U.S. State and Local Pension Risks Amid COVID-19

Volker Alliance, “Special Briefing on Assuring Public Worker Retirement Security Amid COVID-19 Fiscal Stress”

Nov. 19, 2020
How S&P Global Ratings Measures Pension and OPEB Affordability

Funding Discipline

• Actuarial Plan
  – Minimal deferral to future

• Last Year
  – Service cost plus interest (Static)
  – Paying down principal (MFP)

Assumed Rate of Return and Discount Rate

• Currently 6.0%

• Focus on contribution volatility and market shocks

For more information see S&P Global Ratings, Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings; and Guidance FAQ: How S&P Global Ratings Will Implement Pension And OPEB Guidance In U.S. Public Finance State And Local Government Credit Analysis
**Aggregate U.S. State Pension Funding Ratios Remained Stable**

At the time of our survey, a 2019 CAFR was unavailable for California and prior year data is depicted. States with plan reporting periods that align with calendar year-end, we utilized reports ending Dec. 31, 2018. Source: S&P Global Ratings

### Fiscal 2019

#### Highest Funded Ratios (%)

<table>
<thead>
<tr>
<th>State</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Dakota</td>
<td>100.09</td>
</tr>
<tr>
<td>New York</td>
<td>97.97</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>96.45</td>
</tr>
<tr>
<td>Washington</td>
<td>96.26</td>
</tr>
<tr>
<td>Idaho</td>
<td>94.58</td>
</tr>
</tbody>
</table>

#### Lowest Funded Ratios (%)

<table>
<thead>
<tr>
<th>State</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>38.92</td>
</tr>
<tr>
<td>New Jersey</td>
<td>39.73</td>
</tr>
<tr>
<td>Kentucky</td>
<td>44.24</td>
</tr>
<tr>
<td>Connecticut</td>
<td>44.37</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>54.41</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings, Sudden-Stop Recession Pressures U.S. States' Funding For Pension And Other Retirement Liabilities, Aug. 3, 2020
More States Increased Contributions To Cover Growing Liabilities in Fiscal 2019

State Pension Plan Aggregate Actual Contribution Funding Progress

At the time of this report a 2019 state CAFR was unavailable for California and prior-year data is depicted. States with plan reporting periods that align with a calendar year-end, we utilized reports ending Dec. 31, 2018.


At the time of our survey a 2019 CAFR was unavailable for California and prior year data is depicted. States with plan reporting periods that align with calendar year-end, we utilized reports ending Dec. 31, 2018. Source: S&P Global Ratings.
20 Largest U.S. Cities’ Pension Funded Levels Were Stable Entering Fiscal 2020

Top Plans’ Funded Ratios For The Past Two Years

Funded ratio based on most recently available GASB Funded Ratio, as reported in the city’s audit or plan CAFR.

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Source: S&P Global Ratings, Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding, Oct. 26, 2020
Fixed Costs Remain Elevated For Most of the Largest Cities and are Likely to Grow

Source: S&P Global Ratings, Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding, Oct. 26, 2020
Contribution Deferrals

Consistent % of budget
**IF** payroll growth is met!

Pension Obligation Bonds (POBs)

Why the Increase?
• “Arbitrage”
• Contribution smoothing

Considerations
• Market risk
• Contribution trajectory

Source: S&P Global Ratings, Pension Brief: POBs See Increasing Activity In Low-Interest-Rate Environment, Oct. 14, 2020; Image © 2020 by Standard and Poor’s Financial Services LLC. All rights reserved.
Risks on the Horizon for Public Pension Plans

• Governments may reduce required or excess contributions to pension and OPEB plans for budgetary relief

• Persistent low interest rates may increase asset allocation into riskier investment

• Declining public employee payrolls weaken plan demographics and increase future costs

• Issuers may consider taking on additional risk by issuing Pension Obligation Bonds
Select Pension and OPEB Publications

Surveys
- Sudden-Stop Recession Pressures U.S. States' Funding For Pension And Other Retirement Liabilities
- Overall Not-For-Profit Health Care Pension Funded Ratios Are Stable
- Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding
- U.S. States Are Slow To Reform OPEBs As Decline In Liabilities Masks Increased Risk

Financing
- Pension Brief: POBs See Increasing Activity In Low-Interest-Rate Environment
- OPEB Brief: The Credit Impacts Of OPEB Obligation Bonds
- Pension Brief: Are Asset Transfers A Gimmick Or A Sound Fiscal Strategy?
- Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers

Other
- Pension Brief: Liquidity Is A Rising Concern For U.S. Public Pensions In Down Markets
- Pension Brief: Credit Effects Of Municipal Pension Plans Approaching Asset Depletion
- Pension Spotlight: Massachusetts
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