How public pensions strive to be similar to large deductible Workers Comp (although they are a much bigger problem)

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San Ber'dino

- As reported by *Chicago Tribune* on August 30, 2012:
  - San Bernardino, a city of about 210,000 near Los Angeles filed for bankruptcy on July 31, 2012.
  - It listed the California Public Employees' Retirement System (Calpers) as its largest creditor, with unfunded pension obligations totaling $143.3 million.
  - But Calpers, in response to an inquiry from Reuters, estimated the debt at $319.5 million.
  - Calpers official said that San Bernardino had used an *actuarial value* in determining its unfunded pension obligation, while Calpers used *market value.*

Stockton …

- Calpers is the largest pension system in the United States. It serves many California cities and counties, including the city of Stockton, which is in bankruptcy.
- Calpers has long argued that pension claims take priority over bond debt, even *pension obligation bonds.*
- Stockton issued $125 million in pension obligation bonds in 2007, which declined in market value by a third in 2008. But Stockton must pay annual interest about $6 million, 75% of the city's deficit in 2012.
- In June 2012, the city filed for bankruptcy, unable to make the payments on these and other bonds.

Vallejo …

- Another California city, Vallejo, filed for bankruptcy in 2008, and it emerged from it in 2011. Throughout the bankruptcy it continued making payments to Calpers.
- Stockton also continued making payments to Calpers in bankruptcy.
- But San Bernardino has failed to make payments to Calpers in excess of $1 million, and has been deemed delinquent by Calpers.
- Payments by Calpers to all beneficiaries have been unaffected.

Prichard, Alabama

- In Prichard, Alabama, in 2009, the city pension plan ran out of funds, and the city stopped paying pensions.
- The city filed for bankruptcy under Chapter 9 on October 29, 2009. It was its second bankruptcy, the first one occurred in 1999. The judge of the 1999 case ordered the city to replenish the pension fund, the city did not.
- In 2004, the city hired an actuary to analyze and summarize their employees' pension plan. He told the city the plan would run out of money by the Summer of 2009. He was off by a bit, they ran out of money in September 2009.
- As of April 2011, pensioners have not received their pension checks nor has a budget been passed in eighteen months.

Even with amortization leeway

State Universities Retirement System of Illinois, percentage of Annual Required Contributions paid into SURS:

2005	47.0%
2006	27.2%
2007	37.0%
2008	48.8%
2009	51.7%
2010	69.4%
2011	61.3%
2012	69.0%

A story of a pension plan

- Plan covers certain workers in a union.
- Important and valued group of state/municipal employees.
- Accounting rules subject to the Governmental Accounting Standards Board (GASB)'s generally accepted accounting principles used by state and local governments in the United States.
- Not subject to Employee Retirement Income Security Act of 1974 or Pension Protection Act of 2006, which affect private pension plans, and require strict standards of funding.
- Using projected unit credit actuarial method.

Some More Information

- Multiple employer defined benefit pension plan, also providing certain survivor and disability benefits.
- Current total membership is approximately 60,000.
- Approximately 60 employers participating.
- Two tier benefits, for employees prior to 2011 and past 2011:
  - Prior to 2011: A member with at least 20 years of service and who has attained 55 years of age is entitled to a pension. A member with at least 5 but less than 20 years of service is entitled to a pension on attainment of age 62.
  - Past 2011: A member with at least 10 years of service and who has attained 67 years of age is entitled to an unreduced pension. A member with at least 10 years of service and who has attained 62 years of age is entitled to a reduced pension.
  - About 2.2% of final average salary for each year of service.

