SPRING 2018

What is IPFI?

The Institute for Pension Fund Integrity (IPFI) is a non-profit that focuses on getting politics out of public pension fund management and bringing market-based assumptions to the calculation of public pension unfunded liabilities.

What is the problem?

Unfunded pension liabilities present a significant economic problem to state and local governments. As these governments continue to rack up increased unfunded liabilities, the burden of the liabilities falls on taxpayers and beneficiaries.

Three of the major problems that are leading to higher than anticipated unfunded pension liabilities are:

i. Politically–driven pension fund management

ii. Longer life expectancy

iii. High assumed rates of return

Politically-driven Fund Management

Many public pensions are managed by politically appointed individuals who are beholden not just to plan beneficiaries, but also other stakeholders like voters and special interest groups

Because of this, public pension managers have been increasingly pushed to use investments to make political statements: either more investing in specific funds, or divesting from negative industries (oil companies, tobacco companies, nuclear weapon/ defense industry manufacturers, gun manufacturers, etc.)

It is estimated that the New York Common Retirement Fund would lose **between $188 million to $302 million** over five years if forced to divest from fossil fuels

CalPERS missed approximately **$8 billion in investment** earnings due to its various divestments. Tobacco divestments alone cost the pension fund nearly **$3 billion over 14-years**

Most of these stocks are incredibly well performing. Over the last 5 years:

- Northrop Grumman's stock has grown 489%
- Boeing has grown 379%
- Lockheed Martin has grown 352%

It is time to get **politics** out of public pension fund management
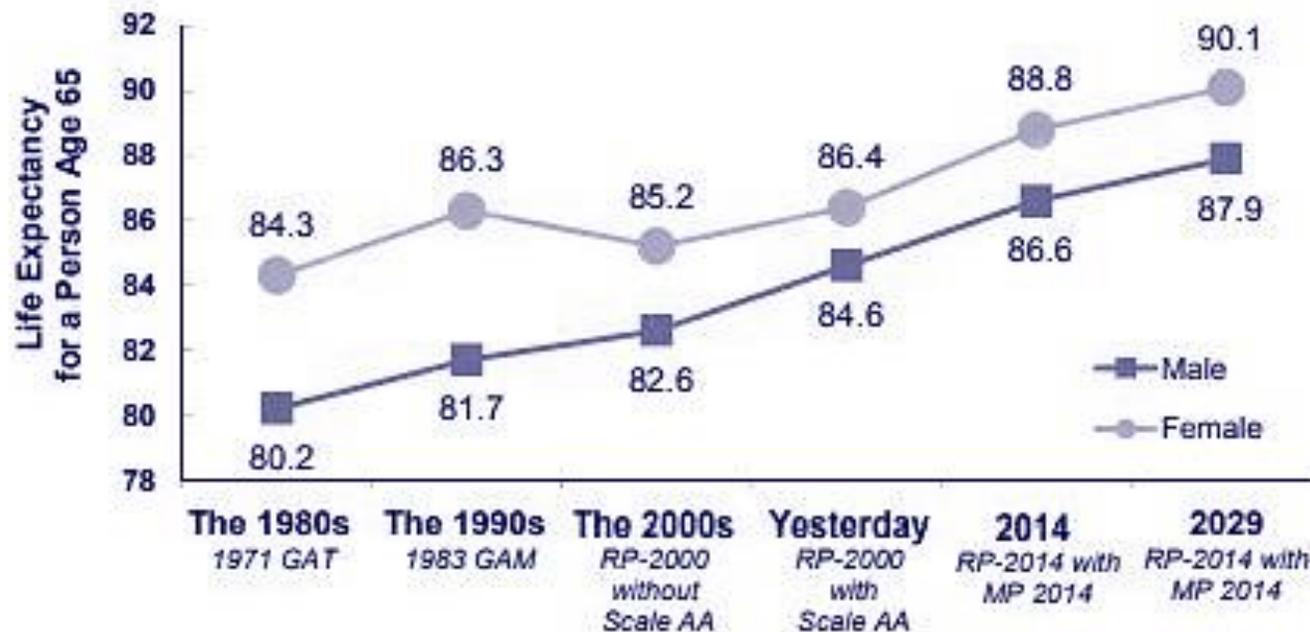
Longer Life Expectancies

