

# Past, Present, Future of Public Pensions in the State of California

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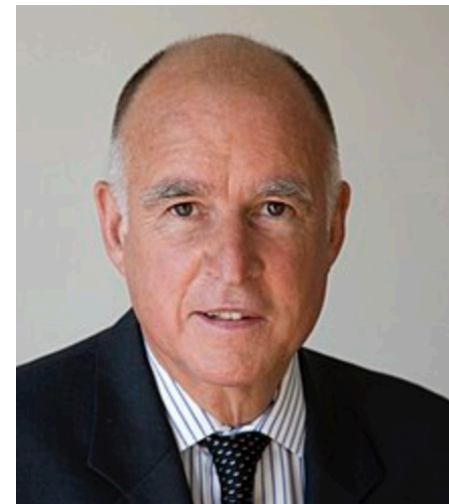
# As We Move Forward, Keep This in Mind.....

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— California Governor Jerry Brown, Oct. 13, 2011



# Life Was Good in 1999

- Stock market was on a high
  - S&P rose 225% between Sept. 1992 and 1999, an average annual rate of 15.9%
- The state's civilian unemployment rate fell from 9.7% to 5.0% over the same period
- The state's general fund budget climbed nearly 40%

# Life Was Good in 1999

- Ricky Martin's "Livin' la Vida Loca" ('Crazy Life') was the #1 song



# Life Was ~~Good~~ Great in 1999

- Dems controlled the Assembly, Senate, and for the first time in 16 years, the Governor's office

# And What Happens When Times Are That Good?



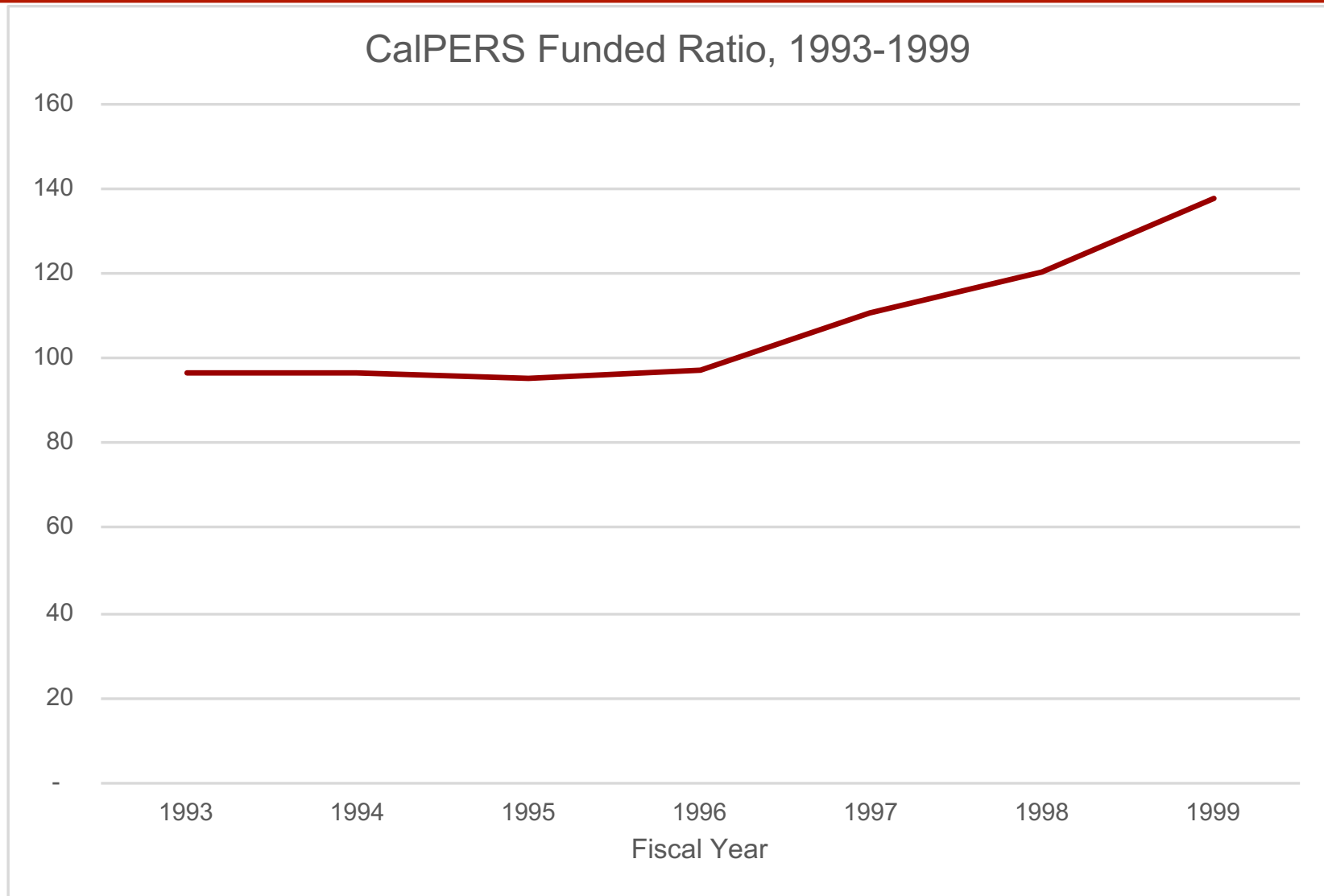
Source: <https://www.publicdomainpictures.net/en/view-image.php?image=128056&picture=party-time>,  
retrieved Dec. 16, 2018

# SB 400 and AB 616 Enhanced Public Pension Benefits

- SB 400 (1999)
  - State employee focus, sponsored by CalPERS
- AB 616 (2001)
  - Local government employee focus
- Both enhanced benefits with more generous formulas
  - Examples
    - ▶ CHP 2% at 50 became 3% at 50
    - ▶ Retirement pay based on final 12, not 36 months
    - ▶ Retired state and school members (back to 1974) received *retroactive pay*