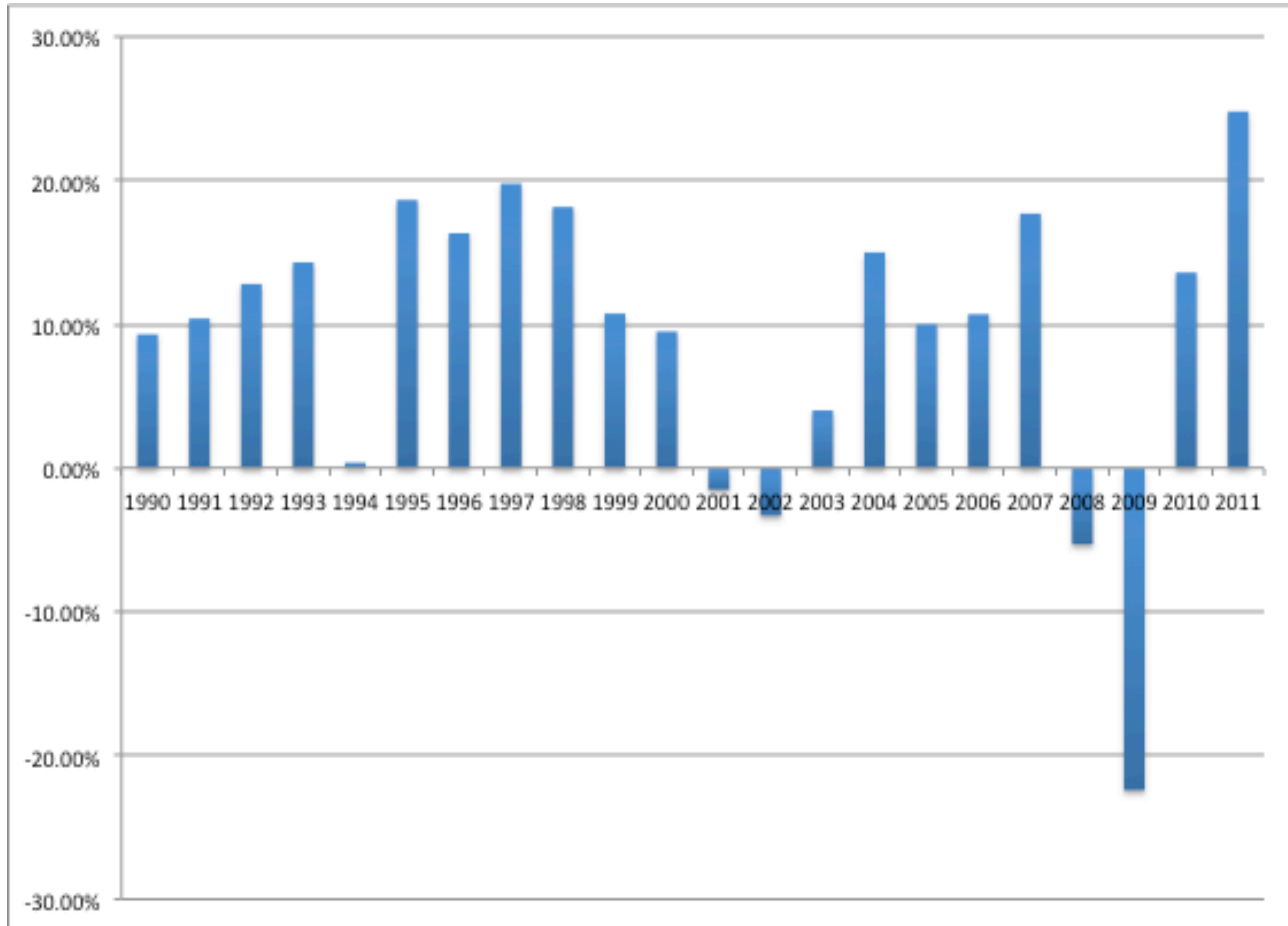
Fiscal year 1999

- Assets $9,535,832,009
  - Current liabilities $1,670,822,885
  - Actuarial accrued liability $8,551,879,683
- Funded ratio based on market value 115.50%. Based on (smoothed) actuarial value of assets it was 100.80%.
- Total normal cost $278,144,477
  - Employee contributions $136,906,335.
  - Employer's annual required contribution: $138,440,544 (after amortization of past gains).
  - Actual employer contribution: $60,781,723.
- Benefit payout $372,389,829.
  - That's 3.33% of available assets.