State and local governments must also address the fact that people are living longer than current actuarial tables

The mortality assumptions used for pension plans have not been updated in well over a decade—the most recent IRS-required mortality table was published in 2000, and the most commonly used mortality improvement scale was published in 1995[*]

As people live longer, they spend more years in retirement, raising the costs of providing their pensions

[*]Keener, Eric, and Matt Maloney. *Society of Actuaries Finalizes New Mortality Assumptions*. November 2014.

Life Expectancy Increases

This chart, from the Society of Actuaries, shows the predicted life expectancy for males and females using different mortality assumptions published by the IRS

**Keener, Eric, and Matt Maloney. *Society of Actuaries Finalizes New Mortality Assumptions*. November 2014.

Life Expectancy by Age and Gender – 2000 vs 2014*
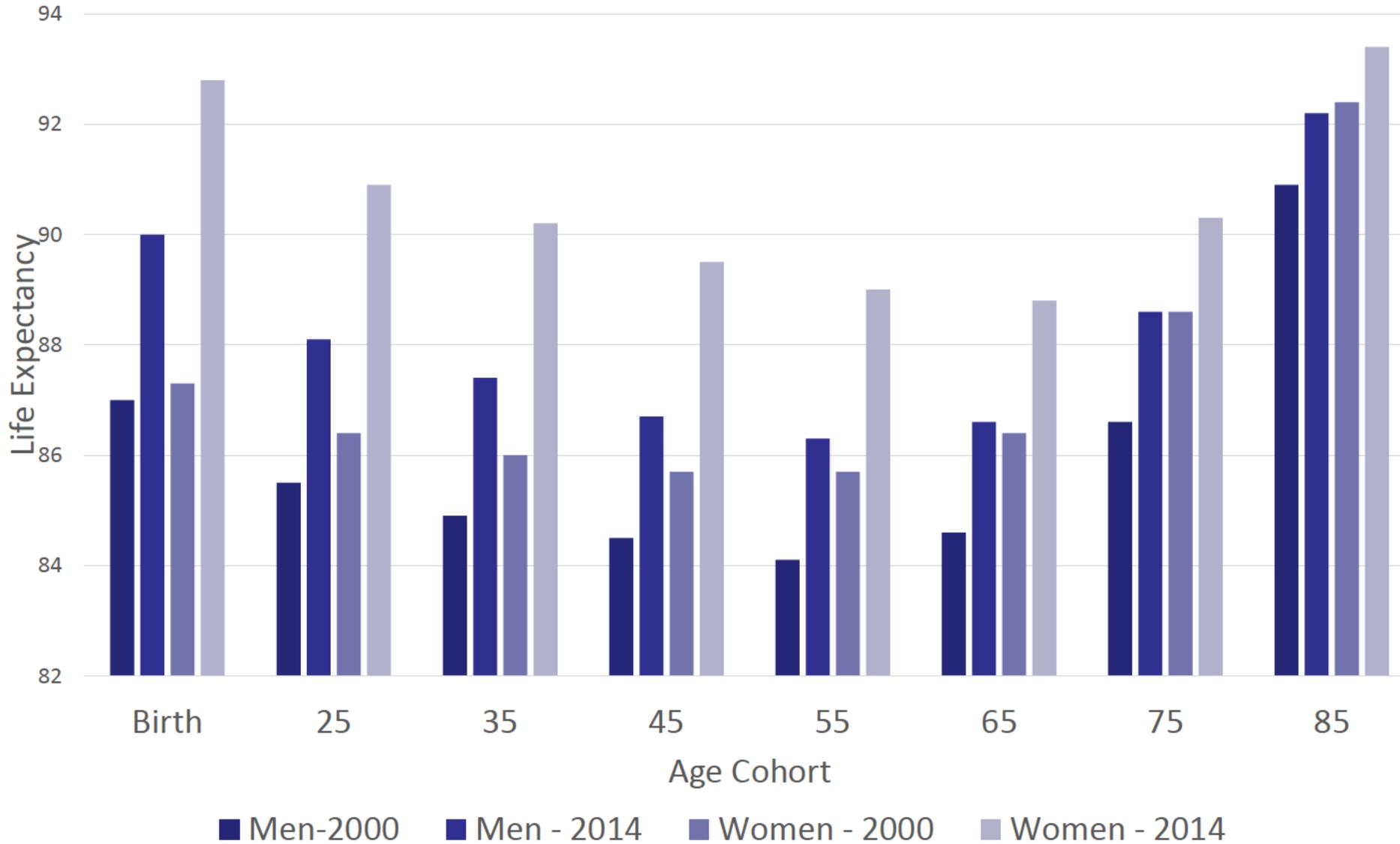
Comparing life expectancy between 2000 and 2014, we see the latter estimates are significantly higher among all age groups

