The ADVISOR
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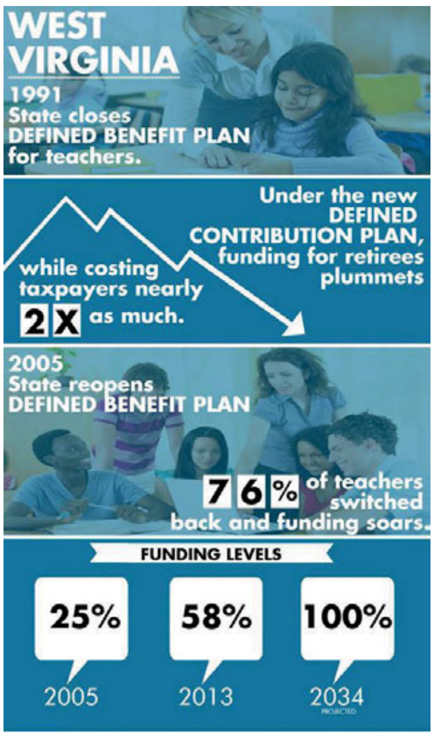

Source: National Institute on Retirement Security Public Pension Resource Guide February 2015

Myths and Truths about Pensions

SOURCE: NATIONAL PUBLIC PENSION COALITION

In the conversation around public pensions, there are a lot of myths that get repeated over and over again. We're going to dispel three of the most common myths here.

Myth #1: Pensions are Underfunded and Unsustainable

Truth: Most public pensions are back on sound financial footing after the Great Recession and on a path to full funding. Recently, the Center for Retirement Research at Boston

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There is No Pension Crisis RSA Is Sound and Healthy

BY LEURA G. CANARY, GENERAL COUNSEL

There seems to be a national and local trend in the news of criticizing public pensions generally and, in Alabama, RSA specifically. The gist of the argument is that public pensions are too expensive and on the brink of failure leading to the conclusion that there is a public pension crisis both nationally and in Alabama. Our members should rest assured that there is no pension crisis in Alabama. RSA is sound and heading in the right direction.

There are three factors that are key to the health of any public pension plan: (1) does the state pay the actuarially determined contribution every year, (2) is the plan design sustainable, and (3) does the plan have a responsible funding policy? In the case of RSA, the answer to all three questions is **yes**.

First, the Alabama Legislature should be commended because it is in the minority of state legislatures that have always paid the full actuarially-determined contribution every year. And it has not always been easy. It would be much more politically advantageous to skip a payment every now and then (like Illinois, New Jersey, and Kentucky) and instead use the money to pay for more politically popular things, like pay raises or new state programs. But the Alabama Legislature has wisely realized that what may seem like a short-term win could lead to disaster in the long run. A missed payment now would result in hundreds of millions of dollars of additional unfunded liabilities that could cripple the system later. Unfortunately, the Legislature doesn't get the recognition or appreciation it deserves for doing the right thing by fully funding RSA and keeping the commitments to teachers and state employees.

Second, the RSA plan design is sustainable. In 2012, the Alabama Legislature determined that a change in benefits for new employees was necessary to ensure the continued sustainability of the plan. These changes are projected to save $4 billion over the next 30 years and have made RSA more affordable and less risky for taxpayers and members. This guarantees that our pension system will be around to pay the promised benefits to current and future employees.

Third, the plan's funding policy, adopted by the RSA Boards, is responsible and designed to further improve the fiscal health of the pension plans. Under the new policy, the regular employer contributions made by the Legislature will pay off the unfunded liabilities of the plans over time in a way that balances the affordability of the plan with the desire to improve the plans' funded ratio.

It should also be noted that RSA has historically met its assumed investment rate of return of 8%. According to RSA's third party custodian, State Street, who calculates RSA's investment returns, RSA's weighted average 25-year investment return is 8%. This includes two of the worst market downturns since the Great Depression.

Finally, don't just take my word for it: Keith Brainard, the Research Director of the National Association of State Retirement Administrators, and a national expert on the state of public pensions, recently testified before the Joint Committee on Alabama Public Pensions. He testified that although some state and local governments face difficult pension funding challenges,

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Second Meeting of the Joint Committee on Alabama Public Pensions

BY NEAH MITCHELL, LEGISLATIVE COUNSEL

On October 5, the Joint Committee on Alabama Public Pensions held its second meeting at RSA Headquarters to hear presentations from RSA staff and pension experts regarding the state of RSA. After an introductory presentation, the staff and experts presented information on trends of public pensions nationwide, how RSA compares on actuarial funding, and RSA investments. The conclusions from each presentation were that RSA is fiscally healthy and headed in the right direction. Below are a few highlights from each presentation.

