Testimony of
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Via Webcam

Good morning. My name is Hank Kim and I am executive director and counsel of the National Conference on Public Employee Retirement Systems (NCPERS). I would like to thank the co-chairs of this task force, Senator White and Representative Copeland Hanzas, for their leadership in convening ongoing hearings as they work to determine how to design and fund pension benefits in the future. I was very appreciative when Representative Gannon reached out to my organization this summer after reading a number of our reports this summer.

I am pleased to speak on behalf of NCPERS, the largest trade association for public sector pension funds. We represent more than 500 funds throughout the United States and Canada, including Vermont State Employees Retirement System. Through our members, we are the voice of 11 million beneficiaries and nearly 15 million active public servants — including but not limited to firefighters, law enforcement officers, teachers, judiciary employees, judges and elected officials.

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Before I dive in, I would like to commend the task force for undertaking a thorough analysis of state employees' and teachers' pensions. The deliberate, careful approach this task force is pursuing should prove very helpful in understand the net economic impact of pension reform in Vermont.

Public Pensions in Perspective

Defined-benefit pensions provide public employees a safe, reliable retirement plan that does not put all the risk on the individual. They are highly regulated and are operated with professional money management. They have three income streams: Employer contributions, employee contributions, and income earned on the investment portfolio.

No one becomes a firefighter, police officer or teacher to get rich. They choose these jobs to serve their communities. One reason public servants are willing to accept pay that is below private-sector levels is because they also have the opportunity to earn a pension.

Pensions are not a gift to employees—they are a cornerstone of the compensation benefits package offered to public servants. Workers earn their pensions as they go, and they consistently put in their own contributions. In fact, they make their contributions through thick and then, whether or not their governmental employers come through with their own contributions. Many state and local have had the unfortunate experience of not receiving their statutorily mandated employer contribution, even though employees had no choice but to continue to pay.

Pensions are important, but on average they are very modest. Nationally, the average Defined Benefit pension benefit in 2020 was $28,852 a year, less than $2,400 a month. In Vermont the average pension benefit was 31 percent less than the national figure - $21,954. Even a modest pension can underpin a secure and dignified retirement.

Unintended Consequences Study

NCPERS publishes a biennial study titled "Unintended Consequences." Its centerpiece is a one-of-a-kind, state-by-state analysis of the economic and revenue impact of public pensions. We develop impact estimates using the latest aggregate pension data published by the U.S. Census Bureau's Annual Survey of Public Pensions. We also draw on economic and revenue data from public sources including the Bureau of Economic Analysis and the U.S. Census of Governments.

Our study is unique in that it estimates how investment and spending connected to pension funds impacts each state's economy and revenues.

Our approach is to develop an estimate of what the combined economic impact of investment of assets and payments of pension checks means for state revenues. We then compare the revenues attributable to public pensions with employer or taxpayer contributions to public pensions to examine states' net revenue impact.

It’s important to note that this Census Bureau data has a two-year time lag. Thus, our latest report for 2020 draws on 2018 data, while the 2018 report draws on 2016 data.

Let’s take a look at what the data show. Table 1 compares the economic and revenue impact data of 10 public pension plans in Vermont for 2016 and 2018.

Table 1. Why Revenue Impact of Public Pensions Moved from Net Positive in 2016 to Net Negative in 2018

($ in Millions)

Characteristic	**2016**	**2018**
Total Assets	$4,100	$4,650
Total Pension Checks Issued	$340	$390
Economic Impact of Investment of Assets	$22	$30
Economic Impact of Spending of Pension Checks	$854	$977
Total Economic Impact of Public Pensions	$876	$1,007
Revenue Impact of Public Pensions	$165	$191
Taxpayer Contributions	$153	$204
Net Revenue Impact	$12 (165-153 = 12)	-$13 (191- 204 =-13)
Number of Pension Plans (according to Census)	10 (3 state and 7 local)	10 (3 state and 7 local)

Allow me to walk you through these numbers. As you can see, Table 1 shows that the assets of 10 public pension plans in Vermont rose to $4.65 billion in 2018, up 13.4% from $4.1 billion in 2016.

During the same period, the benefits paid in the form of pension checks increased to $390 million, up 14.7% from $340 million in 2016.

The economic impact of investment of assets and payments of pension checks on Vermont’s economy as measured by personal income increased to $1.01 billion in 2018, up 15.3% from $876 million in 2016.

The revenue impact of public pensions in Vermont increased to $191 million in 2018, up 15.8% from $165 million in 2016.

Employer contributions during this period increased by 33%—to $204 million in 2018, versus $153 million in 2016.

Here is an important observation: Vermont's net revenue position turned negative in 2018. What that means is that the revenue impact of pensions was lower than the amount that employers—that is, taxpayers—put into the plans. The net revenue position was negative $13 million in 2018, versus a positive $12 million in 2016.