# CalPERS Funded Ratio Was Nearly 140% in 1999

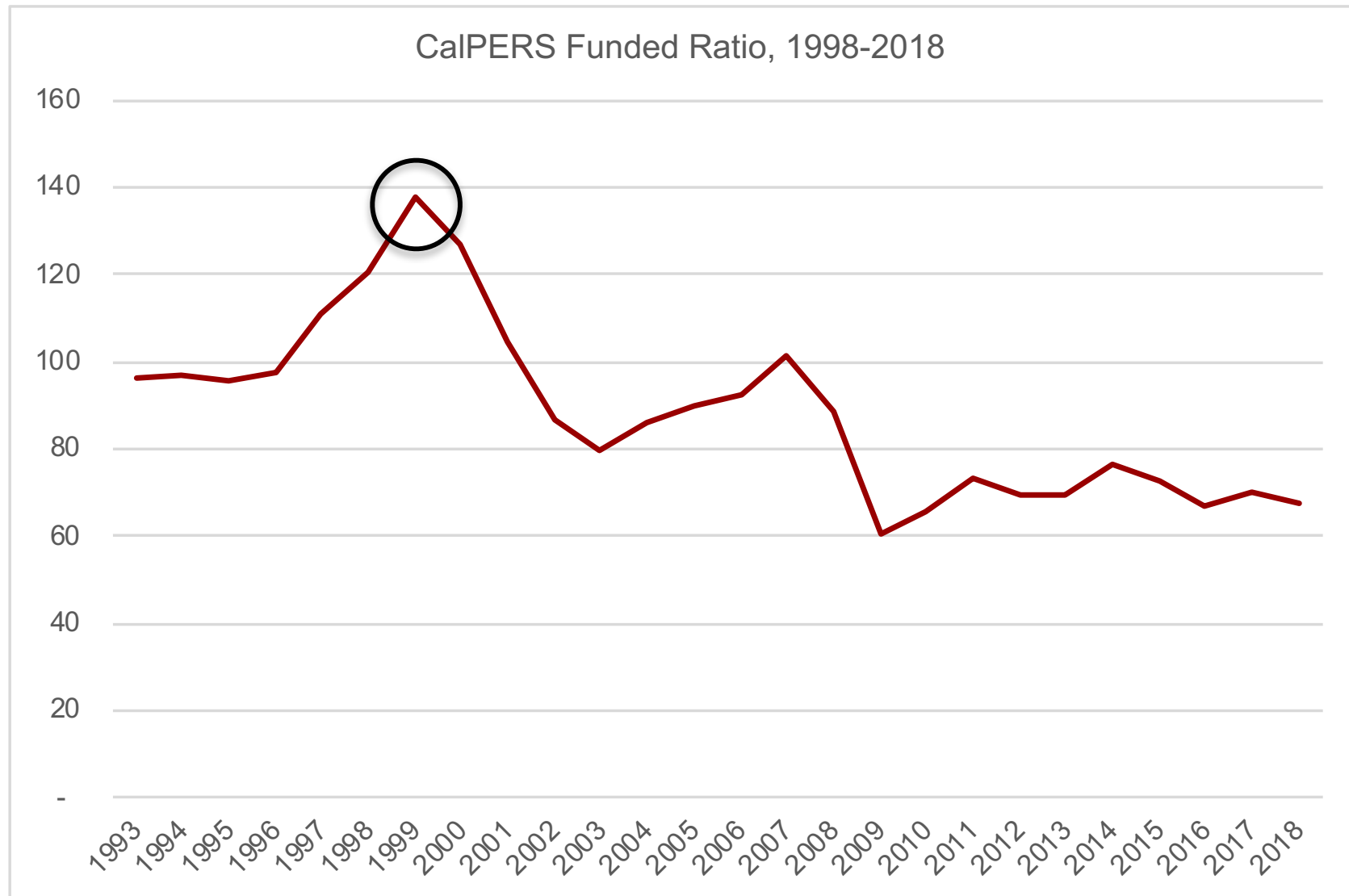


Note: PERF only

Source: CalPERS

Note: Funded ratio calculated using Actuarial Value of Assets (AVA)