INTRODUCTION (LEURA CANARY, RSA GENERAL COUNSEL)

RSA administers defined benefit plans for its 339,237 members. In fiscal year 2014, it paid $2.9 billion in benefits. These benefits are funded from investment earnings, employee contributions, and employer contributions. In 2014, employer contributions constituted 20.7%, member contributions comprised 12.8%, and RSA investment earnings of $3.7 billion accounted for 66.5% of RSA's total income.

In recent years, RSA's funding ratio has declined for three main reasons: (1) market meltdowns and recessions of 2001-2 and 2008-9, (2) unfunded benefits, and (3) the refinancing of the unfunded liability every year.

RSA's funding ratio improved in 2014 and is expected to continue to improve. A number of things have come together to reverse the trend of a decline in funding:

- a bull market and high investment returns (average annualized returns of almost 11% for the past five years);
- no unfunded benefits since 2006;
- a funding policy that will pay off the unfunded liability over time;
- savings from in-house investing (currently saves an estimated $160 million annually over average investment costs for public pension plans), and, most importantly;
- 2011-2012 legislative pension reforms projected to save over $4 billion in the next 30 years.

PUBLIC PENSION TRENDS (KEITH BRAINARD, RESEARCH DIRECTOR FOR THE NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS)

Although there are states that have yet to resolve their pension problems, pensions in Alabama appear to be stable, costs are well-known, fairly predictable, and measured as a percentage of all state and local government spending, are relatively low. In addition, the Alabama Legislature has a commendable record of paying 100% of required pension contributions, which has helped keep RSA healthy.

Nearly every state has modified public pension benefits, raised employee contributions, or both since 2009. These changes have contributed to improved funding levels for most plans, including Alabama. **The pension reforms already passed by the Alabama Legislature are among the most extensive in the country.** And while some states have implemented alternative plan designs, the substantial majority of states, including Alabama, have retained a traditional defined benefit plan.

RSA public pensions are less expensive than the national median cost of public pensions. Alabama public employers' spending on pensions is 2.87% of their total spending, well below the national average of 3.9%. The employer normal cost of Alabama Tier I state employee and teacher pension benefits is approximately one third of the national median employer normal cost of about 6%. Alabama Tier II state employee and teacher pension benefits are even cheaper, with a normal cost to Alabama public employers of less than 1% of payroll.

Given that the normal cost to the state of the pension plans are less than one percent of payroll, policy makers should consider whether any further changes should be made.

ACTUARIAL FUNDING (ED MACDONALD, CHIEF ACTUARY FOR CAVANAUGH MACDONALD)

The actuarial firm that produces valuations for RSA pension plans is well experienced in the field of public pensions and currently acts as the actuary for 15 statewide retirement systems and a large number of smaller public retirement systems.

The funded ratios of both ERS and TRS rose in the FY 2014. The RSA Boards' change in the amortization method will result in an increasing funded ratio and

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There is No Pension Crisis RSA is Sound and Healthy

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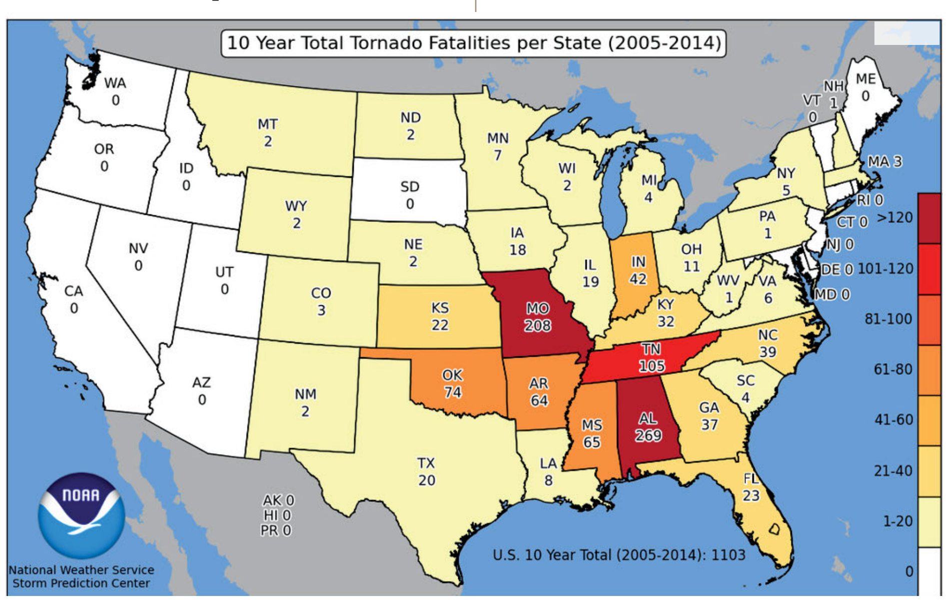
RSA is stable, has relatively low costs and, barring an unforeseen national economic collapse, is safe. Mr. Brainard also pointed out that the Alabama Legislature enacted substantial reforms in 2012 that have enhanced the pension plans' affordability and sustainability. This independent expert concluded that there is no pension crisis in Alabama



