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Public Employee Pension Plans

A. To what extent is it desirable or necessary to provide advance funding of pension benefits under public employee retirement plans?
B. Should annual reports to participants under public employee retirement plans include information as to the financial operation of the plan, including such things as the extent of public financial support and unfunded liabilities?

MR. REINHARD A. HOHAUS: New York's public employee plan funding method has been used over a period of more than forty years. It dates back to the recommendations of two separate Commissions, one for New York City and another for the State Legislature. These reports were made about the time of World War I.

The actuary of the State Employees' Retirement System makes an annual valuation of the assets and liabilities of the System; the head of the Retirement System (who is the State Controller) makes an annual report showing the actuarial valuation as certified by the actuary, a statement of receipts and disbursements, and recommendations. On the basis of each annual valuation and appraisal, the Controller prepares and files with the Director of the Budget an itemized estimate of the amounts necessary to be appropriated in order to provide for payment in full for the past fiscal year of all obligations of the State to the Retirement System. There is a statutory provision that an amount sufficient to provide for such obligations must be included in the next annual appropriation bill.

In New York no local community of any kind outside of New York City can set up and operate a pension plan of its own. The only way they can adopt a plan is for them to have their employees join and become a part of the State System and be subject to all of its rules.

Annual reports are made to participants as to the financial operation of the State Employees' System and other matters. The Retirement System is subject to the supervision of the Superintendent of Insurance, and an annual statement is filed with the Superintendent.

MR. THOMAS P. BLEAKNEY: I feel that advance funding of public employee retirement plans is desirable because such funding very graphically measures increases in benefit costs immediately rather than waiting until the ultimate cost develops. As obvious as this point is, it is exceedingly difficult in some quarters to get the point across. Another factor pointing toward the desirability of advance funding is that there is the distinct possibility that a small unit of government having a pension plan may go out of business and still have a tremendous liability. Proper funding of pension liabilities would avoid this contingency.

About the only argument that I know against advance funding is that a large fund is a target to get increases in benefits without proper funding and is a basis for politically inspired investments, unwarranted pension increases or reduction of payments into the fund at any time when budget difficulties are encountered.

I feel that it is very important that actual scheduling of the method of funding of a plan should be in the law, if at all possible. The funding period should be specified within the range of practicality. Unless the funding is explicit in the law, there is too much pressure to increase benefits without proper measurement of cost.

MR. RALPH R. NELSON: I have noted some California developments which are pertinent to the question of reserves for public employee retirement plans. Unquestionably the small governmental unit with a narrow economic base, such as that of a small town, should have a reserve, because otherwise it may find the time when it is not able to meet its obligations. In California, the courts have held that promise of public retirement benefits is in the nature of contractual obligations and must be met. A public employer cannot then abolish or materially reduce benefits, except for future employees. Another development in California is a trend toward using public system reserves for municipal purposes. There often is no binding obligation on the part of the municipality to repay the amounts by which the reserves are impaired. Whether it can be stopped, nobody knows. Of course this practice entails the risk of having the taxpayer pay twice, once to establish the reserve and a second time to replace impairment in the reserves for unwise purposes, and more important it deprives the electorate of a vote on the project, which usually is prescribed by law, and still further increases the interest cost.

With regard to annual reports to members, in California nearly every plan about which I know makes such an annual report. These reports, however, contain only periodic actuarial valuations, so that the report itself normally is simply a statement of ledger balances and not the actuarial deficiencies. A periodic report, however, does show the actuarial balance sheet, and the amount which the employer is charged for future contributions. I have found over a long time that employees do not take a great interest in these reports. I have yet to find or to hear a demand for increased benefits on account of the size of the pension fund. Personally I have never attached importance to these annual reports, but still I think the employees should have them.