Legend: ■ Men-2000 ■ Men - 2014 ■ Women - 2000 ■ Women - 2014

*Keener, Eric, and Matt Maloney. *Society of Actuaries Finalizes New Mortality Assumptions*. November 2014.

Longer Life Expectancies

According to the Society of Actuaries, if pension sponsors were to use more recent mortality rates, liabilities could **rise by 7%**

After updating mortality rates:
- New York **raised annual contributions rates by 4% and 3.9%** for the Employee Retirement System and Police and Fire Retirement System
- CalPERS **lowered its funded ratio by 5%**
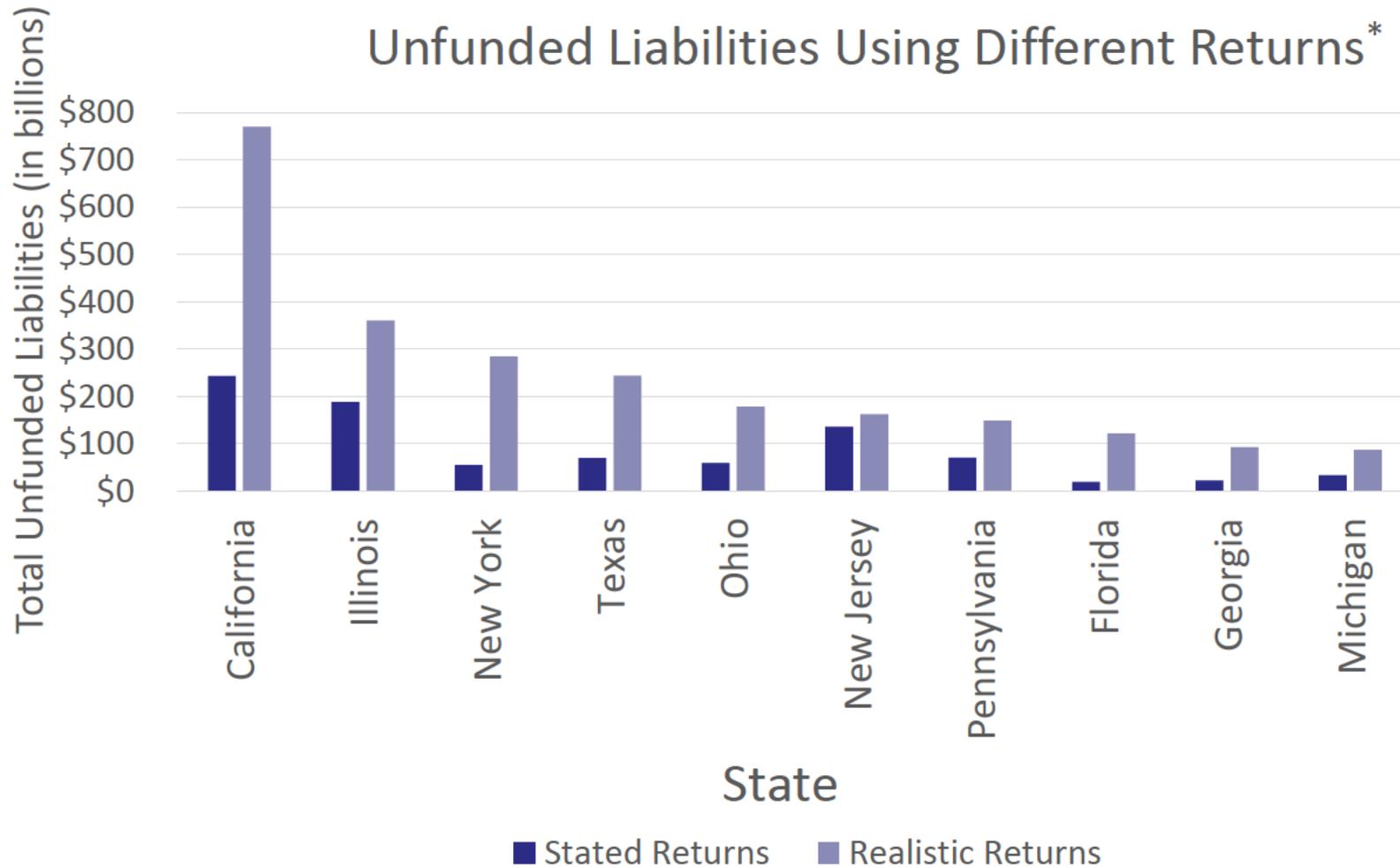- The Minnesota Teachers Retirement Association **gained $600 million in projected liabilities**