# CalPERS Funded Ratio Has Fallen Fairly Steadily Since 1999

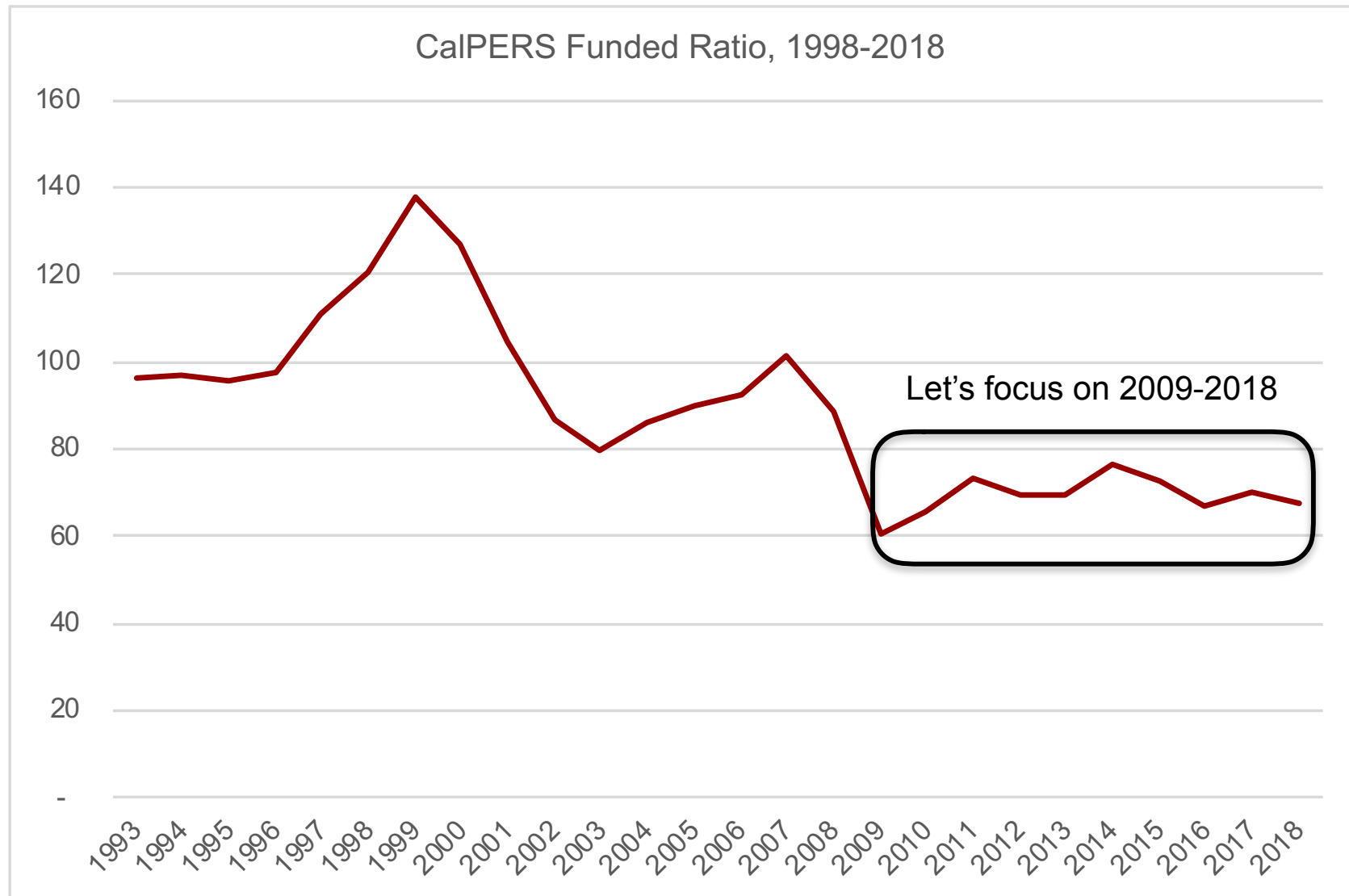


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Sources: CalPERS, author's estimates based on Dec. 2018 reported assets and estimated liabilities

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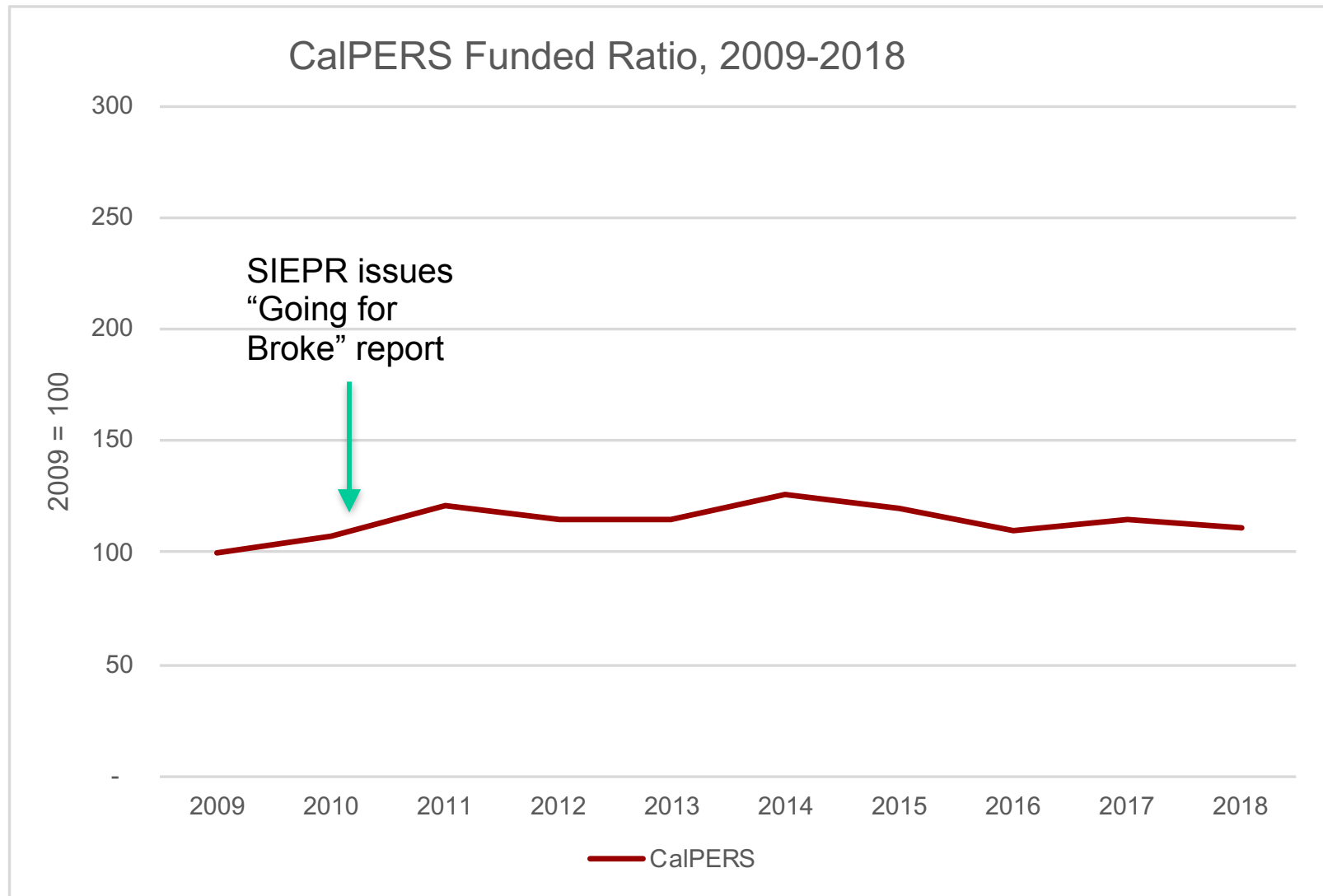


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# CalPERS' Funded Ratio Has Been Essentially Flat Since 2009

