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US public pension deficits squeeze city and state budgets

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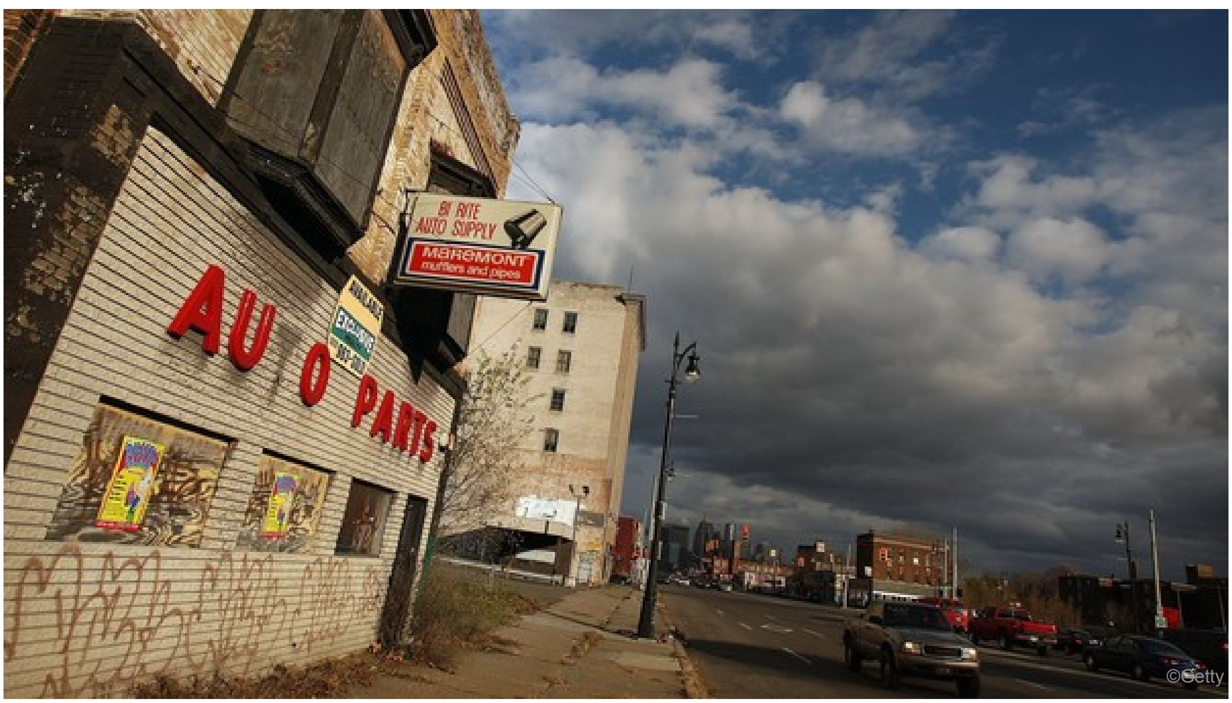

A $3bn public pension deficit contributed to Detroit's bankruptcy

The health of the US public pensions system is deteriorating. The latest figures reveal that retirement plans have less than three-quarters of the assets they need to pay current and future retirees.

The growing pension deficit is putting "enormous" pressure on US cities and states, said Amin Rajan, chief executive of Create Research, a consultancy. It also raises concerns that some public retirement funds might not be able to pay out in future.

According to Wilshire Consulting, an institutional investment advisory company, state-sponsored pension plans in the US had just 73 per cent of the assets they needed in mid-2015, down from 77 per cent in 2014.

“Before the recession, many of these plans were fully funded or nearly fully funded,” said Russ Walker, vice-president of Wilshire Consulting.

In 2007, the state pensions’ funding ratio, a measure of assets to liabilities, stood at 95 per cent. An 80 per cent funding level is generally considered the minimum healthy level for public pension plans.

Large pension funding gaps have caused big problems for many US cities and states, including Detroit, where a $3bn public pension deficit contributed to the city’s bankruptcy.

Josh Rauh, a finance professor at Stanford University, said: “Cities such as Chicago and Philadelphia, and states such as Illinois and Kentucky, are already feeling the pinch as pension contributions are consuming increasing shares of their budgets.”

The full scale of the underfunding problem is likely to be even greater than Wilshire’s figures show, because of how the pension plans measure their funding levels, Mr Rauh added.

City and state officials have tried to take steps to close the pension funding gap, such as requiring new employees to make greater contributions to retirement plans.

Officials at pension schemes are also working hard to close the deficit, said Hank Kim, executive director at the National Conference on Public Employee Retirement Systems, a trade association for public pension plans in the US.

“The plans have learnt greatly from the financial crisis. Risk is a big concern and they have taken steps to mitigate any investment downside,” he added.

However, Tamara Burden, principal at Milliman Financial Risk Management, an investment adviser to pension funds, said many schemes are relying more than ever on making up the funding gap by assuming “exceptional asset returns”.

“Relying on strong asset returns in today’s market is a scary place to be,” she added.

Despite strong stock market performance in the year to mid-2015, many US pension plans found it difficult to meet their return targets, according to Wilshire.

Pension funds are likely to struggle for performance in the year to mid-2016, thanks to volatile trading conditions during the third quarter of 2015 and the start of this year.

Mr Rajan said US public pension schemes are in a difficult place. “Tackling the problem means unpalatable choices: fresh cash injections or reduced retirement benefits or increased retirement age, or some combination of the three.”

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