Public Pension Resource Guide

Key Facts & Data

The Role Public Pensions on the Economy and for Employers, Taxpayers, Employees & Retirees

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Overview

- Why Do Pensions Matter?
- Public Pension Basics
- Strong Public Pensions for Today & Tomorrow

Why Do Pensions Matter?

- The offer the best chance for retirement security…
  - Lifetime income
  - Broad based participation
  - Spousal protections & disability benefits
- Ensure self-sufficiency in retirement – 4.7 million fewer households below/close to poverty line in 2006

Why Do Pensions Matter?

- Defined contribution (DC) individual accounts are insufficient as primary source of retirement income…
  - 35% of early Baby Boomers at risk of being unable to maintain pre-retirement income at retirement.
  - Risk ***higher*** for those with no workplace retirement plan (50%), or just a DC plan (49%)
  - Risk ***lower*** for those with DB plans (15%)
  - Even lower for those with DB & DC plan (12%)

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Why Do Pensions Matter?

- Reduce risk of hardship, especially for women & minorities
  - Women, racial, and ethnic minorities at higher risk of retirement insecurity than white males
    - ➢ Earn less over career
    - ➢ Less access to retirement plan
  - DB plans shrink the gap by decreasing percentage of households classified as poor/near poor

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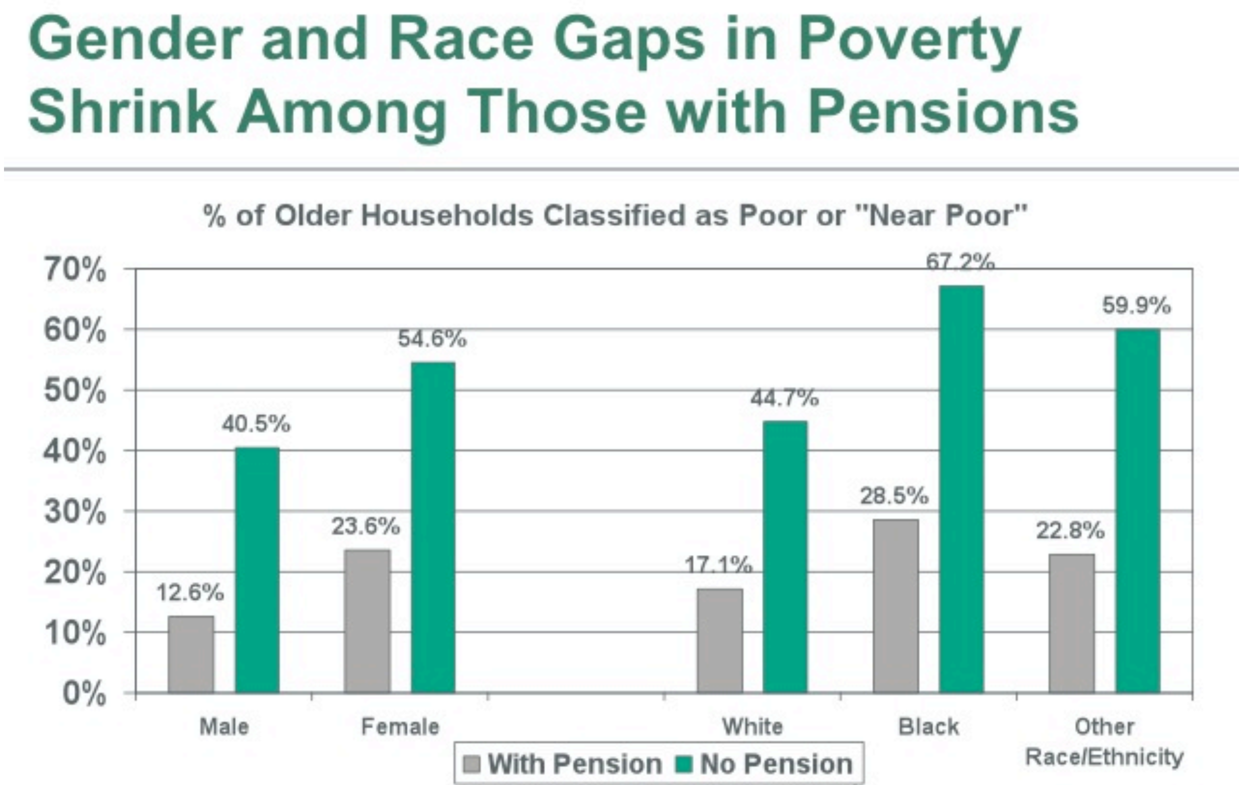
Why Do Pensions Matter?