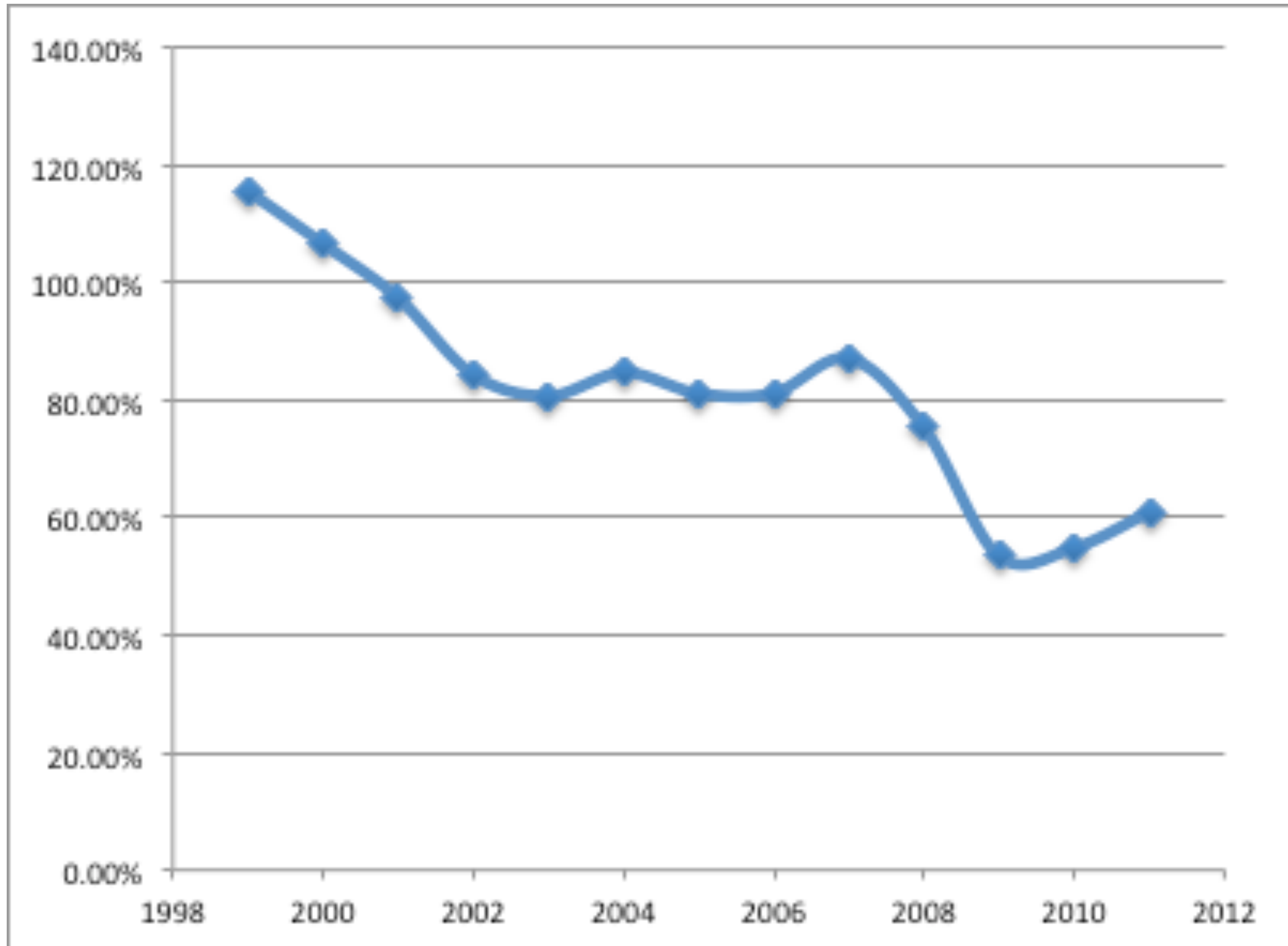
Fiscal year 2011

- Assets $11,283,027,138
  - Current liabilities $970,264,974
  - Actuarial accrued liability $16,940,626,445
- Funded ratio based on market value 60.88%. Based on (smoothed) actuarial value of assets it was 59.90%%.
- Total normal cost $ 299,247,550
  - Employee contributions $ 175,805,483
  - Employer's annual required contribution: $123,442,067
  - Supplemental cost to amortize deficit: $10,931,000
  - But benefits increases were granted increasing SC to $11,654,000
  - Actual employer contribution: $206,031,563
- Benefit payout $1,077,980,337.
  - That's 10.45% of available assets.

