Executive Summary

We Believe in a Secure Retirement for All

Retirement security is an important building block for Missouri Communities. Every hard working Missourian should be able to retire with dignity whether they work in the public or private sector. Retirement security is an important issue in this state. LAGERS understands this importance, and strives to ensure this security every day.

LAGERS is a defined benefit pension plan that serves over 60,000 current and former Missouri local government workers. Defined benefit plans pay a retiree a protected, pre-determined amount each month. The amount of the benefit is based on a formula, not an account balance, and is driven by the employee’s years of service and salary. Defined Benefit plans remain the most economical and effective retirement plans not only for employees, but for employers and taxpayers as well. They provide a clear and secure path to retirement for employees and help employers recruit and retain a strong, loyal workforce.

Public Pension plans return value to the communities as well. Approximately 93% of the benefits are paid to retirees living in the communities they served as public workers. The steady monthly retirement benefits received by these pensioners are not stuffed under a mattress, but reinvested in their hometowns. LAGERS paid out over $266 million to 20,219 benefit recipients last year, with $244 million staying in Missouri. That’s a pretty nice annual economic stabilizer for the Show-Me State!

This booklet discusses the issues surrounding Missouri’s public pension plans. We trust the information contained here will serve as a guide to help you make decisions about public pension plans.
Pensions Can Help Secure Missourians’ Retirement Future

Defined benefit plans have a long track record of success in the public sector and continue to be the plan of choice for state and local government workers.

A defined benefit retirement plan is a traditional pension that provides a retiree with a pre-determined benefit after meeting certain criteria. The main purpose of a defined benefit plan is to provide income during the retiree’s remaining years. Benefits are paid on a monthly basis and extend until the retiree’s death. Benefit amounts are often based on a retiree’s average working salary and the length of the retiree’s employment.

A defined benefit plan is “pre-funded.” This means that a retiree’s benefit is paid for before he or she reaches retirement. There are three sources of income to the plan, employer contributions, employee contributions, and the return of the plan’s investments. Contributions to the plan begin when a worker is hired and continue until the worker leaves employment. It is common in the public sector for both the employer and the employee to contribute to the plan. The returns that are generated from the plan’s investment portfolio provide the majority of the funding. In LAGERS, investment returns account for about 62% of the plan’s funding.

LAGERS administers a defined benefit plan available to all of Missouri’s political subdivisions, except school districts. LAGERS is a voluntary system that adds about 15 new political subdivisions to its membership each year. There are approximately 3,000 political subdivisions in Missouri, nearly 700 of which are currently participating in LAGERS.

It is very important that the required contributions are made to the plan each year. Failing to collect the full contributions puts the plan at risk of higher future required contributions, a higher unfunded liability, and may affect the plan’s ability to make benefit payments.

RSMo 70.730 and 70.735 requires that all of LAGERS participating political subdivisions fund 100% of their required contributions. Because each subdivision is required to make their full contribution each month, every employer is working toward and will eventually be 100% funded.

LAGERS’ funding policy requires we strive to promote intergenerational equity and continue progress in reducing unfunded liabilities. Each generation of members and employers should incur the cost of benefits for the employees who provide services to their communities, rather than deferring those costs to future members and employers.
Pensions Are an Investment in Our Communities

A pension plan is a tool for public employers to improve services provided to their communities.

The pension provides a mechanism to attract and retain a skilled workforce to provide the best possible service to the citizens.

There are real consequences for taxpayers when individual savers fail to adequately prepare for retirement.

LAGERS is:

**Flexible**
- Employers choose benefits based on local goals & budgets
- Benefits can be changed either up or down

**Portable**
- Goal is to retain skilled workers
- Nearly 700 Participating Employers, 15 Join Each Year
- Once a member is vested (5 Years), they are vested at any LAGERS employer
- Lump sum option for members leaving local government service with less than 10 years

**Secure**
- 94.7% Funded
- Required contributions & no delinquent employers
The Unfunded Liability Nobody is Talking About

Elizabeth Althoff, LAGERS Senior Communications Specialist

You hear a lot in the news these days about a looming pension crisis and their supposed mounting unfunded liabilities. When I try to imagine how I would react to these headlines if I did not work in the retirement industry, I imagine that the phrase ‘unfunded liability’ would sound absolutely terrifying, and that if I ever heard that phrase being thrown around when it came to my retirement plan, I would be concerned.

