**Discussion**

**City of Burlington Retirement Committee**

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**Topic: Plans that have experienced a larger-than-average decline in funding level**

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The average decline in funding level from FY 01, which was at or near the collective peak in public pension plans’ funding level, to FY 13, was approximately 28 percent from around 101 percent to 73 percent.

Predictably, there is variability in this experience: some plans experienced smaller declines, while others experienced larger declines.

I reviewed around 20 plans that experienced declines in their funding level of more than 30 percent. The cause of the extraordinary funding level decline varies by plan, but one or more of several factors were present in each case:

* Failure by the employer to pay the Annual Required Contribution
	+ The most common factor contributing to extraordinary declines in funding level has been a consistent failure by the employer to adequately pay the ARC.
* Modification of benefit levels, in most cases in the 1995 to 2000 timeframe, without adequately altering the plan’s funding requirement
	+ Benefit levels for many plans, particularly those that had attained funding levels well in excess of 100 percent, were increased during the late 1990s. In some cases, the actual cost of benefit changes was underestimated when actuarial experiences played out.
* Adjustment of actuarial assumptions or methods
	+ Many public pension plans have altered their actuarial methods and assumptions over the last 15 years. The most popular change (and usually the one with the greatest effect on the plan’s funding level and cost) has been to reduce the plan’s investment return assumption. Reducing the investment return assumption increases the plan’s unfunded liability and reduces its funding condition.
	+ Some plans have increased the length of the period over which the plan phases in investment gains or losses. A plan that has lengthened its smoothing period recently (of which at least two did in the examined group) would have had the experience of recognizing all or most of the 2008-09 market decline, but still is phasing in its investment losses.
	+ Similarly, altering a plan’s amortization policy, such as by reducing the length of its amortization period, also can reduce its funding level.
	+ Finally, instituting a new mortality table, which assumes plan participants will live longer, also worsen a plan’s funding condition.
* Substandard investment performance
	+ Investment performance also can affect a pension plan’s funding condition. The median annualized public pension fund investment return for the 10-year period ended June 30, 2013 was 7.1 percent, but actual results vary widely, ranging from below six percent to above eight percent. Underperforming by even one percent on an annual basis over a decade can have a significant effect on a pension plan’s funding condition.

In some cases, a combination of these factors took place, such as a failure to receive the full ARC, combined with changes in the investment return assumption.

Additionally, it is possible that some plans have had an actuarial experience that has not been recognized but that is having an effect on the plan’s actuarial condition. For example, a larger than expected percentage of participants could have retired and are receiving benefit, but the cost of that experience has not yet been measured or funded.