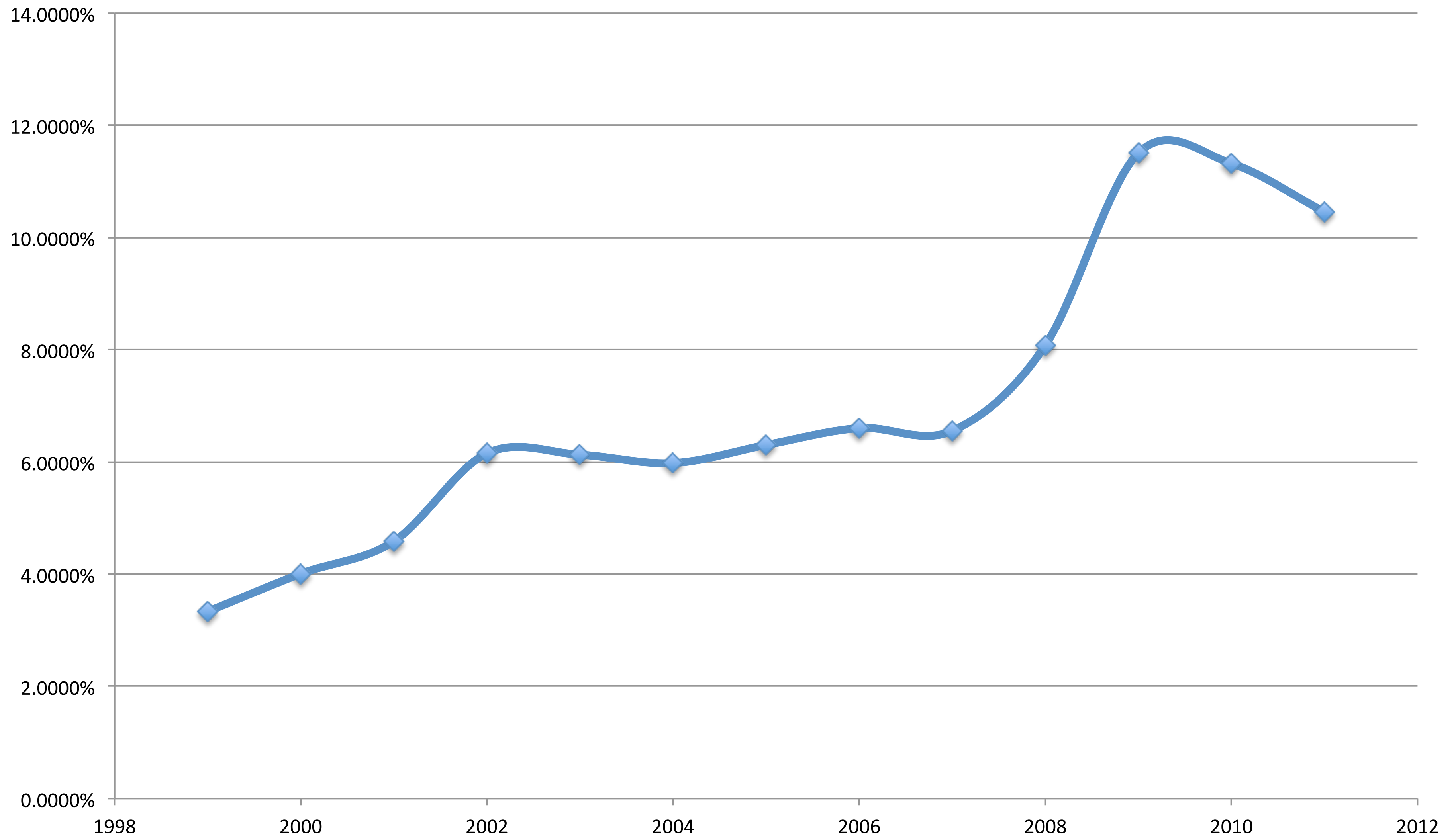
Rates of return of the plan



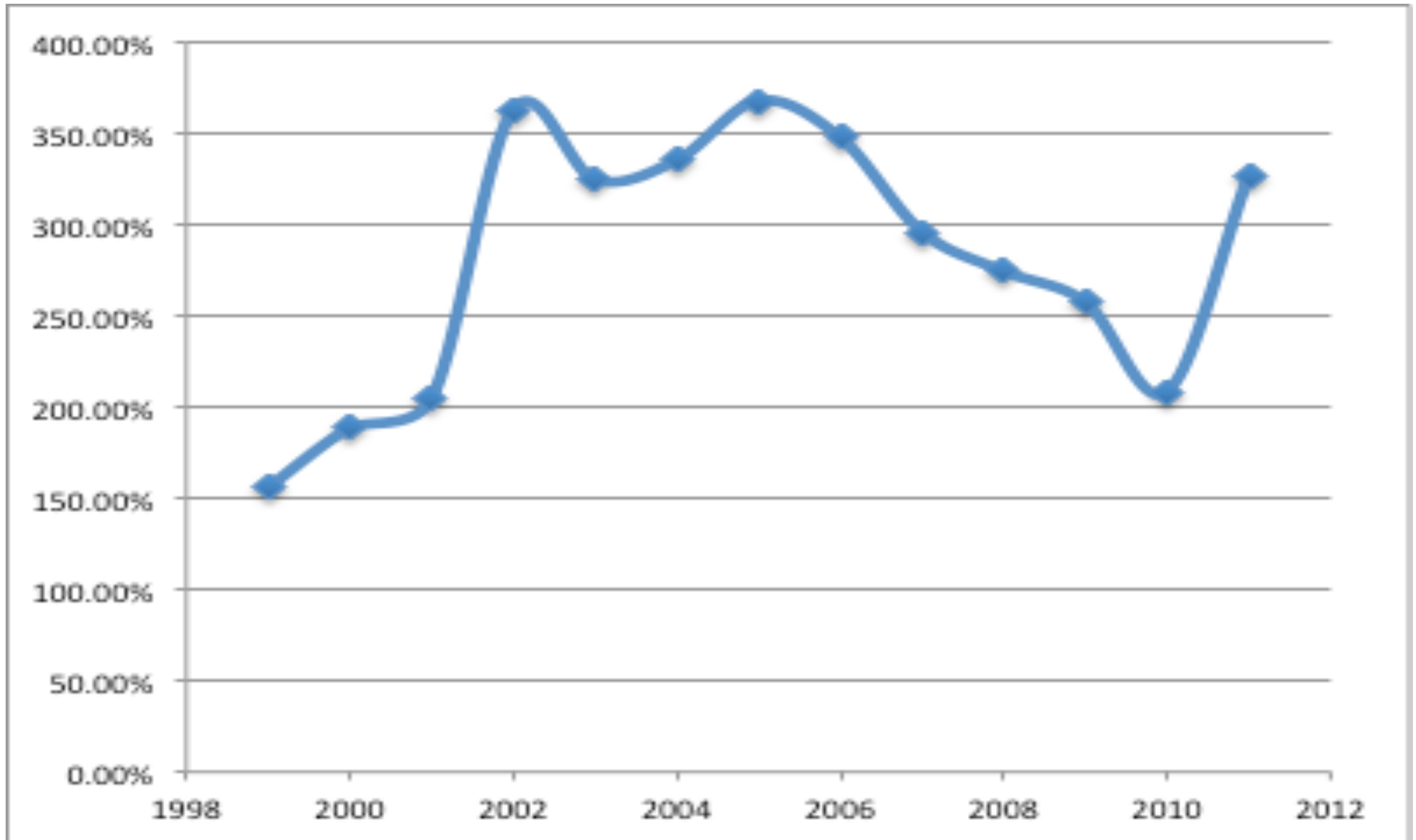
Funded ratio (assets/actuarial liabilities) based on market value of assets