Is a negative figure cause for concern? Is it reason for hand-wringing and predictions of gloom and doom? No, it is not. What was going on in 2018 was that the state was making contributions to pay down the pensions' unfunded liability—in effect, making up for payments that were skipped or underpaid in prior years. What you're seeing in these numbers is the overlay of short-term fiscal policy on a long-term pattern of pension investing and payments to beneficiaries. The data are all "going in the right direction"—the only significant change is that during this period, Vermont's government applied more money than usual to pensions because it was actively trying to make up previous shortages on payments it was supposed to make.

Sustainability Study

In addition to biennial study of the economic and revenue impact of public pensions, we are conducting a state-by-state study on sustainability of public pensions.

What do we mean by sustainability? It means our ability to keep paying on the commitment the state has made to public sector employees.

Much of the focus on public pensions' ability to pay benefits has focused on a figure called the funding ratio. This calculation compares how much in assets the pension plan has on hand at a given moment versus its future needs and expresses the result as a percentage funded. For example, the funded levels of Vermont's three state-wide pension systems currently range from 51 percent for Teachers System to 76 percent for Municipal Employees System, with State Employees System funded at 66 percent.

When pension funding is analyzed using this calculation, any ratio below 100% is commonly characterized as a shortfall. We believe we need to challenge that logic by asking, What is the implication of that shortfall? How much of a hindrance is it to the ability of public pensions to continue paying benefits?

The key is that the ratio is comparing cash on hand to funds needed over a 30-year period—as if all of the funds might be needed at once.

Think about it this way: Suppose you owe $200,000 on your mortgage, with 28 years to go and a monthly payment of $1,600.

One thing you can be pretty sure of is that nobody is going to ask you for the entire $200,000 loan balance tomorrow. Time is on your side.

It is, of course, reasonable to ask, How much money do you need to have in the bank to feel confident that you're going to be able to pay that mortgage?

The answer is: It depends. Do you have a job? Is it steady? If you lose it, can you get a new one? Do you have savings? How much?

If you had a job and let's say $100,000 in the bank, you'd probably feel really good about your ability to pay that mortgage. That $100,000 would be akin to a 50% funded ratio.

It is our view that it's incorrect to focus the debate over the health of public pensions on funding levels. We believe that asking "Is the pension 100% funded?" is the wrong question. The reality is that money is still coming into public pensions in the form of employee and employer contributions and earnings on investments.

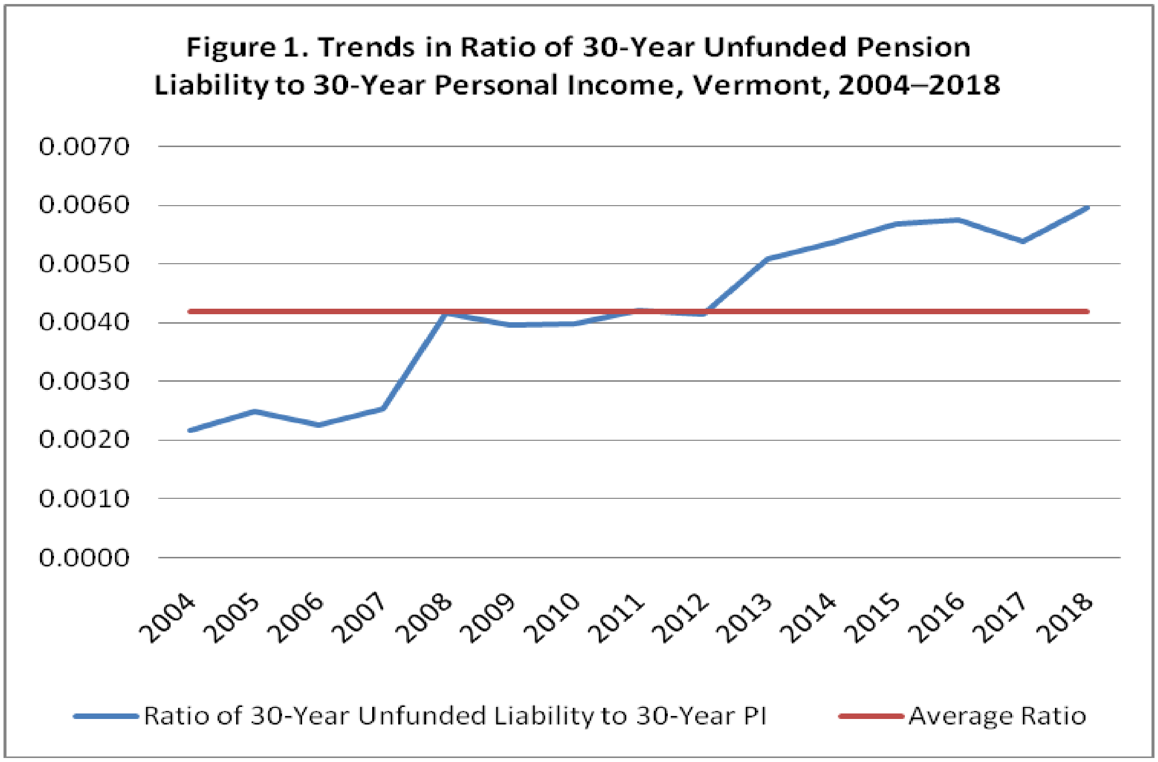
Considering public pensions to be faulty if they could not pay out every single dollar today is a distortion of the long-term nature of pension investing. It's like declaring nearly every American homeowner broke because they couldn't pay off their entire mortgage if they were asked to do so today; that would be a ludicrous misunderstanding of how a mortgage works.