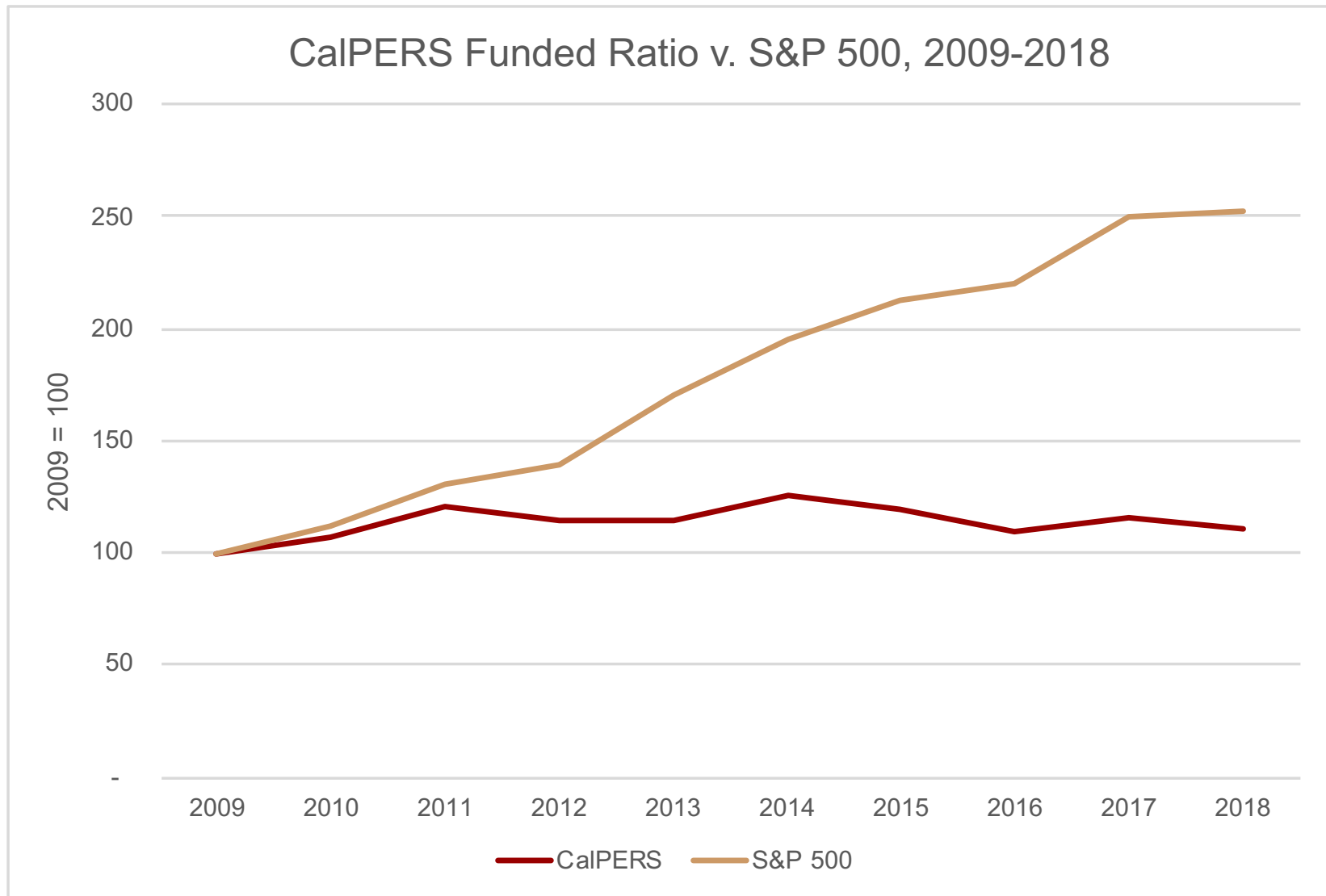


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# How Can The Funded Ratio Still Be Low If the Market's Been So Good?

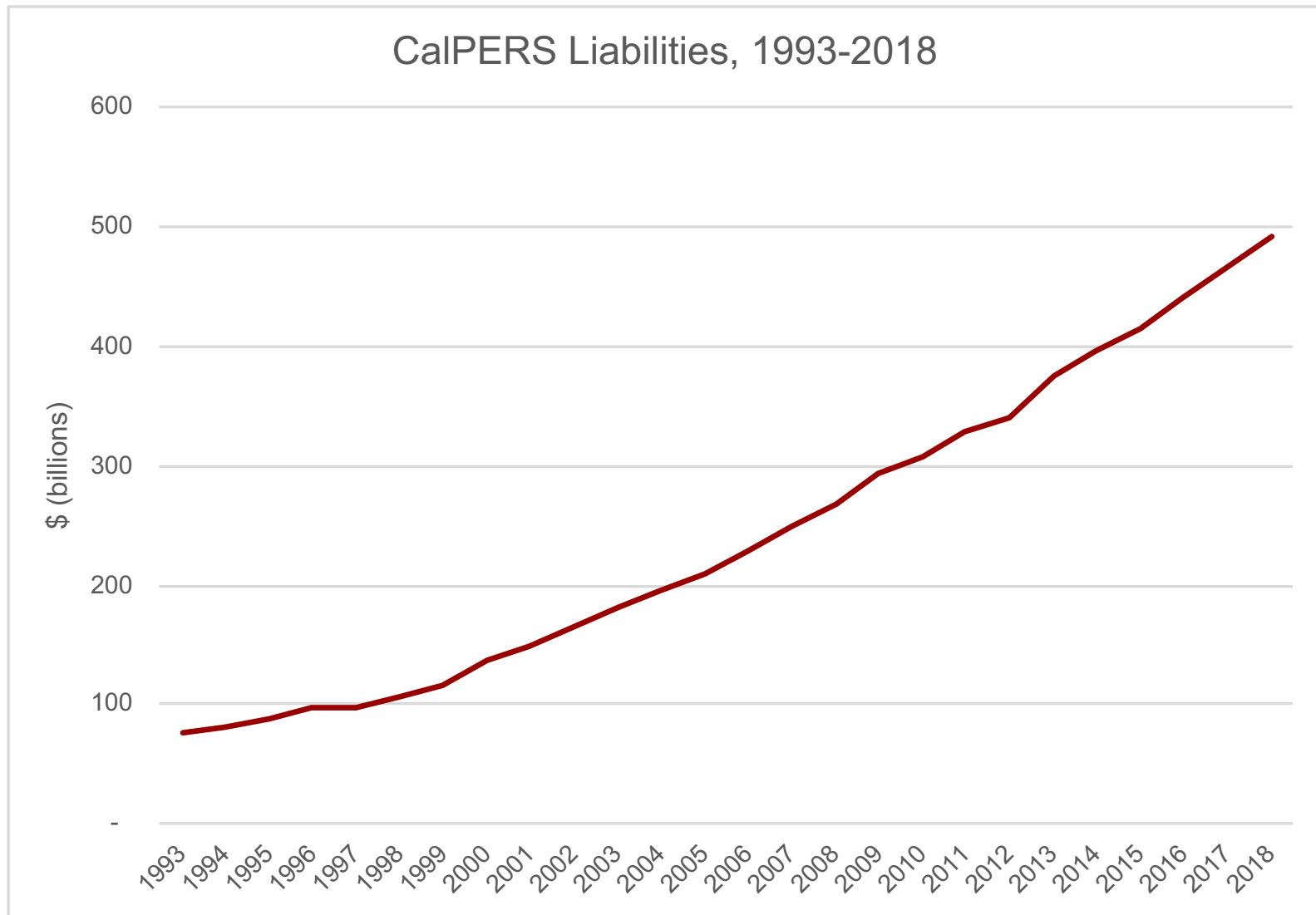


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# Steady Rise In Liabilities Explains CalPERS' Current Status