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Pensions Matter to Employers

- A valued recruitment & retention tool. Research shows:
  - 72% of employees cite retirement benefits a loyalty factor
  - 84% of plan sponsors say pensions have positive impact on retention
  - Pensions reduce turnover by 13% and quit rates by 20%
  - Retention translates into increased productivity

- For public sector employers, pension facilitate recruitment & retention of specialized workforce to deliver public services

Pensions Matter to Taxpayers

- Pensions are economically efficient and can deliver the same retirement benefit as an individual account at HALF the cost.
  - Pool longevity risk
  - Optimal portfolio balancing
  - Higher returns and lower fees

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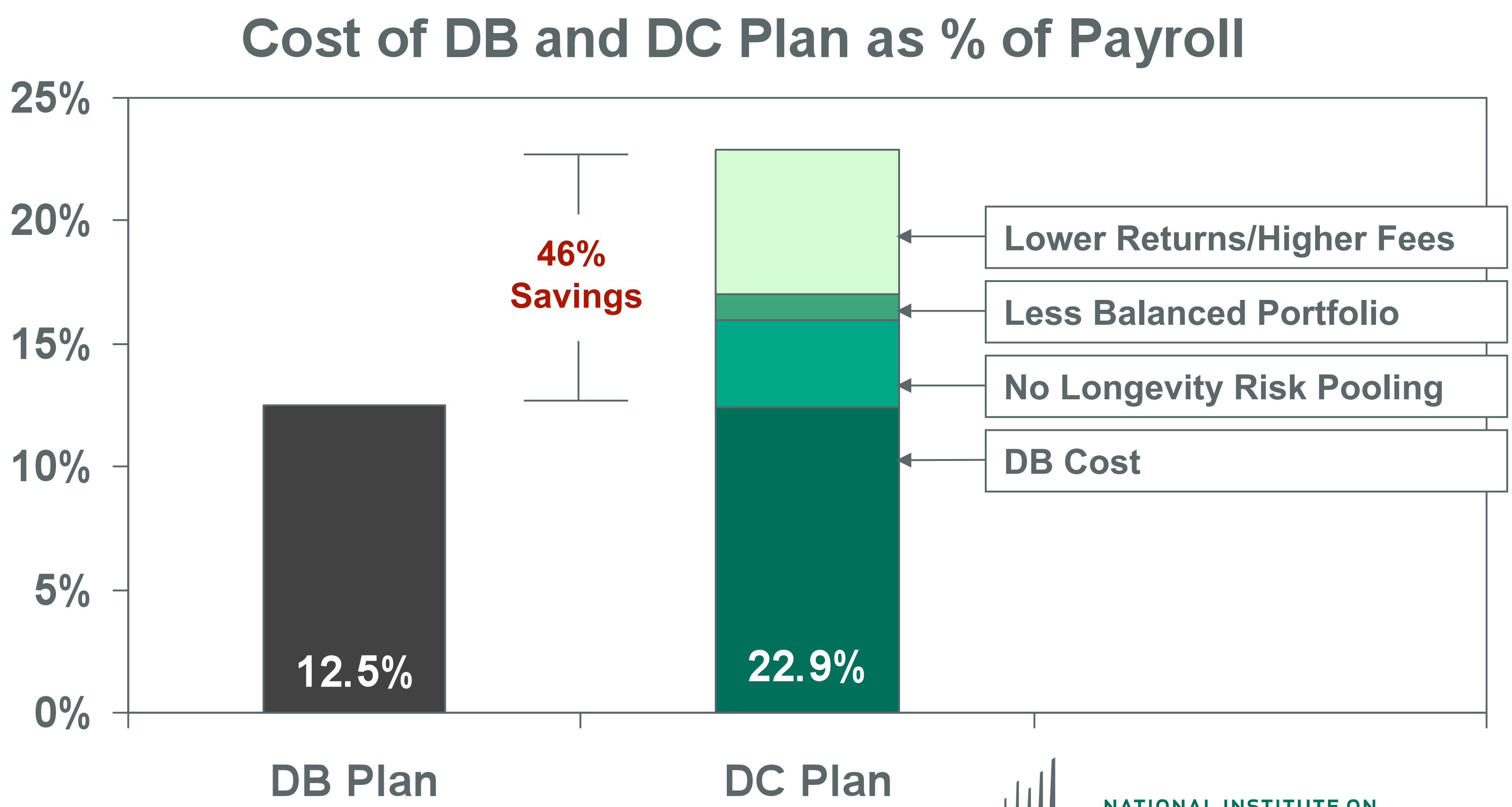
DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plan