Unrealistic Rates of Return

One major cause of the funding gap is the discrepancy between assumed and actual rates of return

The **median annualized 10-year rate of return for public pension plans in 2016 was 5.9%.**[*] The median assumed rate was 7.5%

Even small changes in rates can result in huge changes to unfunded liabilities

*Kilroy, Meaghan. "Cliffwater: U.S. State Pension Plans Returned a Median Annualized 5.9% over 10 Years." Pensions & Investments. October 02, 2017.

Unfunded Liabilities Using Different Returns*

Using data from 2015, we can see that unfunded liabilities rise significantly when using a risk-free rate of return – **Rising by over $525 billion for California alone**

Unrealistic Rates of Return

Pew estimated that investment underperformance in 2016 resulted in an **additional $146 billion** to the funding gap in state and local pension funds across the country
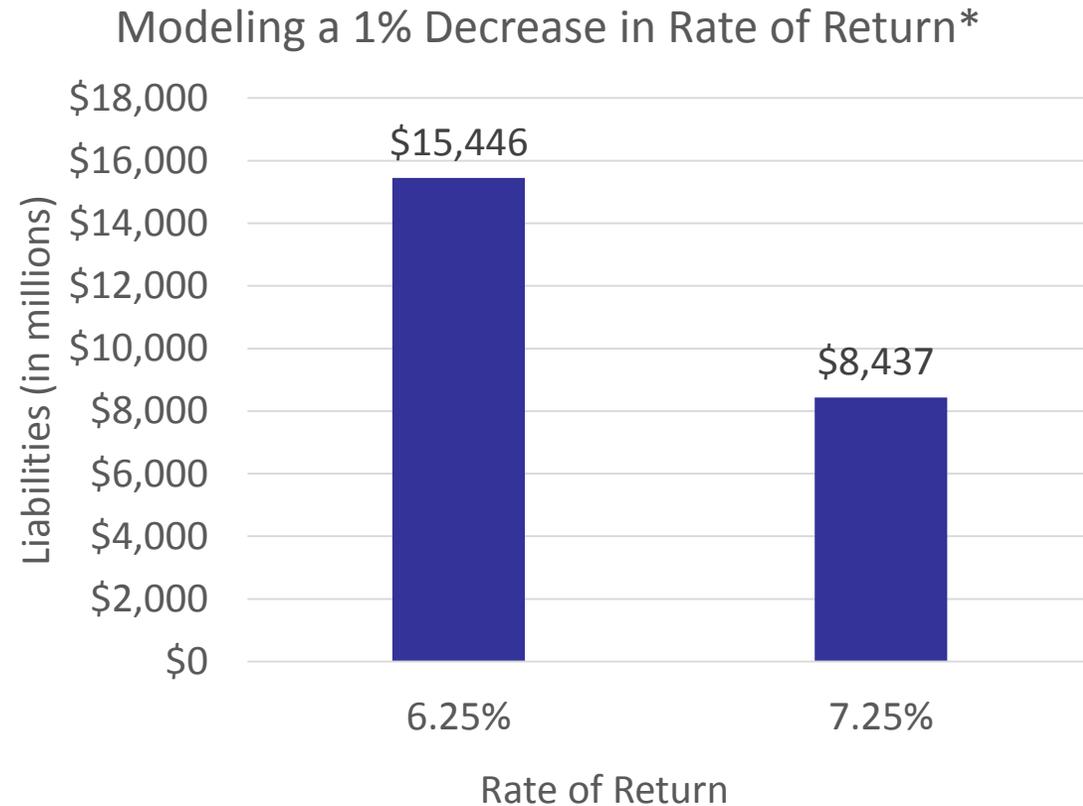
Over the past 30 years, state and local governments have been turning to riskier investments for their pension funds

