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BLUE MODEL CRACKUP

Ratings Agency Calls Pension Returns Into Question

A major ratings agency has soured on the ability of state and local pension funds to achieve the rate of return they will need to stay solvent without benefit cuts. *Pensions & Investments* reports:

> Fitch Ratings will now discount U.S. public pension plan liabilities at a 6% investment return assumption, down from the current 7%, according to a news release from the ratings agency.
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> The ratings agency released the new updated U.S. public finance tax-supported rating criteria on Wednesday.
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> "U.S. growth has been slower and more incremental over the current economic expansion than over longer time horizons. There is little evidence to suggest the economy will accelerate to previous levels of growth in the near term. Fitch believes that pensions will be hard-pressed to achieve their long-term growth expectations in the current economic context," said Douglas Offerman, senior director at Fitch Ratings, in the news release.

Many funds currently expect returns in the seven to eight percent range. Fitch's downgrade could increase pressure on funds to reduce their expected return. This in turn will require governments to choose between either reducing benefits—setting the stage for a major battle with public sector unions—and increasing state contributions—requiring either tax hikes or cuts to public services like education and infrastructure.

California's pension fund, for example, recently cut its expected return from 7.5 percent to 7.375 percent. Even this modest reduction has put the squeeze on many local governments; going all the way down to 6 percent would require huge increases in contributions that would force many localities into bankruptcy.

The crisis of public finance at the state and local level remains an under-covered story with potentially far-reaching consequences. And without a clear path for reform, the vise is only getting tighter.

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