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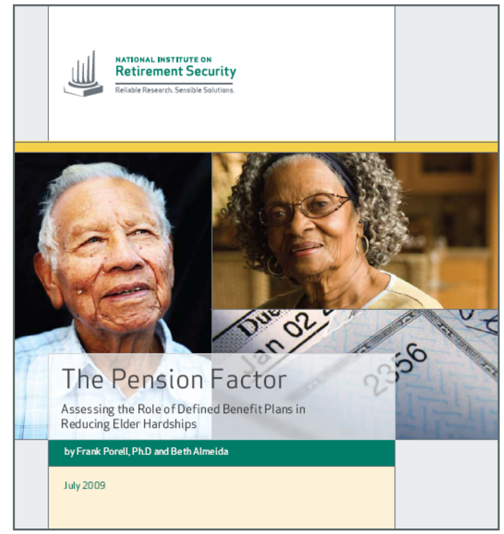
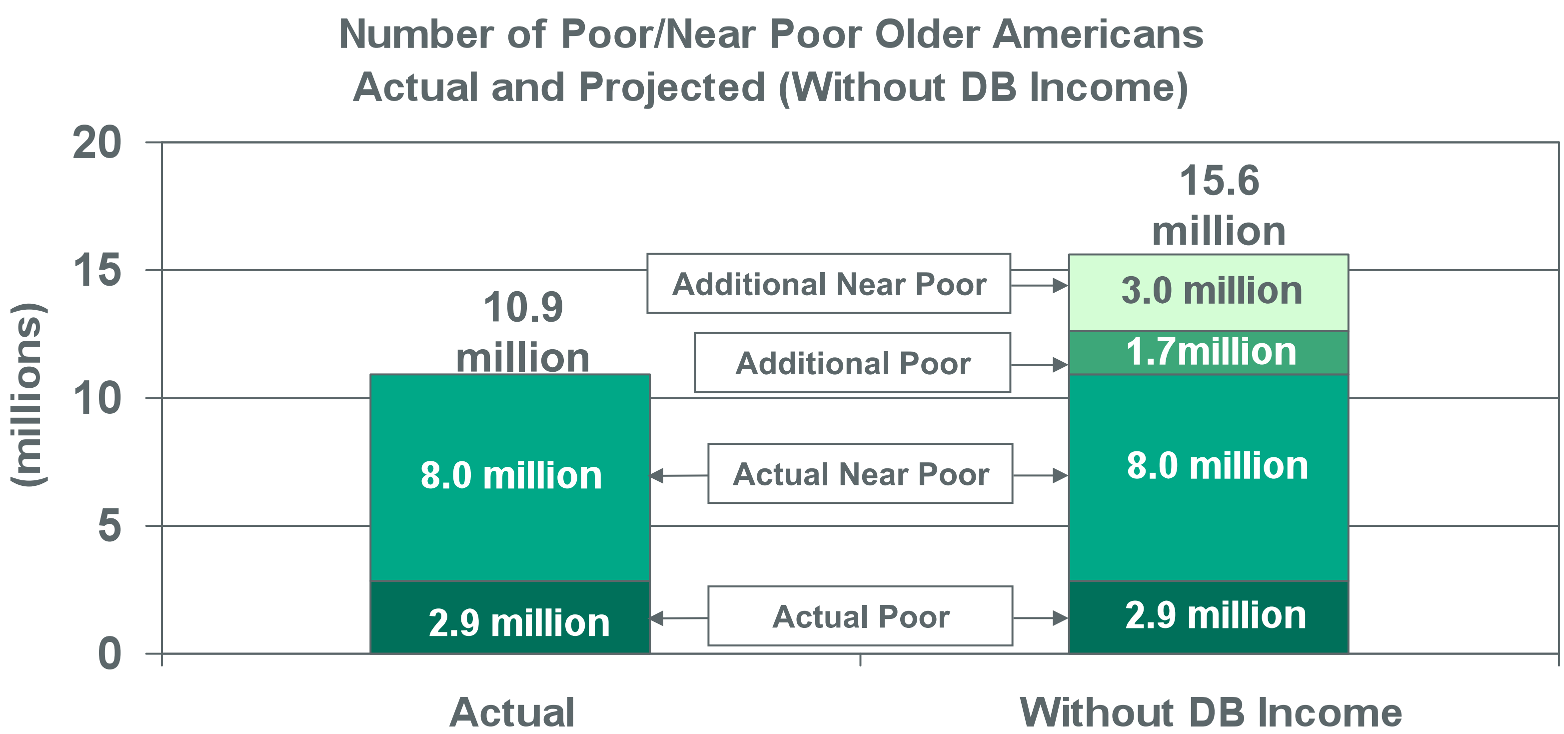
Pensions Matter to Taxpayers

- Pensions save billions in public assistance expenditures. In 2006…
  - Poverty rates ***6x higher*** for older households lacking pensions
  - ***4.7 million*** households avoided poverty/near poverty because of pension income
  - ***$7.3 billion*** in public assistance because lower poverty & hardship means less public assistance expenditures, or