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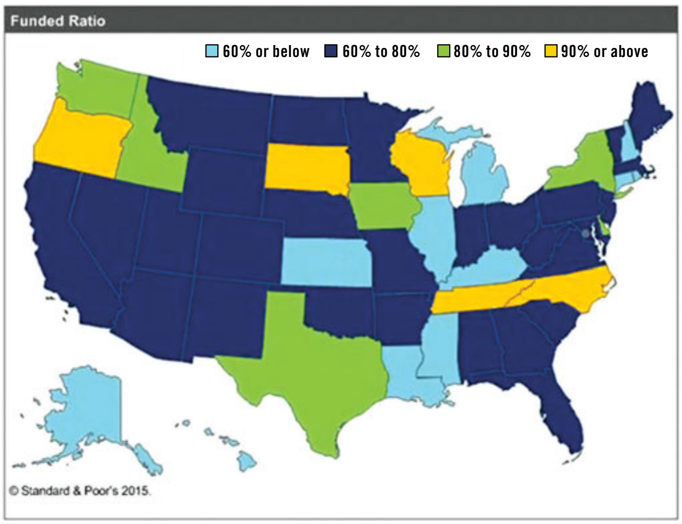
College predicted public pensions would achieve sustainable funding levels by 2018. One of the most important indicators of a healthy pension fund is a state's actuarially required contribution (ARC). The ARC represents the amount of money a state needs to contribute each year in order to maintain a balance between money coming in and money going out.



Myth #2: States are Abandoning Defined Benefit Pensions

Truth: Far from abandoning traditional defined benefit pension plans, states in recent years have rejected bills that would convert their pension systems to riskier 401(k)-style accounts. Not only that, but certain states are considering moving back to defined benefit plans. In Alaska, a state that moved to a defined contribution system with disastrous consequences, State Senator Bill Wielechowski has introduced legislation to return to a defined benefit system. In a recent editorial in the *Greeley Tribune*, he warns other states not to follow Alaska's path:

"…legislators should heed the warnings of states such as of Alaska, where we've learned 401(k)-style plans not only diminish recruitment, retention and retirement security, but actually cost the state more. When states act responsibly, Defined Benefit pension plans are the most cost-effective way to provide workers with retirement security… Recognizing the negative effects of retreating from a Defined Benefit pension plan, we have also introduced legislation to reinstate this option."

Myth #3: 401(k)-style Plans Offer a Secure Retirement to Workers

Truth: 401(k)-style defined contribution plans have failed to live up to their hype. Instead of assuring a safe and secure retirement for workers, defined contribution plans can offer only a fraction of the value of a defined benefit plan, often at much higher cost. Under a defined contribution scheme, retirement resources are not pooled, not professionally managed, and workers must determine how much to contribute to their retirement. Study after study has shown that workers fail to plan adequately for retirement. Defined contribution plans also leave their participants exposed to a great amount of market risk. During the Great Recession, for example, the value of many investments in 401(k) accounts was wiped out by the stock market crash. This left many retirees with no savings for retirement, even if they had been saving for decades.

Reality: Defined benefit pension plans afford the safest and most secure retirement for teachers, firefighters, nurses and other public workers who spend decades working for the public good and have earned their retirement.

Second Meeting of the Joint Committee on Alabama Public Pensions

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will ultimately result in the payoff of the unfunded liability. Currently, the market value of the assets held by the RSA plans exceeds the actuarial value because recent gains have yet to be recognized. The recent Alabama pension reforms lowered risk to the employer by substantially reducing the cost of benefits.

Because the normal cost for Tier II benefits is so low and because the existing unfunded liability must be paid, **the alternative plan designs that have been suggested to replace the current defined benefit plan (such as the cash balance plan and hybrid plans) will be substantially more expensive** to the state than the existing Tier II defined benefit plan. Implementation of one of these alternative plans is projected to cost the State an additional $5 billion to $30 billion more over 30 years depending on the plan selected.

RSA INVESTMENTS (MARC GREEN, RSA'S CHIEF INVESTMENT OFFICER)

RSA investments are made in accordance with governing statutes and board policies. RSA investment staff manage the day-to-day investing. This staff of 18 includes 12 chartered financial analysts (CFAs). To put this in perspective, there are only 178 CFAs registered in all of Alabama.

