TAKE THE QUIZ

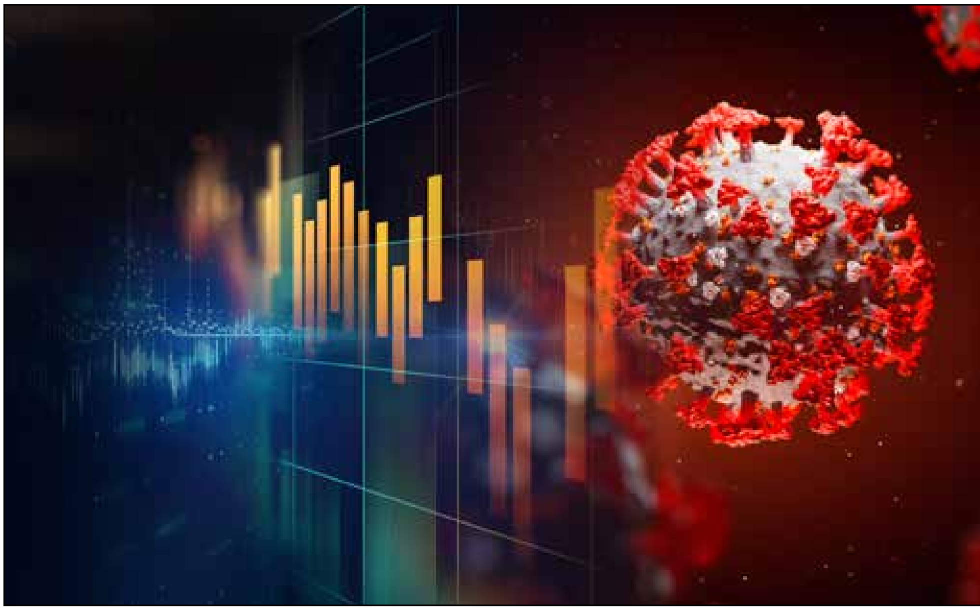
Metric Spotlights Ability of Public Plans to Endure Pandemic

By Bill Hallmark

The disruption of the U.S. economy by the novel COVID-19 pandemic has created challenges for public pension plans.

They may suffer significant investment losses, and at the same time revenues for state and local governments have dropped precipitously while their spending needs have increased. However, that does not mean that public pension plans will collapse.

Retirees of public pension plans are continuing to receive pensions, helping to stabilize the economy. Plans may be asked to do more and should be prepared for requests from their sponsors to defer contributions. In theory, those plans may be able to act as a shock absorber for their local economies by reducing contributions during the crisis. However, a good shock absorber must be able to both absorb the shock and spring back to its original position.



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EVALUATING SHORT-TERM FLEXIBILITY

A fundamental indicator of a plan's ability to tolerate deferred contributions is the Outflow Rate—benefit payments and expenses as a percentage of assets. This shows how much of its assets the plan would need to sell to pay benefits if it doesn't receive any contributions for a year.

This table shows the five plans in the Public Plan Tool reporting the highest Outflow Rate for the 2018 fiscal year. The second column shows the Net Cash Flow Rate—Outflow Rate net of contributions. This represents how much of a plan's assets would need to be sold to pay benefits if contributions remain the same.

Highest Outflow Rates
2018 Fiscal Year

Plan	Outflow Rate	Net Cash Flow Rate
Kentucky ERS	-39%	-7%
Providence ERS	-29%	-4%
Chicago Police	-26%	-3%
Chicago Municipal	-23%	-10%
New Jersey Teachers	-19%	-9%

These plans would be hit particularly hard by a significant drop in contributions. For some, even maintaining the current contribution levels may be insufficient. In comparison, the median plan reported an Outflow Rate of -8 percent and Net Cash Flow Rate of -3 percent.

LONG-TERM RECOVERY

An effective shock absorber must also spring back to its original position, which will require increased contributions at a later date. We don't know how quickly revenues will rebound, but when they do, public plans need to get their share, particularly if they have yielded to requests to defer contributions.

Governance and history are critical factors to this assessment. Plans that can compel governments to contribute an Actuarially Determined Contribution are well-positioned to demand the funds needed for long-term recovery later. In fact, asset smoothing techniques may already provide the needed deferral of costs. However, plans that do not have this authority

CONTINUED ON PAGE 2

ACTUARY CONTINUED FROM PAGE 1

need to proceed with more caution and may need to negotiate additional controls before yielding to requests to defer contributions.

The COVID-19 pandemic has created many challenges. Efforts to stop the spread, care for the infected, and mitigate the impact on vulnerable populations are the current priorities. Plan sponsors may seek to defer part of their pension contributions in order to pay for other priorities. For some plans, the need for contributions is immediate and ongoing while other plans may have some short-term flexibility as long as they can be confident of replacing any foregone contributions at a later date. ◆

__Bill Hallmark__ is a nationally respected retirement consultant with more than three decades of experience advising pension plans. He is a frequent speaker at industry conferences on public pension topics including principles of funding, risk metrics, disclosures, and financial reporting. He has held various positions with professional organizations, including serving as Vice President of Pensions for the American Academy of Actuaries. Bill is an Associate of the Society of Actuaries, an Enrolled Actuary under ERISA, a Fellow of the Conference of Consulting Actuaries, and a member of the American Academy of Actuaries. He joined Cheiron in September 2009.

PERSist Quiz — Actuary

Based on its outflow rate, which plan can best tolerate a temporary suspension of contributions?

- ❍ **A.** Plan with an outflow rate of -5%
- ❍ **B.** Plan with an outflow rate of -20%
- ❍ **C.** Pension plans are long-term entities, and both plans can tolerate a temporary suspension of contributions equally well.

Answer: A