Now to be clear, I believe that every pension plan should have sound plan design with a solid funding policy, so that, like LAGERS (and many other well-run pensions across the county), the benefits are being fully funded today and plan participants can go to work and retire with the peace of mind in knowing that their retirement will be secure. Pension plans that are not doing this should be fixed. But what I find most disturbing is that there appeared to be one major unfunded liability that nobody is talking about….yours.

‘My unfunded liability?’ you may ask. ‘I don’t have an unfunded liability.’ And that is where many of you would be mistaken. Like most Americans, you are probably planning to retire at some point in your life – either at a time of your choosing or perhaps for reasons beyond your control, such as failing health. And when that time comes, you’re going to need to have income to live off of for the rest of your life.

In order to be able to quit working or to reduce your work hours in retirement, you need to be saving every month to ensure your nest egg will be large enough to sustain you for the rest of your life. Savers (especially those without pensions) who fail to set aside enough money each month for their retirement are creating a huge personal unfunded liability – a gap between how much they have saved and how much they will need in retirement.

According to the National Institute on Retirement Security, 45% of American households do not own any type of retirement account, with a disproportionately large number of low-income households saving nothing for retirement. Even more shocking, of households that do have retirement savings accounts, the average balance for individuals nearing retirement (age 55-64) is a mere $104,000; and if we included the households that are saving nothing, that average drops to just $14,500 saved by those who are at the doorstep of retirement.

This means that most Americans will be facing their own unfunded liabilities at retirement, and that presents a big problem. If I’m an average saver with $104,000 and I need to draw out $1300/ month to survive in retirement, my savings would not last 7 years…and that’s not even taking into account inflation or

Until we start quantifying the unfunded liabilities in 401(k)-type plans, many Americans are going to be in for a big surprise when they are ready, but cannot afford to retire.
any unplanned expenses (such as a big medical bill). If I live 20 years into retirement, I need to have saved at least $312,000; and if I live 30 years, I better have $468,000 in the bank. Since I only have $104,000, I have a personal unfunded liability of over $360,000.

While granted, my math is simplified, take that average times the estimated 80 million people who will be retiring over the next twenty years and you get upwards of 30 trillion dollars in unfunded liabilities in Americans' personal defined contribution accounts.

I can't help but think to myself, “What is going to happen when these folks can no longer work? What are they going to do when they cannot afford to retire?” As we usher out the era of private pensions, what is going to happen as more and more individuals enter retirement without adequate savings and with a huge personal unfunded liability? What is going to happen when they lose their home because they can't make the mortgage payment, or go without food to be able to afford their medication? As a society and as taxpayers, what are we going to do?

It seems to me that many are suggesting that the solution to these pensions’ unfunded liabilities is to replace them with even bigger personal unfunded liabilities by forcing people to plan for retirement on their own. Pensions that have sound plan design and solid funding policies work, and they work well. They don't pass cost onto future taxpayers because the liabilities (benefits) are pre-funded, and participants can take advantage of longevity risk pooling and professionally managed investments. And while LAGERS members receive only a modest monthly benefit that often still requires some additional personal savings, their pension is the foundation of their retirement security, and it's one they can count on.

The switch from pensions to defined contributions plans (e.g. 401(k)s) may indeed seem like a simple fix to all the mounting pension headlines, but until we start quantifying the unfunded liabilities in individual retirement plans, many Americans are going to be in for a big surprise when they are ready, but cannot afford to retire.
Pension Plans Invest More Efficiently Than Individuals

Defined benefit plans tend to invest pragmatically, looking to the long-term and engaging in prudent investment practices.

LAGERS is accomplishing this by collecting contributions from employers and employees and then investing those funds in a diversified portfolio. Returns from these investments compound over time and provide the majority of funding for the plan.