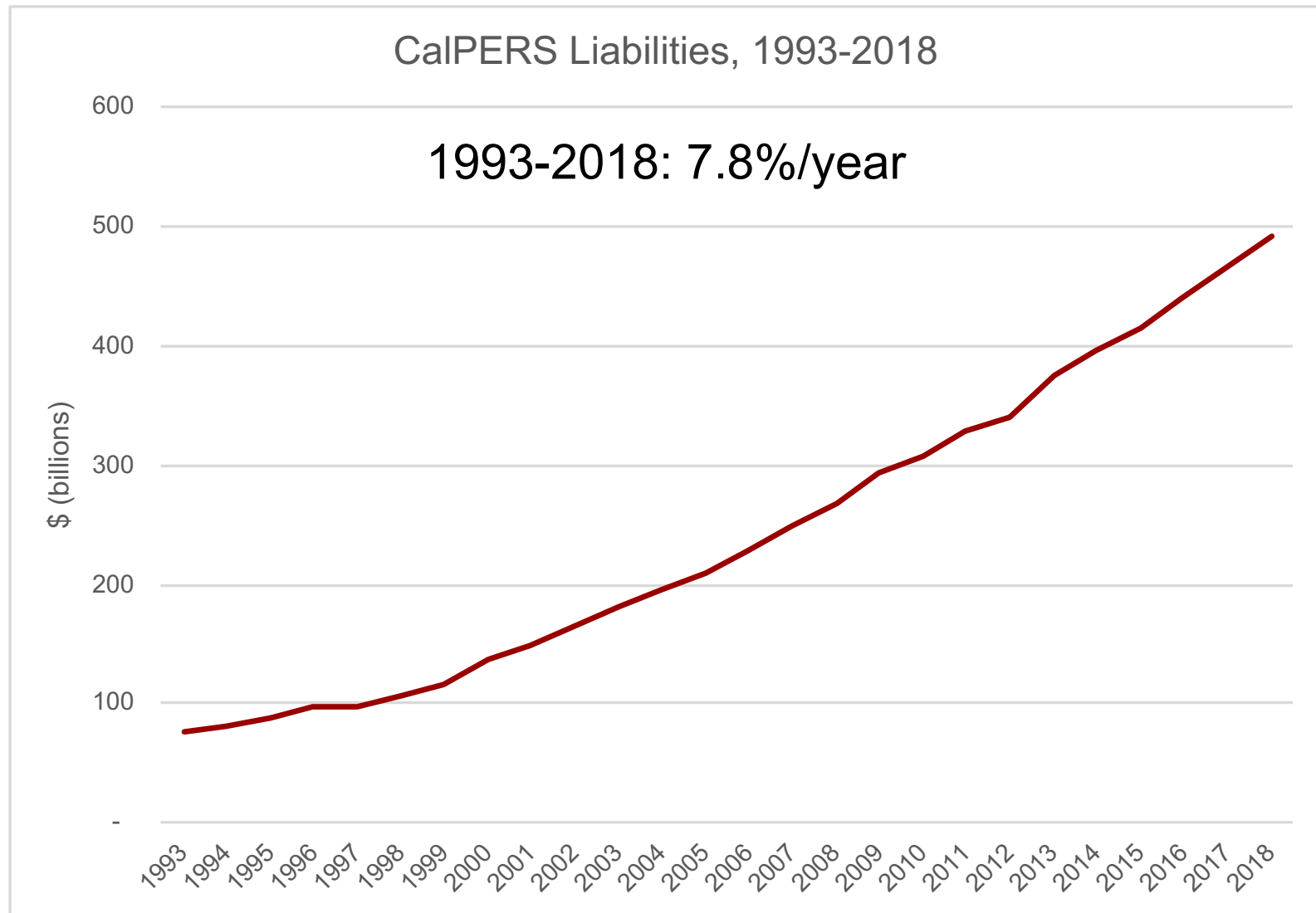


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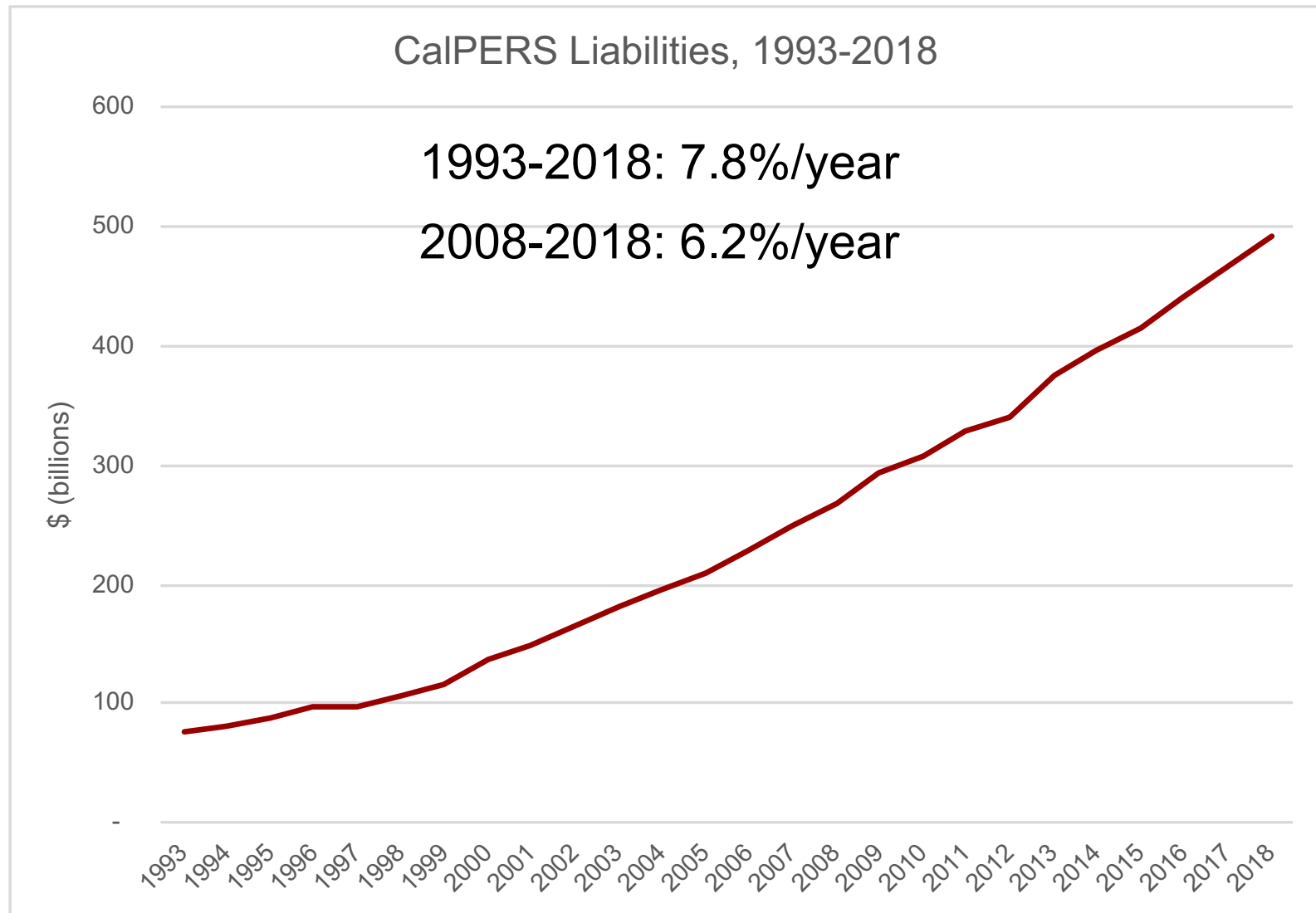