Pensions Matter to Taxpayers



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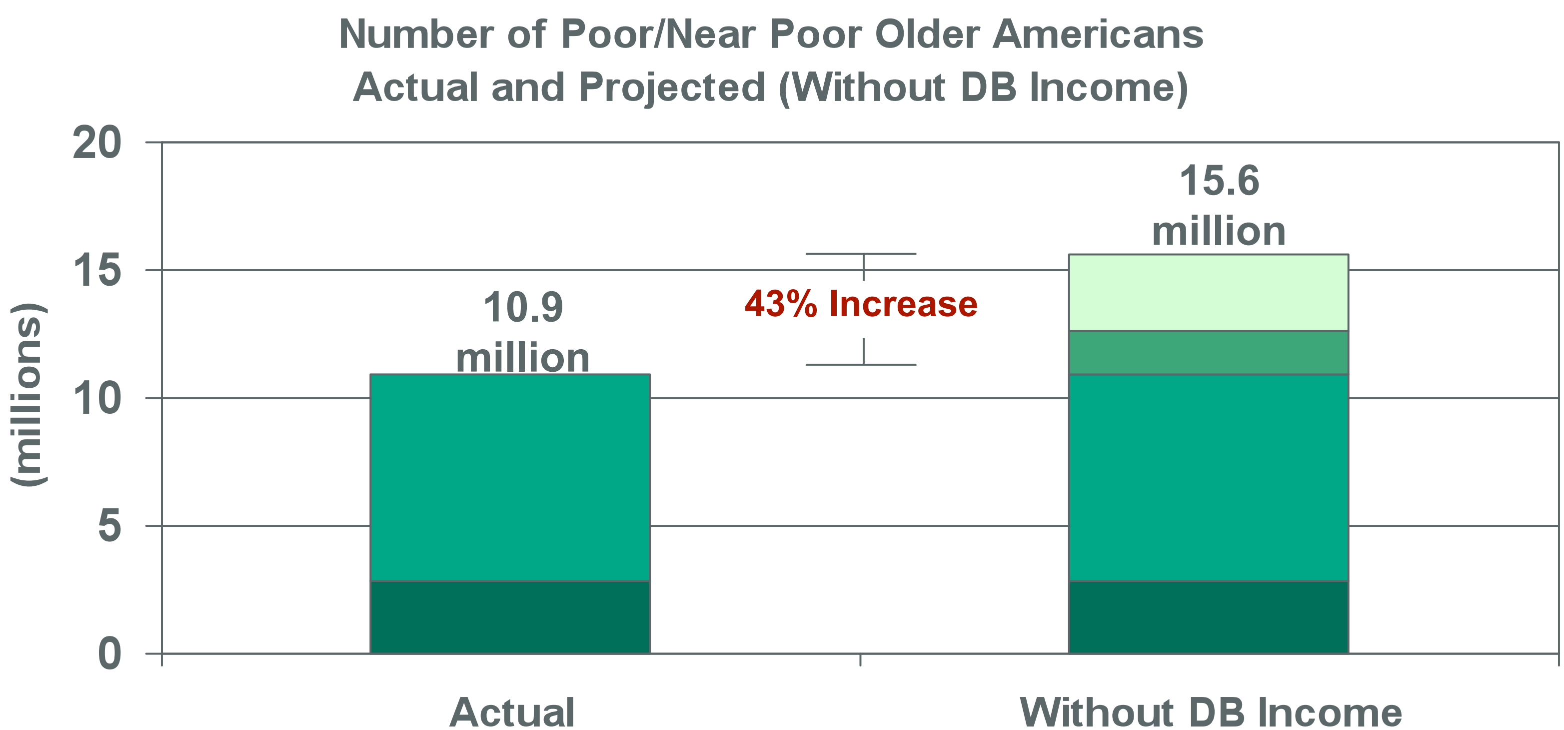
Pensions Matter to Taxpayers



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Pensions Matter to the Economy

Public pension expenditures by retirees have a deep economic footprint. In 2006, pension expenditures supported…

- ***2.5 million*** American jobs that paid more than ***$92 billion*** in total compensation
- ***$358 billion*** in total economic output
- ***$57 billion*** in federal, state, local tax revenue

Pension are "automatic stabilizers" for the economy. In tough times, retirees with a pension continue spending on basic needs.

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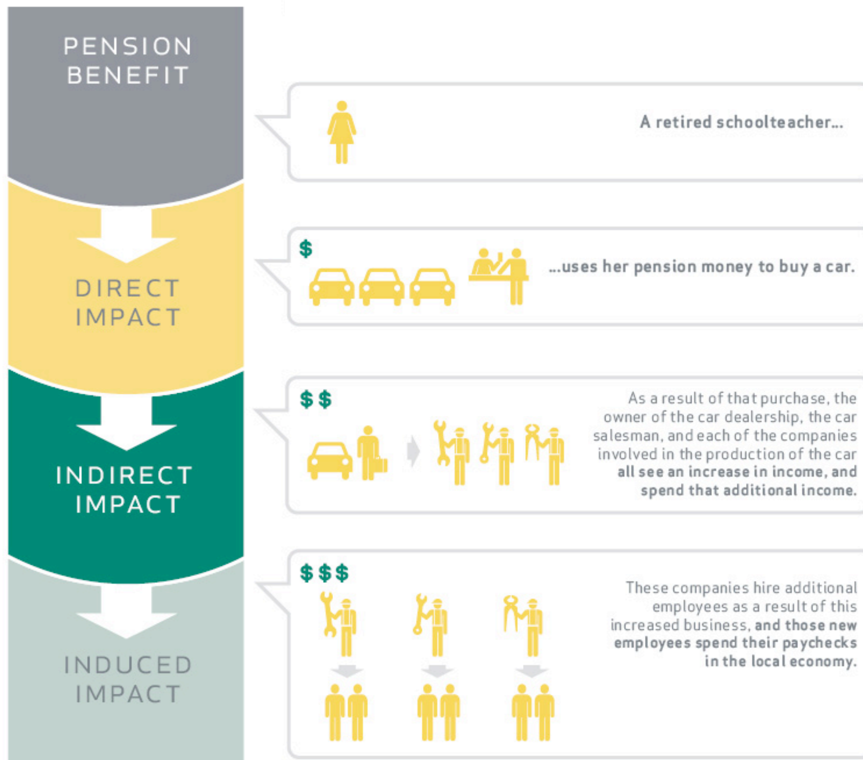
Pensions Matter to the Economy

