
- Greg Brown, CEO of Motorola Solutions, Inc.

"Perhaps the media have drummed up a crisis...We don't have the data to make conclusions, and we don't know t
- Minnesota State Auditor, Rebecca Otto, commenting on a recommendation by the Public Employees Retirement
a board member - for legislative action requiring all employers in its system to break out overtime amounts from sa
pensions.

"Those states that have sort of said, 'We'll worry about it when the place is on fire.' Those states are in serious tro
other critical needs at the city or state or county level to deal with pensions."
- Florida Senate President Don Gaetz commenting on the poor fiscal condition of other states' pension plans and

while the retirement fund is in good condition.

"In other words, either our generation starts paying $4.5 billion per year towards promises we made for services w
pay ten times as much for promises they didn't make and services they won't receive."
- David Crane, President of Govern for California, in an open letter to Governor Jerry Brown on the real need for re
Retirement System.

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Contact the Pension Reform Help Desk

Reason Foundation has set up a Pension Reform Help Desk to provide information on Reason's work on pension
pursue pension reform in their states, counties, and cities. Feel free to contact the Reason Pension Reform Help D

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