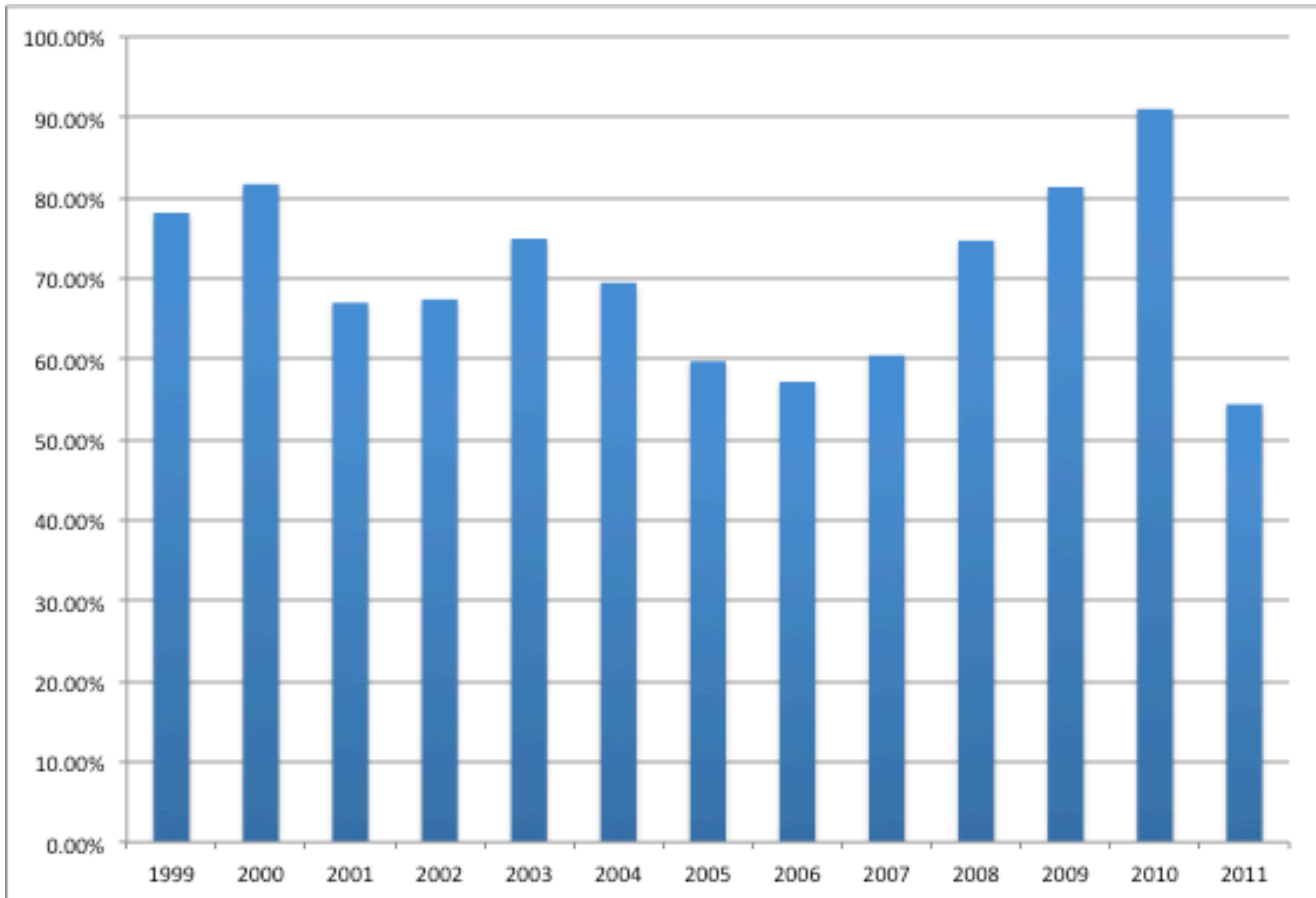
Benefit payouts as % of available assets