The economy benefits by a "ripple effect" when a retiree spends a pension check in the local community.



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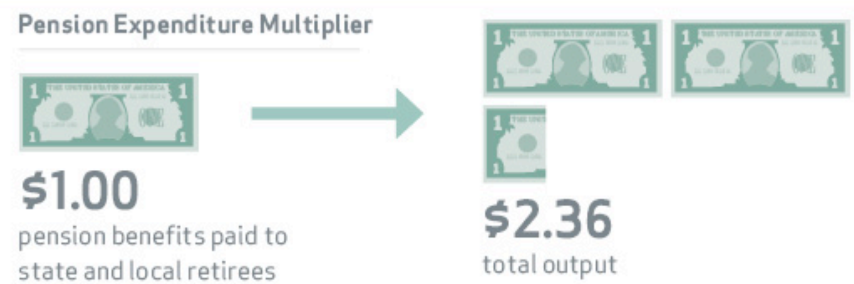
Pensions Matter to the Economy

Public pension expenditures have large multiplier effects. For 2006…

- Every dollar paid out in benefits generated $2.36 of total output in the economy.



- Every dollar contributed by taxpayers supported $11.45 in economic output.

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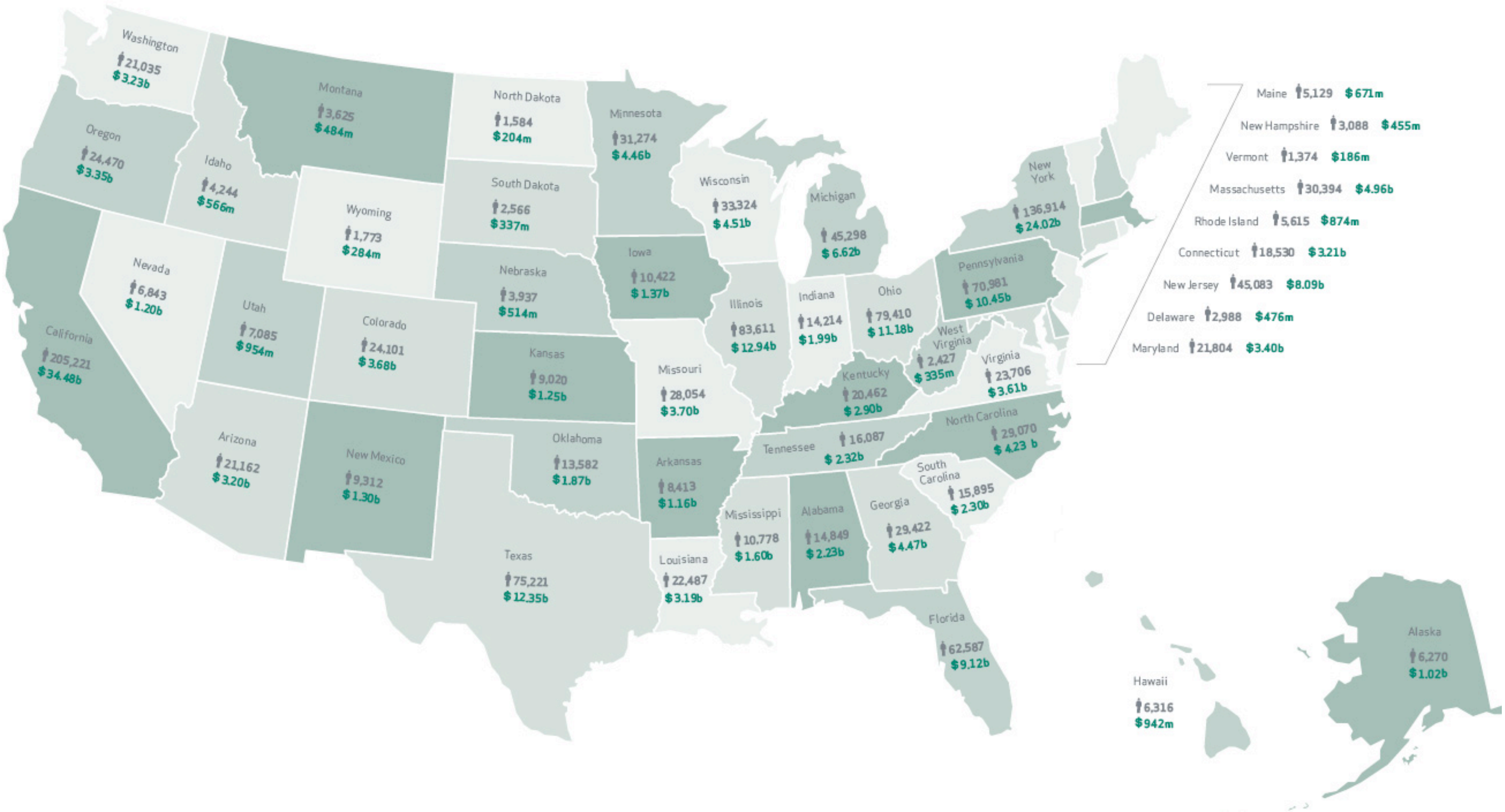
Pensions Matter to the Economy