MR. ROBERT H. LITTLE: I would like to emphasize one point in connection with public employee retirement plans: most pressure for increases in benefits comes from the employees themselves. There is a whipsawing effect as between systems since, whenever one system has a little bit better benefit in one respect, none of the other systems can wait until they match it. This is true even though the latter systems are far ahead of the system in question in all other areas. The cumulative effect may be somewhat delayed, but as taxpayer groups begin to see costs go up they are more inclined to take an interest when suggested benefit increases come before them, either as voters or in the legislature. This, therefore, is one of the strongest reasons for advance funding: those who pay for the benefits will have a better idea of what they are paying for, before the actual benefits become due and payable. One favorable development here in California is that legislation has been presented in Sacramento for the establishment of a committee or board, one of the duties of which would be to analyze the effects of proposed benefits. This should avoid much of the whipsawing which inevitably leads to a higher level of benefits for all of the plans.

In regard to annual reports to members of retirement plans, I might mention that the Municipal Finance Officers Association has a committee which is active on the problem of financial statements of public retirement systems. They will soon come out with a report on a recommended form. Their objectives are to obtain statements which facilitate comparison of the operation of various systems and to produce reports which will include such items as unfunded liability which are often omitted in public retirement system reports.

MR. WILLIAM F. MARPLES: One of the most vivid illustrations of the effects of deferred funding or ultimate pay-as-you-go financing is the comparison of advance funding contributions with the ultimate benefit pay-out of a plan. I remember seeing a plan operated on a pay-as-you-go basis where the benefits would have cost about 23% of payroll on an advance funding basis; the pension outgo, after a large number of years of operating on a pay-as-you-go basis, was 55% of payroll. The fact is that deferred payment may actually double the cost, or more, in the course of time.

DR. ALAN A. GROTH: There are more than 300 public employee pension plans in Illinois. Of these only about 15 are major ones and the rest are mostly policemen's and firemen's funds. In 1945, a Pension Laws Commission was established for the purpose of formulating standards and policies for the guidance of the state government in the evaluation of pension laws and future pension legislation. The Commission has done an excellent job in guidance of the legislature. There are other organizations in the state which are trying to affect and influence legislature. Some of these, in order to keep the expenses of the state to a minimum, deemphasized the importance of prefunding. This resulted, in certain cases, in insufficient contributions so that, in some cases, the fund assets were not sufficient even to cover the accumulated contributions of active members.

MR. WILLIAM R. HALL: It seems to me that the interest element is much more important in a public employee retirement plan than it is in a private plan. You can argue that in a private plan a reduction in advance funding has been invested in the business. This doesn't hold as well for a public plan; in fact, since most municipalities are borrowing money they are probably borrowing at a lower rate of interest than the rate at which they can invest. By advance funding, they are able to go into the investment business at a profit.

MR. JAMES E. HOSKINS: To round out the discussions, I give some of the arguments that have been given for pay-as-you-go financing of public employee retirement plans without necessarily endorsing them.

1. Since the taxing power of states and their subdivisions is usually unlimited, income equal to the entire outgo is available. While it is possible that the necessary appropriation might fail to be made in some year, the same is true of that needed under a funded plan. To reduce the benefits of retired employees would require a good deal of political hardihood.

2. A funded plan would involve higher initial taxes which would go into a fund yielding less than some taxpayers could earn in their own business.

3. In the case of small governmental units, unless pooled, the investment of this fund would create practical problems.

4. The presence of a large reserve might cause pressure for an undue liberalization of benefits. However, increases in benefits without regard for the cost would be more likely to occur under a pay-as-you-go plan where payment of the cost would be mostly deferred.

5. The higher initial cost when a funded plan is initiated, or substituted for an unfunded plan, is a greater financial strain than annual increases under a pay-as-you-go plan, which will not reach the cost of a funded plan for many years, and under which the ultimate cost, often only a small part of the total budget, may be only moderately greater than under a funded plan. (Of course, an intermediate plan could be devised which

would have a low initial cost but larger increases and a lower ultimate level than the pay-as-you-go plan, *e.g.*, funding the benefits of new entrants.)

6. The primary reason for funding is to guarantee the payment of benefits in case the employer goes out of business, a contingency which does not have to be considered in relation to a presumably perpetual governmental body.

7. Since such plans are usually not contractual as regards the benefits provided by the employer's contribution, there is no legal liability requiring a reserve. This argument is obviously inconsistent with argument 1 above and is not usually uttered in the same breath.