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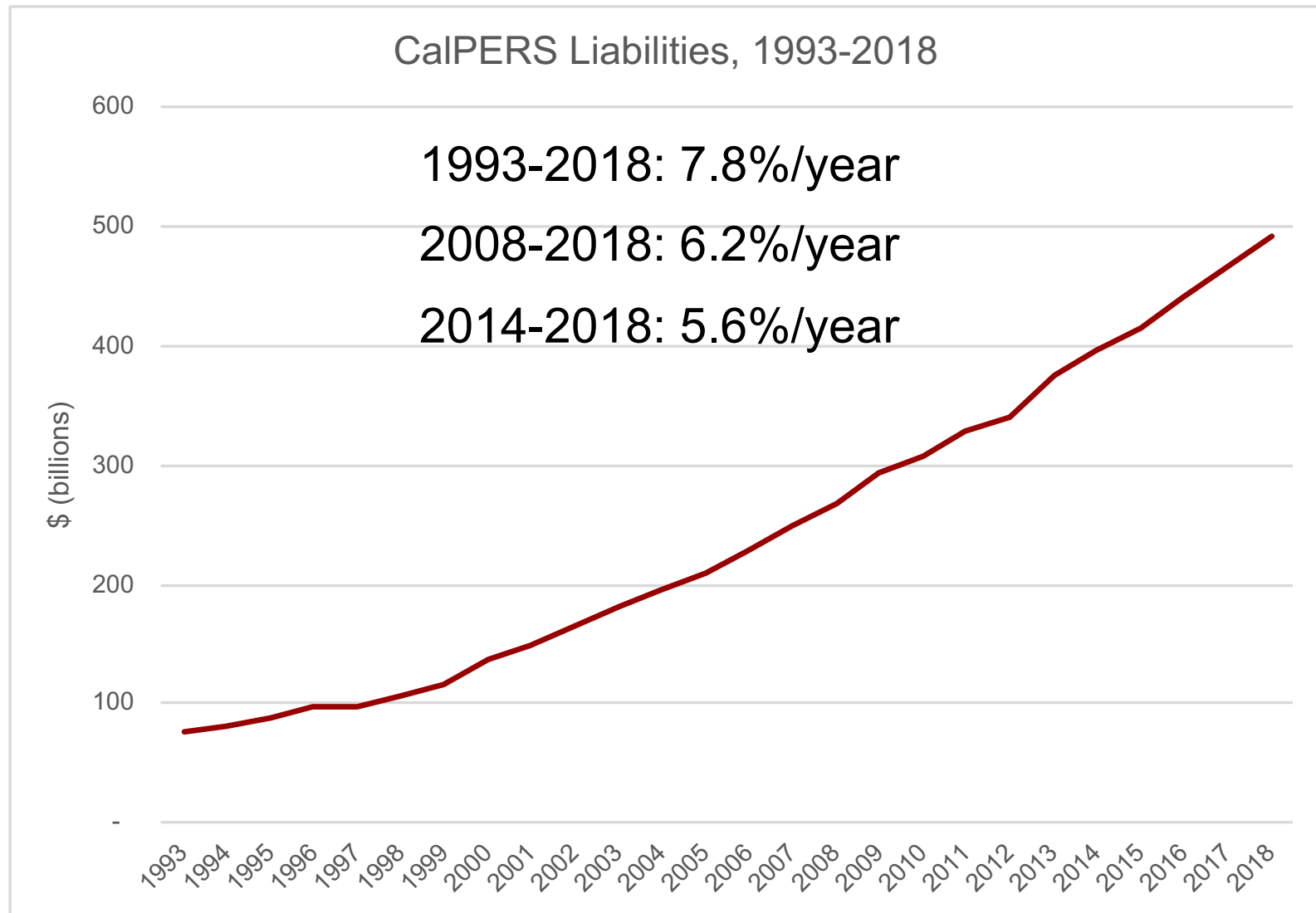
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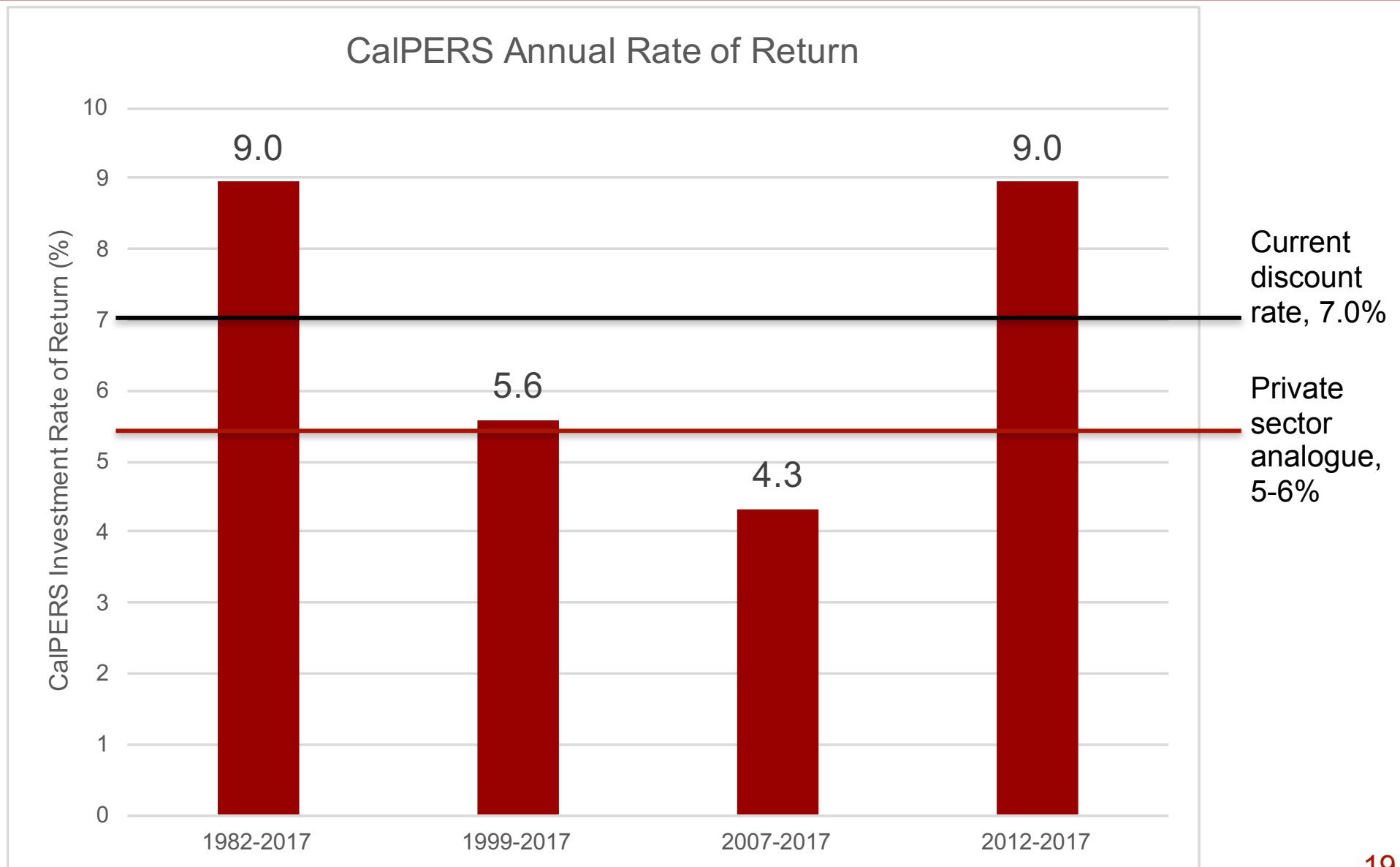
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# Why Public Pensions Are Unlikely to Recover