in every state and municipality in the country.



Pensions Matter to Capital Markets

- Pensions invest assets in the capital markets – stocks, bonds, mutual funds, and alternatives.
- As long horizon investors, pensions provide "patient capital".
- Pension assets provide business capital to develop products, invest in technologies, and create jobs.
- Pension investments account for much of the growth of venture capital between 1980 ($4 billion) and 1990 ($28 billion).
- This VC has launched companies like Federal Express, Staples & Starbucks.

"The U.S. venture capital industry would not be the economic it is today without the strong investment participation from defined benefit pension plans."

Sherrill Neff testimony before the US Congressional Joint Economic Committee, July 10, 2008

Public Pension Basics

What is a pension?

- A traditional pension plan is a group retirement plan that offers a predictable monthly defined benefit in retirement.
- It provides workers with a steady, predictable income stream in retirement that cannot be outlived.
- The average public pension benefit in 2006 was $20,947 per year or $1,746 per month.

Public Pension Basics

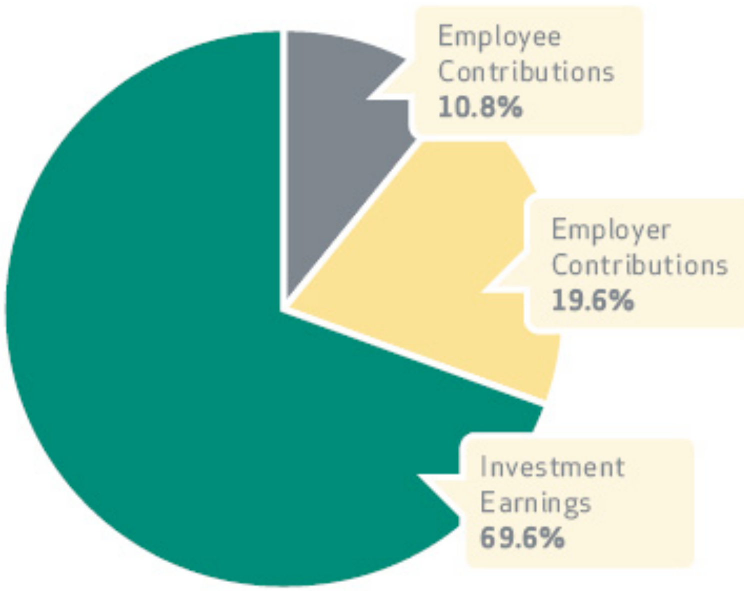
How are pension benefits earned?

- After an employee has worked a certain number years, he or she is "vested" or eligible to receive pensions benefits.
- The benefit is usually a function of three elements:
  - Years of service with the employer;
  - The worker's pay;
  - A fixed multiplier determined by the plan.

Public Pension Basics

How are pensions funded?

- Public pensions are pre- funded
- Contributions are usually made by both employees and the employer.
- Investment earnings pay for most of the benefits – 70% from 1993-2007.



Aggregate Contributions by Source, 1993-2006

Public Pension Basics

How are pension contribution rates determined?

- An actuarial analysis determines the how much employers and employees need to contribute annually to the plan.
- It is important to make this ‘actuarially required contribution” on time. Postponing payments can:
  - Increase the ARC in future years;
  - Damage the credit rating and increase borrowing costs for the plan sponsor; or
  - Create a situation over time where the plan sponsor has insufficient assets to pay benefits.

Public Pension Basics

How are pension contribution rates determined?

- In recent years, public pensions have been diligent in pre-funding obligations.
- Recent research indicates that public pensions have more than 80% of funds to pay future benefits.
- The vast majority of public pension systems are right on track in meeting their pension obligations.