As these governments adopt riskier portfolios, it is becoming increasingly difficult to accurately predict the rates of return

Case Study: Los Angeles

Los Angeles (LA) has three pension funds totaling over $47 billion in assets

LA assumes a rate of return of 7.25%

Modeling a 1% Decrease in Rate of Return*

Liabilities (in millions)

Rate of Return	Value
6.25%	$15,446
7.25%	$8,437

Rate of Return

Case Study: Philadelphia

The Philadelphia Municipal Pension Fund totals $4.357 billion in assets

Philadelphia assumes a rate of return of 7.75%

In 2016, the average return -3.2%

Modeling a 1% Decrease in Rate of Return*

Bar chart — Liabilities (in millions) vs Rate of Return:
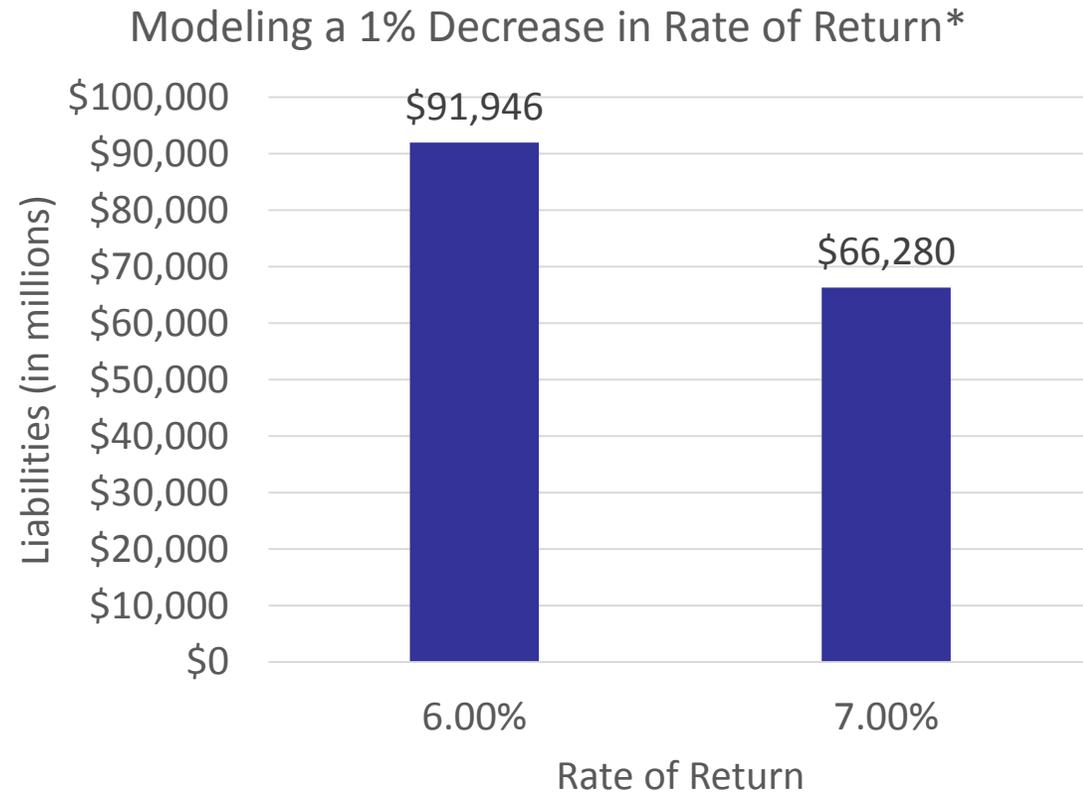- 6.75%: $7,611
- 7.75%: $6,519
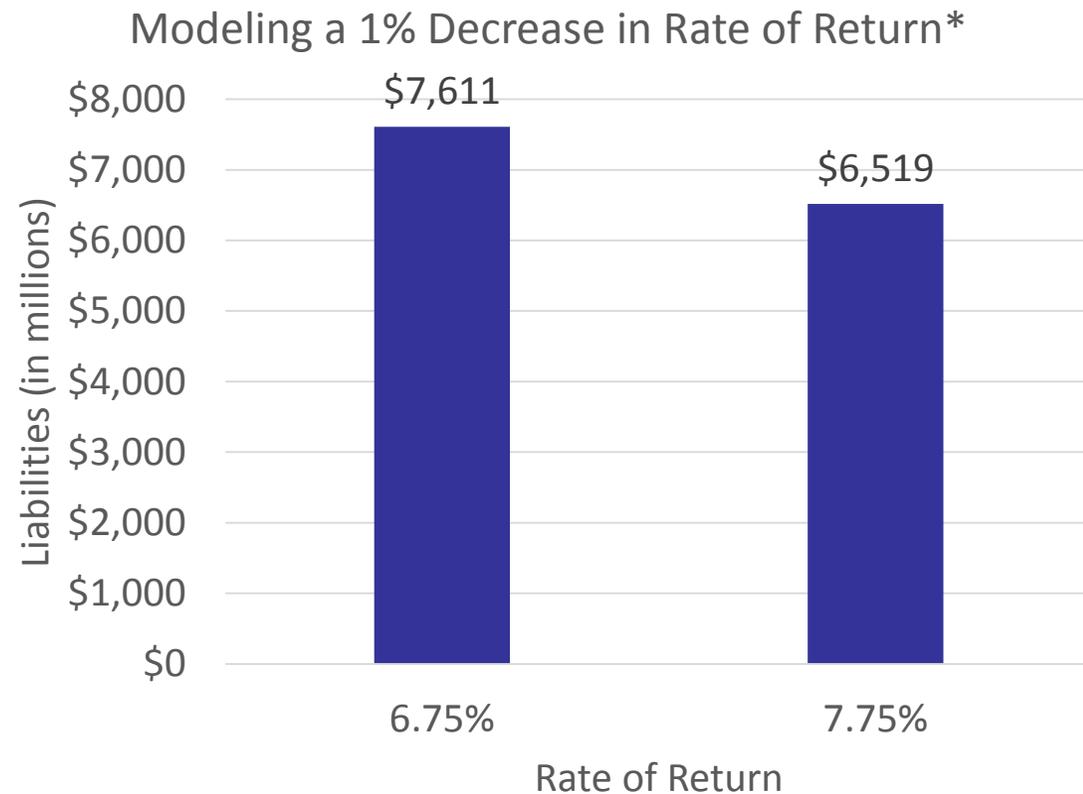
Case Study: New York City

New York City has five separate pension funds with a total of $189 billion in assets and a funding ratio of below 70%

NYC assumes a rate of return of 7%

In 2016, the average return was 2%

Modeling a 1% Decrease in Rate of Return*

Bar chart — Y-axis: Liabilities (in millions), ranging from $0 to $100,000. X-axis: Rate of Return.
- 6.00%: $91,946
- 7.00%: $66,280