The thing to keep in mind is that as long as debt and income are in sync, or income is outpacing debt, there is no problem. It will be possible to sustain your costs, whether it's operating your household and paying your mortgage, or paying out pension benefits.

It's only when debt increases faster than income that problems begin to accumulate.

Synchronizing pension liabilities and economic growth is the key to the sustainability of pension funds. If we keep the ratio of unfunded liabilities to economic growth stable, pension can keep on paying even if they never reach their 100% funded ratio.

Figure 1 shows trends in Vermont in the ratio of 30-year unfunded pension liabilities to 30-year personal income, which serves as a proxy for the economy.



What are we seeing here? It is showing us that after the unfunded liability of Vermont's pension has been rising relative to the size of the economy. This increase began around 2012, after a four-year period of relative stability.

Equilibrium can be achieved by matching the pension liability ratio to economic growth. It would take a $253 million reduction in unfunded liabilities to restore equilibrium. (That figure would have been higher if it hadn't been for the $204 million employer contribution the state made in 2018.)

Obviously, $253 million is a large sum of money. But it isn't needed all at once; equilibrium can be reached at a reasonable pace, through manageable adjustments. Whittling that unfunded figure down over a period of perhaps five years would be sufficient to sustain the pension funds. Fully funding them may be a worthy goal, but it is not necessary to do that in order to keep the pension funds going.

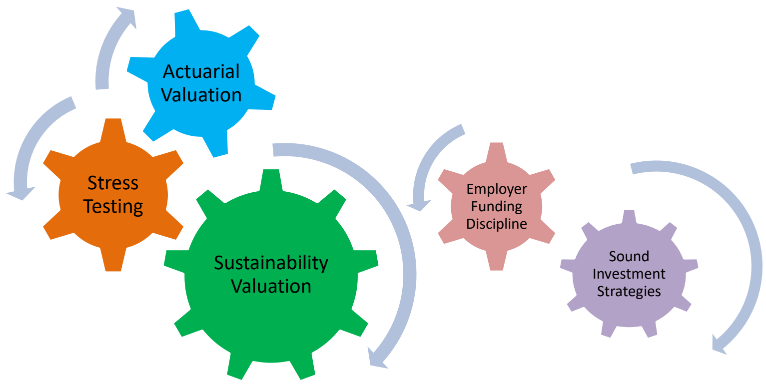
One practice that can helpful to pension funds is to conduct a “sustainability valuation” on an ongoing basis. Sustainability valuation is novel and original idea developed by NCPERS.

By sustainability valuation we mean regularly monitoring the ratio between unfunded liabilities and economy and paying down unfunded liabilities to keep this ratio stable.

Our research shows us clearly that it is more important to stabilize unfunded liabilities in relationship to economy than looking at the size of unfunded liabilities in isolation to make good pension policy decisions.

Simply put, as shown in Figure 2, we can enhance sustainability of public pensions by adding “sustainability valuation” on top of current pension funding practices such as actuarial valuation, stress testing, employer funding discipline, and sound investment strategies.

Figure 2. Enhancing Sustainability of Public Pensions



Public Pensions Bolster Income Security

More and more people are reaching retirement age every day, yet Americans don't have enough savings for retirement. They have good reason to be worried about their ability to make their resources last through retirement.

Pensions have always been a cornerstone of compensation for public employees. They are also a powerful economic stabilizer, as they provide retirees with a stable income every month—even during a recession, as we have seen recently. Retirees with a pension are able to spend steadily, while retirees who rely heavily on savings for retirement income may hesitate to do so. Pulling money out of a 401(k) savings plan can feel very risky when markets are gyrating.

Safeguarding pensions signals to workers who have committed their careers to public service that they are valued and supported. It also stabilizes communities. The Vermont General Assembly is wisely taking time to dig deep into the questions before it. NCPERS stands ready to assist you with facts, research, and expertise as you delve into policy discussions on retirement security. We invite this body to contact us should you need additional information.