Public Pension Basics

How are investment decisions made?

- Trustees oversee pensions and have a fiduciary obligation to ensure the plan is operating in the best interest of workers and retirees.
- Trustees hire professional asset managers to steer investments.
- Plans maintain a balance portfolio of stocks, bonds, alternatives and cash. This is consistent with modern portfolio theory.
- Public pensions are prudent investors in both bear and bull markets.

Pensions by the Numbers

- Who has a pension? Among older American households in 2006…
  - Half of the 31.6 million older Americans had pension income
  - 9.4 million had pension income from private sector jobs
  - 3.9 million older Americans had pension income from public sector jobs
  - 1.7 million older households had both public and private sector pension income

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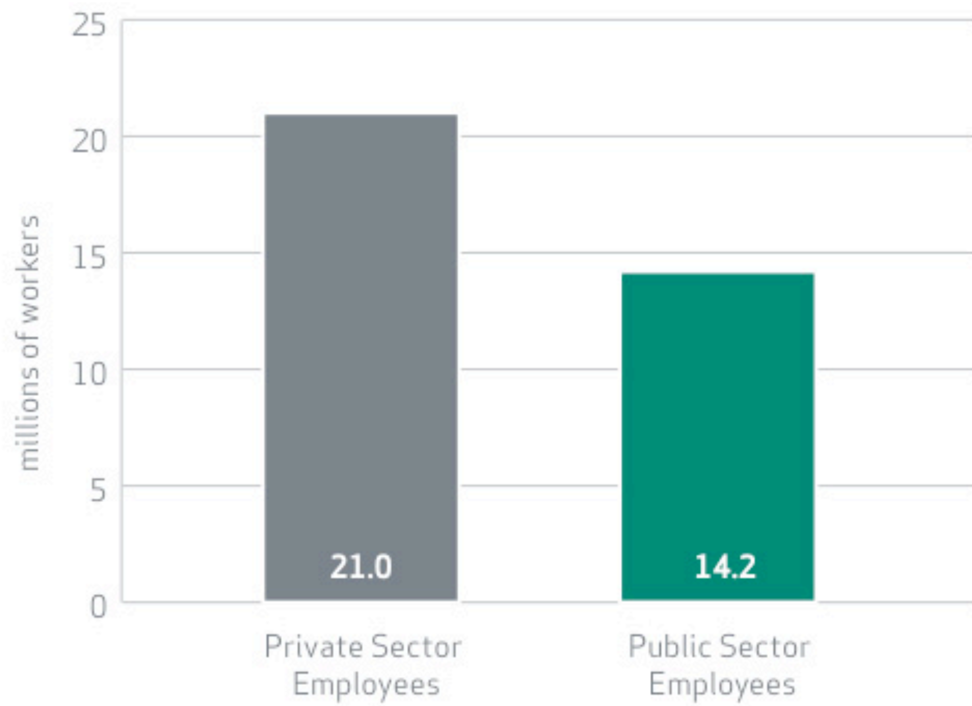
Pensions by the Numbers

- Who has a pension? Among U.S. workers in 2007…



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Pensions by the Numbers

- Who has a pension? Among demographic groups in 2006…
  - 23% of women and 42% of men.
  - 31% of white women, 26% of black women, 17% of Asian women, and 13% of Hispanic women.
  - Among racial/ethnic groups, 33% of whites, 32% of blacks, and 23% of Hispanics aged 60+.

Pensions by the Numbers

- How much pension income to Americans typically receive? In 2006…
  - For Americans aged 60+, the average benefit was $15,784 annually and median benefit was $11,467.
  - For women aged 60+, the median pension benefit from a former employer was $8,400 as compared to $13,500 for men.

Strong Public Pensions for Today and Tomorrow

- Pensions well suited benefit employees, employers, taxpayers, and the economy.
- The financial crisis has brought attention to ensuring long-term health and vitality of *all* retirement plans.
- All stakeholders share a common interest in the ensuring pensions are adequately funded and prudently financed.

Strong Public Pensions for Today and Tomorrow

Integration of benefit, funding, and investment policies enhances long-term pension sustainability.

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Strong Public Pensions for Today and Tomorrow

- Defining the three elements:

1. Funding Policy – how contributions to the plan will be made
2. Investment Policy – how contributions are invested
3. Benefit Policy – how employees earn benefits