Asset allocation decisions are made by LAGERS’ trustees who have a fiduciary obligation to ensure the participants’ funds are invested prudently. The trustees rely on recommendations from professionals to help aid in making their decisions. Public pension plans, depending on their size, often have an internal investment team consisting of a chief investment officer and an investment staff that hire outside firms to manage portions of the portfolio to help aid in producing the best possible results for plan participants.

Defined benefit pension plans tend to earn higher returns on their investments than individuals earn in their private accounts. This is for a few reasons. One is that pension plans have an infinite time horizon on which to base their asset allocation. An individual typically adjusts their asset allocation based on their current stage of life. For instance, someone nearing retirement may decrease their portfolio’s risk by adjusting their allocation to mainly consist of fixed income assets (i.e. bonds) which would produce a lower return. A 25 year-old that just started their career can take on more risk by having a portfolio mainly of equity assets (i.e. stocks) and produce a higher return. Since the pension plan is investing for the average individual and not just one person, it can create an asset allocation to optimize the return for a given level of risk. Therefore, continuing its course of seeking the best returns for its participants into perpetuity.

The level of risk for a pension plan is mitigated by its ability to consolidate its assets into one large pool, giving pensions the ability to negotiate lower fees and invest in assets that are not accessible to most individual investors. This allows the plan to diversify its asset base and create an additional amount of return for an overall lower amount of risk. The average individual usually has no ability to negotiate with the firms setting the expense for their investments. Most investments also have a minimum investment size which can deter individual investors from getting the best diversified portfolio.

Another reason pension plans’ returns tend to be higher than individuals’ is because the pension fund hires professional investment managers to manage the portfolio’s stock selection and asset allocation. Typical working class Americans generally have little knowledge of the investment landscape and may have no interest in learning more. LAGERS works with investment professionals which gives participants one less worry and allows them to focus on serving their communities.
LAGERS Uses an Appropriate Assumed Rate of Return

A discount rate is the interest rate pension plans use to calculate the current value of future retirement benefits. This tells you how much money is needed today to be able to pay future benefits, which in turn is one factor in determining the contribution rates required from employers and employees.

The process chosen to arrive at an appropriate assumed rate of return is of utmost importance so that contributions may remain level for decades, helping to ensure the taxpayers of today are charged as appropriately as the taxpayers of tomorrow.

The assumed rate of return is the return that a pension fund plans to receive on its investments and is determined by using a set of assumptions to project future investment returns. The discount rate and assumed rate of return are one in the same which helps to ensure level contribution rates as well as making sure there is enough investment income to cover future liability shortfalls. The investment income matters, as investment earnings account for a majority of pension funding. A shortfall in long-term expected investment earnings must be made up by higher contributions or reduced benefits.

The most important thing to understand about a discount rate and assumed rate of return is that ultimately, the pension fund’s actual return on investment matters much more than the discount rate and the assumed rate of return.

Here is an example. Let’s say a pension fund assumes a low discount rate of 4%. Initially, the contributions required from employers and employees would be high because the fund expects only a 4% return on investments. But over time, the fund’s investment returns exceed a 4% return, and so, the contributions required will decrease because more money than expected is being poured into the fund from investment return.

Now let’s assume a pension fund has a high discount rate of 9%. Initial contributions would be low because the plan is expecting a high return on investments. But, over time, if the pension fund’s investments do not return 9%, contributions would have to increase in order to pay for the benefits.

The process chosen to arrive at an appropriate assumed rate of return is of utmost importance so that contributions may remain level for decades, helping to ensure the taxpayers of today are charged as appropriately as the taxpayers of tomorrow. In other words, the end result should create generational fairness.

LAGERS uses an appropriate discount rate of 7.25%. This is based on an asset liability study that incorporates capital market assumptions and liability projections for the future. As of 2016, LAGERS’ 20 year return is 7.80% and its return since inception is 8.50%. LAGERS is very comfortable with its assumptions and the contribution rates charged to employers and members and performance and experience is evaluated every five years to ensure the appropriate figures are being used to maintain a financially stable pension fund.
Consequences of Switching from a Pension Plan to a 401(k)-Type Plan

Pension reform has been a popular topic in recent years and some of that discussion has focused on eliminating defined benefit pensions and transitioning public workers into a 401(k)-type defined contribution plan. While it is always good to look into ways to be more efficient and improve the financial condition of pension systems, switching government workers from a defined benefit pension plan to a defined contribution plan will ultimately hurt the retirement security of workers and be more costly to governments.