- Unrealistic assumed rates of return
- Public pension actuarial assumptions and methods
- Local government options to address funding problem are limited

# CalPERS Discount Rate vs. Historical Rates of Return



Source: <https://www.calpers.ca.gov/docs/forms-publications/facts-investment-pension-funding.pdf>

# Are Current Investment Return Assumptions Too Optimistic?

- McKinsey forecasts long-run equity returns 20-50% lower than last two decades\*
- Blackrock suggests an equity return of 6%\*\*
- The St. Louis Federal Reserve's outlook for equities is 6.4%\*\*\*
- Wilshire (CalPERS) says 6.1% total return next decade
- Equals long-term rate of return of about 5% for most pension funds

\*McKinsey Global Institute, "Diminishing Returns: Why Investors May Need to Lower Their Expectations," <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-investors-may-need-to-lower-their-sights>, retrieved Nov. 19, 2017.

\*\*BlackRock Investment Institute, <https://www.blackrock.com/institutions/en-us/insights/portfolio-design/capital-market-assumptions>, retrieved Nov. 18, 2017.

\*\*\*FRED, "The Equity Premium," <https://fredblog.stlouisfed.org/2016/07/the-equity-premium/>, retrieved Nov. 19, 2017.

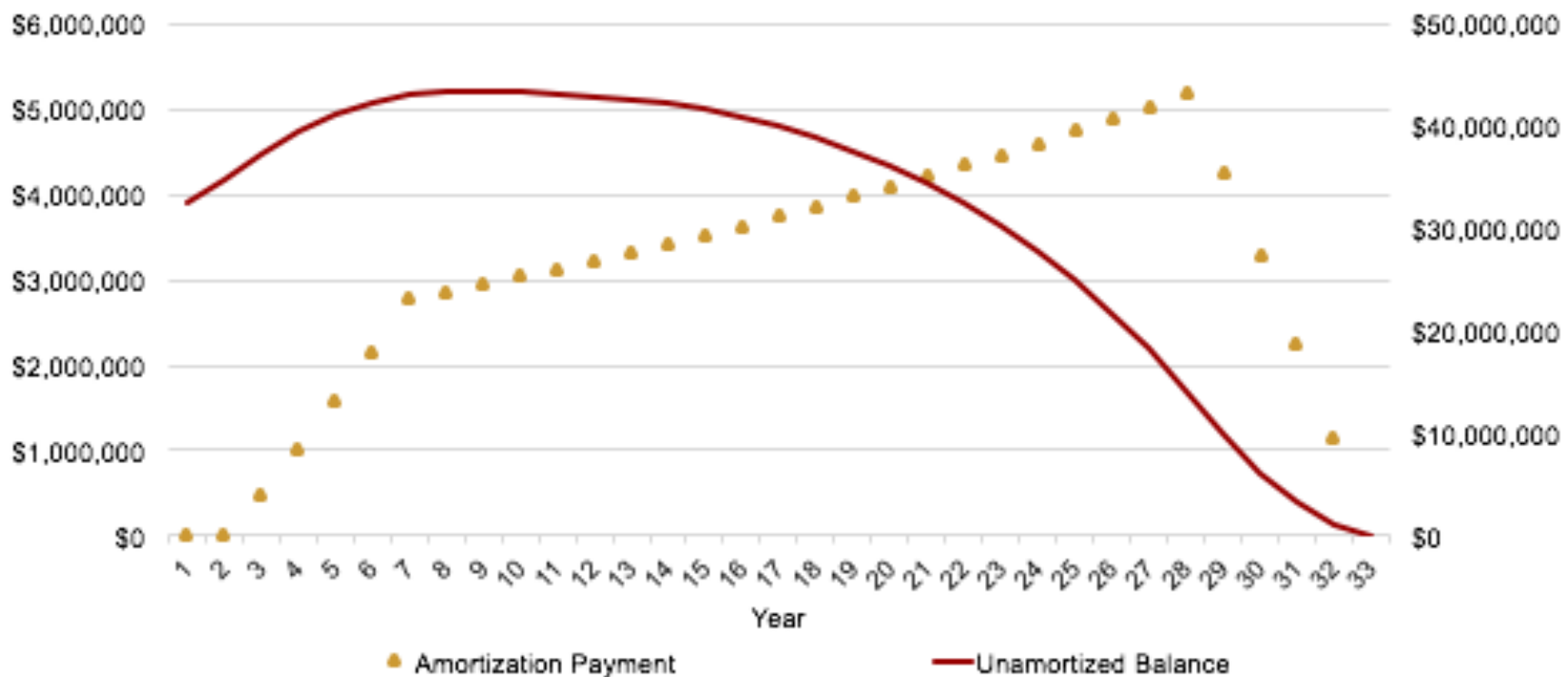
