



GLOBAL CONNECTIONS, LEGAL SOLUTIONS

Municipal Pension Reform

October 15, 2012

There is a \$1 trillion shortfall

- Total US state & municipal shortfall is **\$1 trillion**
 - \$3.5 trillion pension obligation
 - \$2.5 trillion assets on hand
 - **75% funded**
- Aggressive actuarial assumptions
 - Assumes **8%** average investment earnings



Many believe the shortfall is larger

Other organizations estimate the shortfall in the \$2-4 trillion range

Note: Moody's shortfall estimated July 2012; State Budget Solutions is an Alexandria-based think tank



Pew findings show mixed results on a state by state basis



- In 2000, **just over half the states had fully funded pension programs**
 - By 2006, that number had shrunk to six
 - By 2008, only four: Florida, New York, Washington, and Wisconsin
- By 2008, many states were struggling
 - In **8 states, total pension liability was only two-thirds funded**: Illinois, Kansas, Kentucky, Massachusetts, Oklahoma, Rhode Island, and West Virginia
 - 2 states, Illinois and Kansas, had less than 60 percent of the necessary assets on hand
- Other Post-Employment Benefits (OPEB)
 - 40 states need improvement**
 - 20 states have no assets** on hand to cover these obligations



There are a lot of reform initiatives, but few have succeeded

- Pension taskforces are top of mind

- Google search for “pension taskforce” yields over 6 million results



- Even initiatives that seem to have succeeded face legal challenges

- Rhode Island (Nov 2011): led by State Treasurer Gina Raimondo

- San Diego and San Jose: approved by voters in June 2012, litigation to follow



City of Atlanta tackled pension reform in 2010-2011

*"The stark reality is that **one out of every five tax dollars is currently going to fund a pension system that is strangling our city.** We need to face this challenge head on, being mindful of the responsibility to taxpayers who fund that pension system, without breaking the faith with the public servants who have dedicated their lives to Atlanta."*

Mayor Kasim Reed,
Inaugural Address January 4, 2010



Atlanta faced a worsening pension situation by 2009

Pension structure: defined pension, no social security

**FUNDING FOR PENSION LIABILITY
DECLINED**

**ANNUAL REQUIRED CONTRIBUTION
(ARC) INCREASED**

\$3.5 billion
liability

23% of city's
operating
budget



Problems were in part due to changes in plan design

- Growth in ARC due to **market performance** and **plan design**
 - Market performance of assets accounted for two thirds of the growth
 - Changes in plan design caused one third of the growth
 - Active litigation regarding 2001 plan design changes
- As a result, S&P and Moody's **downgraded Atlanta**
 - Moody's issued Negative Outlook due to **lack of financial capacity and political will**



Atlanta Pension Panel Charter tightly defined the initiative's scope and taskforce's role

WHAT THE PANEL WILL DO

- 1. *Where are we?*** Delineate the facts
- 2. *What could we do?*** Identify our options
- 3. *How could we get there?*** Describe the relative path forward

WHAT THE PANEL WILL NOT DO

- Audit and investigate the past
- Recommend, endorse, or champion any single option



Process design proved critical for success

- Created an independent review panel
 - Included elected officials, employee representatives, business leaders
- Presented the facts, explain the complexity of the matter, and initiated a comprehensive “deep dive”
- Raised \$1.5M for professional fees
 - Hired lawyers, actuaries, accountants, and communications consultants
- Conducted four panel meetings to create transparency
 - Open to the public, employees, and media
 - All reports available at www.Atlantaga.gov

Atlanta reduced pension liability by more than \$500 million through reform efforts

- End-to-end process took **~18 months**
- With union acceptance, Atlanta's City Council **voted 15-0** for pension reform
 - Existing employees keep defined benefit plan; new employees switch to hybrid system
 - Existing employees increase cash contribution and share in investment risk
- Reform reduced pension liability by more than **\$500 million** and annual cost by **\$25 million**
- **No litigation**



Key insights from Atlanta Pension Reform

It's all about process

- Get commitment from decision makers up front
 - Risk of becoming another "task force" or "study group"
 - Pension issues create political risk for elected/appointed officials
- Find the right Chairman
 - Must be neutral, independent and credible in the community
 - Able and willing to face the community and take criticism
- Get the right stakeholders and experts to the table
 - Employees/unions, academics, politicians, business people
 - Independent consultants, lawyers, accountants, actuaries
- Be open and transparent
 - Open records, open meetings, open data
 - Everyone working from the same fact base
- Clearly define scope and charter for the panel
 - Panel provides facts and options; decision makers own the solution
 - Forward looking; no evaluation of the past



Overview of legal issues encountered

- Federal level

- United States Constitution: Contract Clause, 5th Amendment, and 14th Amendment
- Statutory provisions: government plans and ERISA

- State level

- State constitutional issues
- State or local legislative concerns

- Litigation

- As of July 2012, **at least 25 states have had pension cases**



Potential role of State Capital Group member firms

- Historical involvement in government
- Identification of opportunities
- Critical role in advising on pension reform efforts
- Potential litigation