A recent study by the National Institute on Retirement Security (NIRS) examined states that have transitioned from defined benefit pensions to defined contribution plans. The study found that these states experienced increased retirement plan costs and increased plan underfunding.

West Virginia, one of the states studied in the report, switched to a 401(k)-like plan in 1991 only to switch back to a defined benefit pension 2005. Why? The state found that the costs were lower for the DB plan and employees were not saving like they should in the 401(k)-type plan. In fact, there were 1,767 West Virginian teachers over the age of 60 in 2005. Only 105 of them had account balances over $100,000 for retirement. Hardly enough to allow them to retire and maintain their standard of living.

Another study by the Boston College Center for Retirement Research found that defined contribution plan features are linked to retiree poverty.

“The transition from DB to DC plans will require future retirees to negotiate their way through a minefield of challenging decisions that may reduce retirement income,” the authors of the study wrote.

The research found that defined contribution plan features like pre-retirement lump sum withdrawals and limited options for steady monthly income increased the risk of retirees from these plans becoming financially insolvent. For example, one out of five defined contribution plan participants in the study reported that they had received a lump sum distribution from their plan prior to age 55, compared to only one out of ten of those with a defined benefit plan.

“Workers in future cohorts that rely on non-annuitized DC plans as their sole source of retirement income are likely to be demonstrably worse off [than those studied in this report],” the authors wrote.

Not only does the move from DB to DC hurt workers, it also costs more. Employers who have made this move cite cost as their #1 reason for moving to a DC plan. This is often because they are not providing the same level of benefit. Another recent NIRS study found that DB plans have a 48% cost advantage over DC plans to offer an equivalent benefit.

“The transition from DB to DC plans will require future retirees to negotiate their way through a minefield of challenging decisions that may reduce retirement income.”

—Boston College Center for Retirement Research
Every pension plan’s goal is to be 100% funded. That is when a plan’s assets are equal to its liabilities. A pension plan that is not 100% funded is not necessarily in danger so long as it has a sound funding policy and receives its full contributions each year.

**Funded Percentage**
LAGERS is currently 94.7% funded. The funded percentage of a pension plan is its assets divided by its liabilities. A plan’s assets are the sum of the contributions it has collected plus the returns from the plan’s investments. Liabilities, officially called, “Actuarial Accrued Liabilities” are the present value dollars of plan promises to pay benefits in the future allocated to employee service that has already been earned. A liability has been established (“accrued”) because the employee has earned service, but the resulting monthly cash benefit may not be payable until years in the future. Accrued liability dollars are the result of complex mathematical calculations, which are made by the plan’s actuary. An actuary is a person who is trained in statistical analysis of life expectancy, market expectations, inflation, and other data important to pension plans.

**Unfunded Liability**
When a plan is not 100% funded, that means that its actuarial accrued liabilities exceed its assets. When this happens, an unfunded accrued liability is created, which is the difference between the accrued liabilities and the assets on hand. The existence of an unfunded accrued liability is not necessarily a problem. The amount of this liability is amortized over future years by the plan’s actuary and paid for by contributions and investment return over time.

**Employer Contributions**
The amount an employer must pay to fund its pension plan is often called the annual required contribution, or ARC. The ARC has two components, the first of which is called the normal cost. This is the cost for retirement benefits for current year. The second component is the supplemental cost, sometimes called prior service cost, or the unfunded accrued liability cost. This is the portion of the ARC that is used to cover the amortized unfunded accrued liability payment.

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<th>Year</th>
<th>LAGERS’ Unfunded Accrued Liability 2009-2016</th>
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<tr>
<td>2009</td>
<td>$831 million</td>
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<tr>
<td>2011</td>
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2017 Missouri
PUBLIC PENSION ISSUES

Missouri Local Government Employees Retirement System

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