As of June 30, 2015, RSA's assets were allocated in line with other public pensions, with 65% allocated to public/private equity, 24% in fixed income, and 11% in alternatives. For the year ending September 30, 2014, TRS earned 12.13% and ERS earned 12.02%. **RSA's investment returns for 1 and 3 years were in the top 14% and for 5 years were in the top 25% among peer public pension plans.** Although final numbers are not in, RSA's returns for FY 2015 are expected to be flat.

RSA's weighted average 25-year investment return is 8%.

The full presentations are available online at www.rsa-al.gov.

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The Battle House,
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- December 2-3, 5-10, 13-17, 24-29
- January 2, 6-12, 16-21

The Renaissance Riverview Plaza – Mobile – $99
- November 1-2, 4-5, 12, 21-30
- December 1-3, 6, 11-18, 24-27, 30
- January 1-2, 6-7, 11-13, 17-18

Marriott Grand – $109 plus a 15% resort fee
- November 3-5, 8-12, 15-19, 24, 29-30
- December 1-3, 6-9, 13-14, 20-22, 27-30
- January 3-7, 10-14, 17-18, 24-28, 31

Marriott Grand – RSA Golf Package – $179
plus a 15% resort fee – Promotional code–R2A
Includes: Deluxe Room, One Round of Golf for Two People.
Call for Tee Times after booking package
- November 3-5, 8-12, 15-19, 24, 29-30
- December 1-3, 6-9, 13-14, 20-22, 27-30
- January 3-7, 10-14, 17-18, 24-28, 31

Marriott Shoals – Florence – $99;
Breakfast Package $124
- November 8, 15, 19, 22-25, 29-30
- December 3, 5-7, 13-14, 17, 20-30
- January 1-5, 7, 10-11, 14, 17-18, 21, 24-25, 28, 31

Renaissance Ross Bridge – Hoover – $109
- November 1-2, 8-30 • December 1-30
- January 1-18, 22-31

Opelika Marriott – $99
- November 1-3, 15-16, 19, 22, 26, 29-30
- December 1, 8-10, 13, 15-17, 22-31
- January 1-12, 18-19, 21, 24-25, 29-31

Prattville Marriott – $89
- November 5, 7-8, 12, 14-16, 19, 22-26, 29-30
- December 1, 3-7, 8-13, 15-31
- January 1-11, 14-19, 23-26

Renaissance Montgomery – $109
- November 1-3, 9-10, 22-25
- December 9, 11-12, 20-27
- January 2-9, 13, 17-18, 23-27, 31

RSA Spa Package – **$189 – Promotional code–R2A**
- November 3, 10, 24-25 • December 9, 11-12, 22-26
- January 2, 5-9, 13, 23, 26-27

Specific room requests may require additional charge. Rates available the 1st of the month and are not applicable to groups.
800-228-9290 Ask for RSA rate. **Promotional Code: R2A** on www.rsa-al.gov
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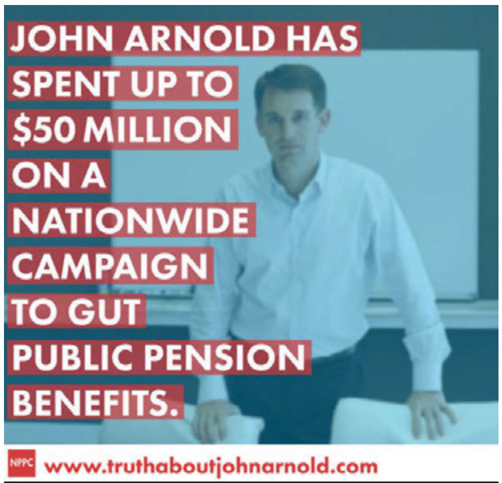

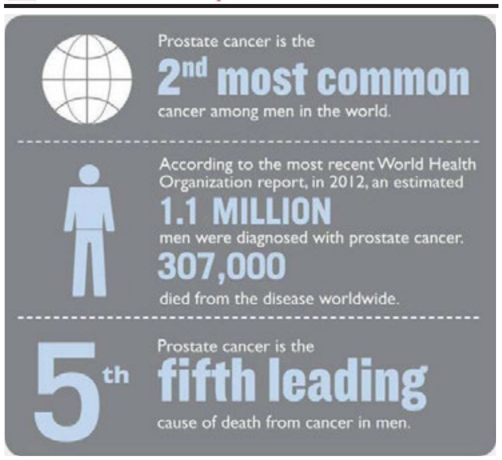

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