Benefit payouts as % of contributions



Contributions actually made as % of required contributions



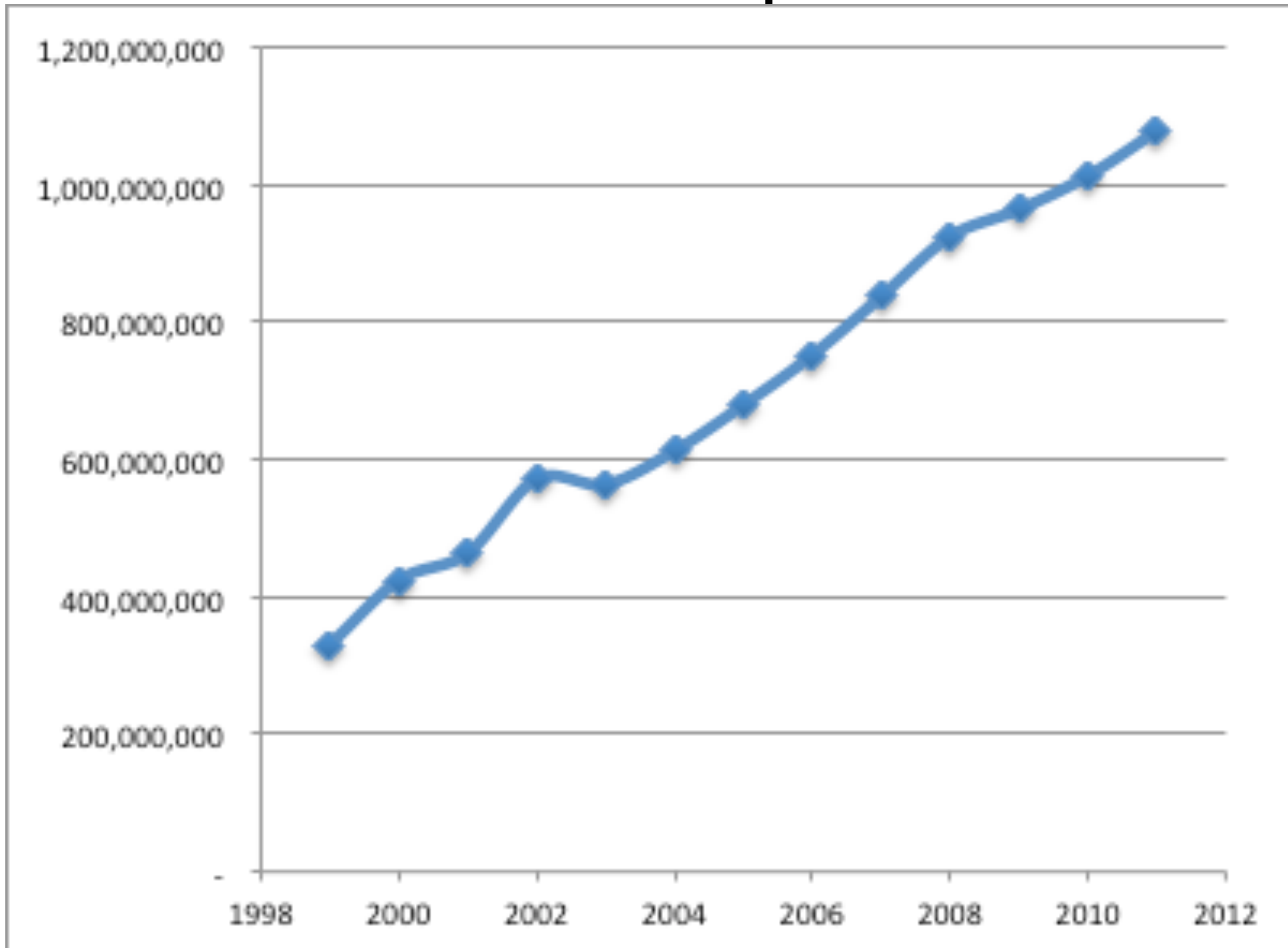
Additional trouble with contributions

- Approximately half of required contributions are made by employees, through automatic payroll deductions. Those are not discretionary. Thus the discretionary underfunding is actually twice as bad.
- States and cities often make contributions by issuing pension obligation bonds:
  – Pension obligation bonds are bonds issued by a state or local government to fund a required payment to the pension fund sponsored by the said municipality.
  – State/municipal pension plan sponsors have issued such bonds in majority of U.S. states.
  – The illusion is that bond interest rate will be lower than the plan actuarial valuation rate.