# Public Pension Actuarial Assumptions and Methods

	Private Sector	Public Sector
Discount rate	High-quality corp.bonds	Expected return
Amortization period	7 years	20-30 years*
Lag before amortization starts	Not permitted	2 years
Amortization schedule	Level dollar	Percent of payroll
Asset valuation	Market value	Actuarial value
Benefit freeze	Funded ratio < 60%	No provision

\*CalPERS moved to 20 years effective June 30, 2019 valuation.

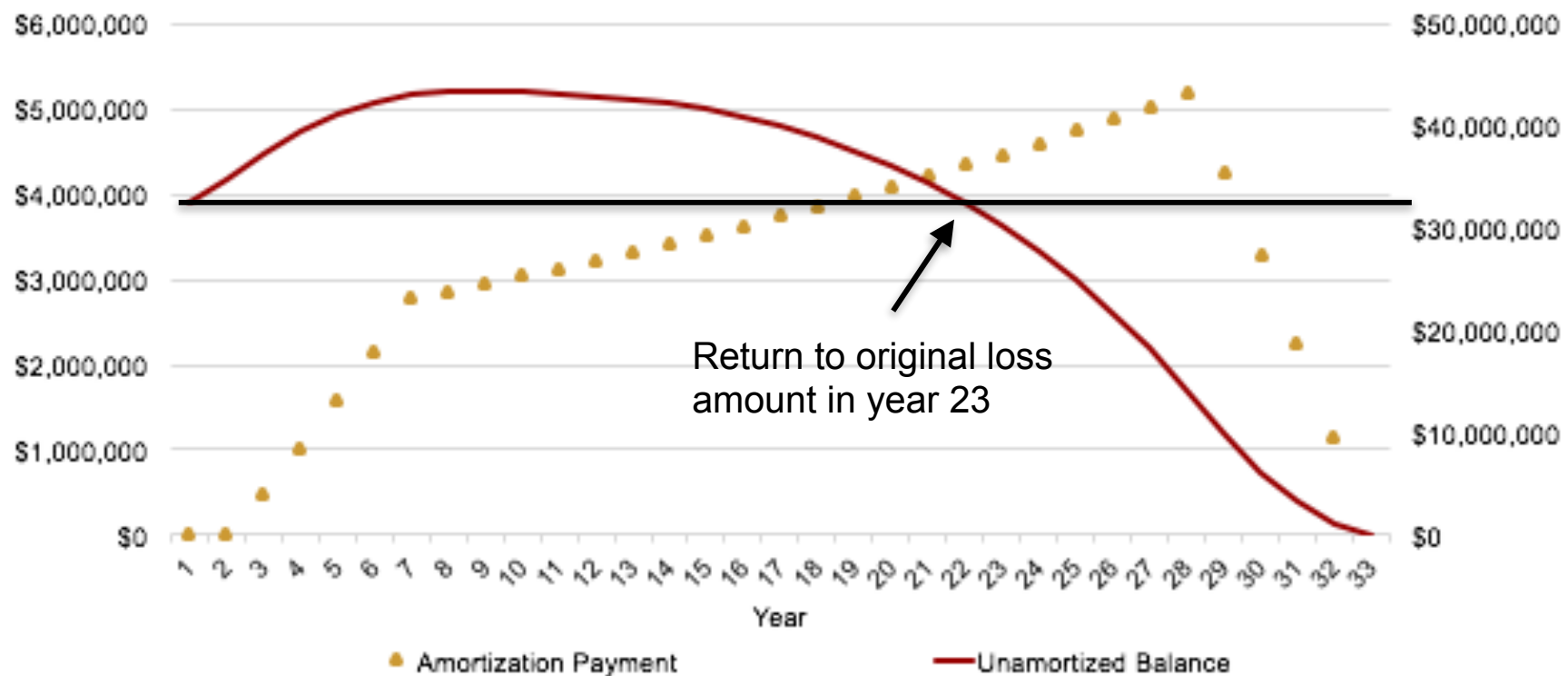
# Public Pension Amortization Policies Delay Cost Recognition

Amortization Payments and Unamortized Balance--\$32mm Loss



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- **Contribute more**
  - Required contribution rates
  - Voluntary high “rates,” e.g., Palo Alto
- **Save/invest more**
  - 115 Trust
- **Pension Obligation Bonds (POBs)**
- **Lower system liabilities**
  - California Rule modification
    - But this helps only slightly, and only in long-term

# Local Government Advocacy Options to Address Funding Problem

- More “private-sector like” assumptions, methods
- Governance reform
- Local flexibility w.r.t. benefits

Reminder: State, school employees have greater protection from insolvency than local employees

# Contact Information

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