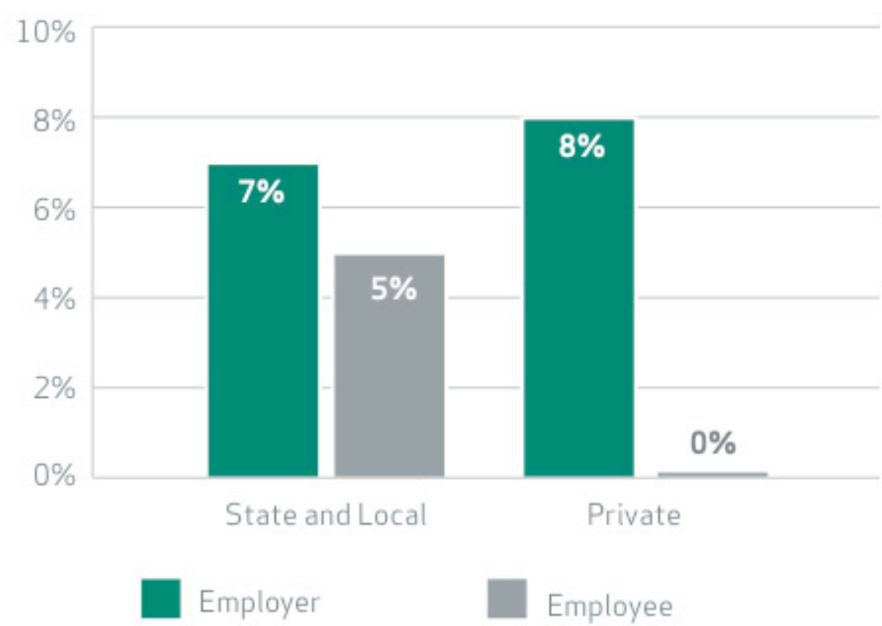
Strong Public Pensions for Today and Tomorrow

- A disciplined funding policy is important to plans' financial health.
- A plan should aim to achieve full funding over a reasonable period of time. This means….
  - Funding the ARC
  - Affordability and shared responsibility for funding.

  - In the public sector, employees contribute, reducing the funding burden on employers.

Strong Public Pensions for Today and Tomorrow

Employer and Employee Contributions as a Percentage of Payroll, by Sector



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Strong Public Pensions for Today and Tomorrow

- Funding & investment policies can support contribution predictability…
  - Government employers need predictable costs.
  - But, cyclical nature of investment returns present challenges.
  - Smoothing asset values and amortizing investment returns can reduce volatility if implemented in disciplined manner in good and bad years.

Strong Public Pensions for Today and Tomorrow

- Funding & investment policies can support intergeneration equity, meaning that those who enjoy public services at a point in time should pay the costs of services.

  – Actuaries apply estimates of long-term rates of return based on a plan's portfolio to calculate pension contributions.

  – The median assumed rate of return is 8% in the public sector, and 8.25% in the private sector.

  – The use of volatile, uncertain interest rates is likely to create a mismatch between a plan's assets and liabilities and is inconsistent with intergenerational equity.

Strong Public Pensions for Today and Tomorrow

- A comprehensive benefit policy integrated with funding and investments can address the following key considerations that come into play when designing benefit plans:
  - Recruitment & Retention
  - Benefit Adequacy
  - Transparency & Fairness

Public Pension Resource Guide

Available at www.nirsonline.org

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Public Pension Basics

OVERVIEW

A traditional pension plan, also called a defined benefit (DB) pension plan, is a pooled retirement plan that offers a predictable defined monthly benefit in retirement. A DB pension provides retired workers with a steady income stream that is guaranteed for the remainder of the retiree's life.[1]

In the public sector, the DB pension has been a steady approach for providing retirement benefits for decades, through good times and bad. Although these benefits are quite reasonable—the average pension benefit received in 2006 was just $20,947 per year, or $1,746 per month[2]—they go a long way in providing for the retirement security of older Americans.[3] Additionally, the public sector employs a shared financing model in which both employers and employees contribute to the pension fund over time, which helps to manage the pension's cost to state and local governments.[4]

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PUBLIC PENSION RESOURCE GUIDE

Why Do Pensions Matter?

Research has long shown that traditional defined benefit (DB) pension plans make sense for most Americans. This is because traditional pension plans offer middle-class Americans secure and adequate retirement benefits, which help to ensure that they remain in the middle-class into retirement. But DB pension plans are not just good for employees—they also make sense for employers, as well as the broader community.

For employers, DB pension plans are a fiscally responsible and cost-effective way of providing broad-based retirement benefits for workers. Also, especially in the public sector, DB pensions help human resource managers to recruit and retain the highly educated and skilled workforce that they require. Finally, DB pensions have a broad economic footprint, supporting jobs and economic output in local economies throughout the United States, and providing much-needed patient capital to domestic equities markets.

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PUBLIC PENSION RESOURCE GUIDE

Strong Public Pensions For Today and Tomorrow

Most state and local government employers offer a defined benefit (DB) pension plan as the primary retirement plan for their employees. The prevalence of DB pension plans in the public sector reflects the appeal of these plans to employees, employers, and taxpayers. From the employee perspective, DB plans are well suited to provide employees with an adequate, predictable retirement benefit that cannot be outlived. DB plans are also very effective in helping public employers recruit and retain skilled employees. Finally, DB plans can be a highly efficient way to provide retirement benefits, thanks to the group nature of these plans. In other words, DB plans make good use of taxpayer dollars.

But the crisis that gripped global financial markets in

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