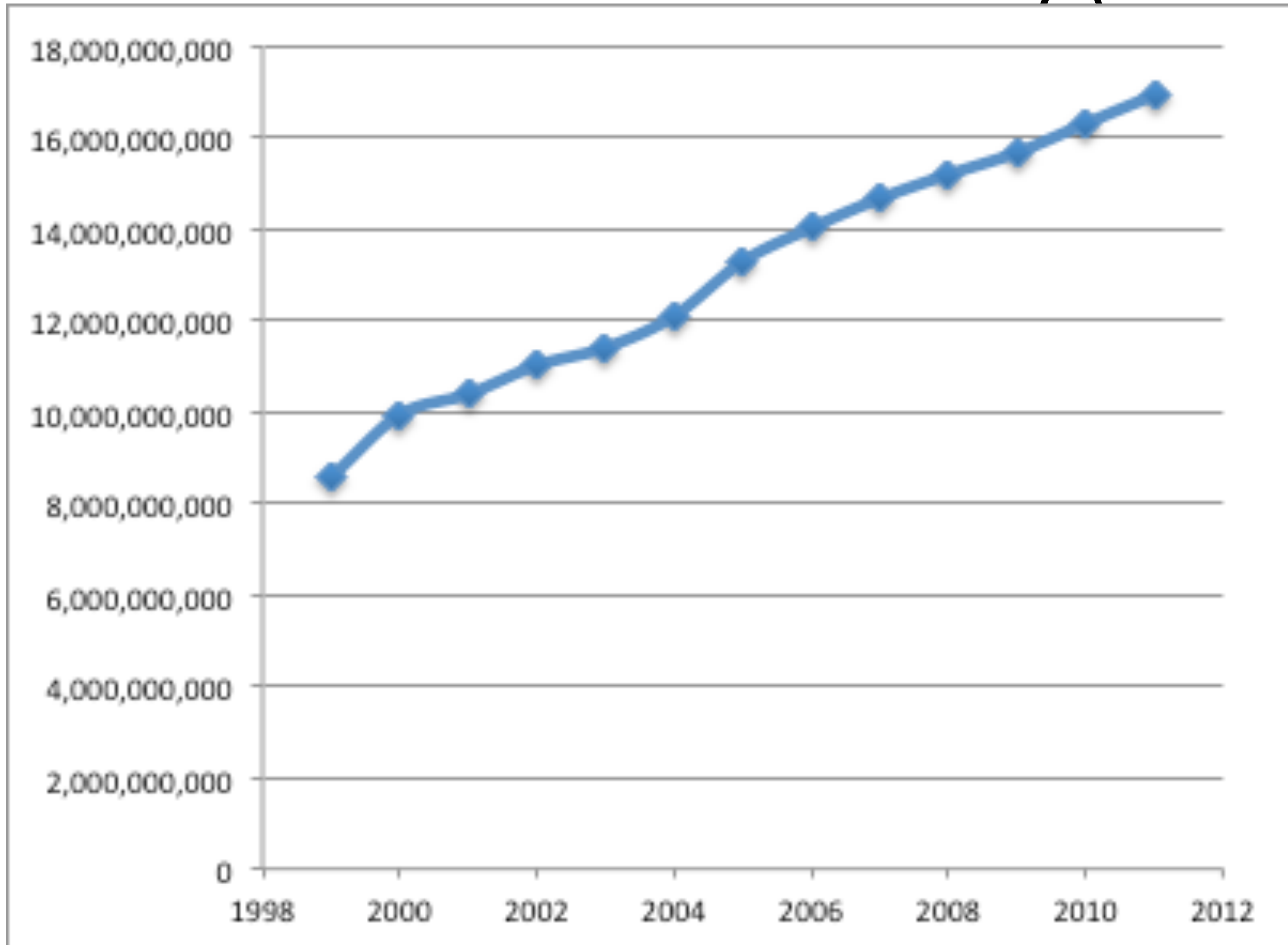
Ominous case of Philadelphia: May 1, 2008, Bloomberg.com story

- Former Philadelphia Mayor Edward Rendell sold $1.29 billion in pension bonds in 1999.
- While trying to balance the city budget, Rendell's successor, John Street, did not make full contributions to the pension fund.
- As a result, Bloomberg reported, "The city has about 54 percent of the funds it needs to pay pension benefits over the next 30 years, about the same as in 1999 before it sold the bonds."

Payouts of the case study pension



Actuarial accrued liability (at 8%)



Analogies

- Unpaid pension contributions vs. deductible
- Taxing power of the state/city/municipality vs. payment by insurer in case of employer bankruptcy
- Shadow reinsurance
  – Municipality keeps funds required for contribution but still reinsures the pension plan for future payouts
  – Insurer acquires desired business, and even may get collateral, but still reinsures the large deductible
  – "We will allocate this specific tax for pension funding" vs. "But employer will post collateral."

But we can require more collateral!

- And we can also raise taxes!
- Or we can cut benefits!
- Or maybe just future benefits!
- If the Supreme Court of Illinois lets us!

- These are responses that happen when crisis already started, and they are like the story of the Polish plumber, who defeated the EU Constitution in the French referendum:

Cut the pipe three times and it is still too short?