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Pensions Wrestle With Return Rates

By MICHAEL CORKERY

Turmoil in Europe, the sluggish economy and low interest rates are intensifying pressure on public pension-fund systems to reduce the annual-performance assumptions they use to determine contributions from taxpayers and employees.

Some lawmakers and pension officials are pushing to abandon the roughly 8% annual-return assumption set by many public-employee funds, saying the rate is unrealistically high given upheaval in markets around the world and the preceding financial crisis.

"After 10 years of listening to the experts be wrong on the downside more than half the time, I would like to be more cautious," said James Dalton, chairman of the Oregon Public Employees Retirement System.

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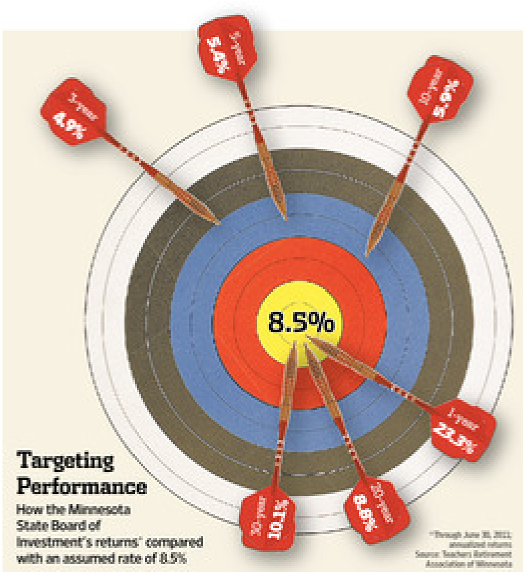

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The pension system, which covers about 325,000 members, affirmed its 8% assumption this summer despite a dissenting vote from Mr. Dalton. Oregon exceeded its 8% assumed rate over the most recent 20-year period but fell short over five years and 10 years.

In Minnesota, lawmakers are considering whether to lower the large state pension funds' 8.5% return assumptions, among the highest in the nation. Pension officials at the Teachers' Retirement System of the State of Illinois are mulling a change to the system's 8.5% return target.

The nation's largest public pension, the California Public Employees' Retirement System, could face pressure to trim its assumptions if the $220 billion fund's monthly returns are disappointing. Calpers is set to release those results this week.

The assumed rate of return is critical because it determines how much a city or state and its workers must contribute to a pension system. As with many other investors, optimism prevails among many pension-fund managers. "We are in a low-return environment with a lot of downside risk," said Joseph Dear, Calpers chief investment officer. Nevertheless, Mr. Dear sees little reason to change the fund's 7.75% assumption, because that target is achievable over the long term, he said.

Since the financial crisis, at least 19 state and local pension plans have cut their return targets, while more than 100 others have held rates steady, according to a survey of large funds by the National Association of State Retirement Administrators.

But to keep meeting these assumptions, pension funds might be tempted to take on more risk, some officials and analysts warn.

"To target 8% means some aggressive trading," said Jeffrey Friedman, a senior market strategist at MF Global. "Ten-year Treasurys are yielding around 2%, economists say we are headed for a double-dip, and house prices aren't getting back to 2007 levels for the next decade, maybe."

"Good luck to them," Mr. Friedman said of pension managers still striving to hit longstanding targets.

The Teacher Retirement System of Texas reaffirmed its 8% annual return target after its consultant said the pension system, with about $100 billion in assets, should expect a median rate of return slightly greater than 8% over the next decade.

The consultant, Hewitt Ennis–Knupp, also noted that, during the past 20 years, the Texas pension fund earned a rate of return of 8.9% on invested assets. Brian Guthrie, executive director of the Teacher Retirement System of Texas, said he hasn't "looked under the hood" of the analysis, though pension officials checked with their actuary to make sure the target is in line with most other pension funds'. A spokeswoman for EnnisKnupp declined to comment.

"It doesn't matter what your assumptions are," said Laurie Hacking, executive director of the Teachers Retirement Association of Minnesota, which supports sticking with its 8.5% target return assumption. "It is what that market delivers that matters and how you react to that."

Ms. Hacking said Minnesota reacted to big investment losses after the financial crisis by cutting back on pension benefits and increasing contributions to the fund from employees and school districts. Those moves had a greater impact on the funding level of the teachers' system, now a relatively healthy 78%, than lowering return assumptions, she said.

But tweaking the number could have immediate, real-life consequences. Many public pension funds use their assumed rates of return to calculate the present value of benefits they owe retired workers in the future. So the lower the rate, the greater the obligations appear.

This spring, the New Hampshire legislature put off implementing a decision by the retirement board to lower the rate to 7.75% from 8.5% this year. The move by lawmakers was meant to spare New Hampshire cities and towns from having to make additional contributions to the fund without much warning, even if it means keeping return assumptions few people expect the fund to meet.

"It's a tough decision," said Jeb Bradley, Republican majority leader in the New Hampshire State Senate. "We knew we had to lower it, but we were trying to give ample warning" to cities and towns, he said. Many unions representing New Hampshire public workers objected to the delay in reducing the assumed rate.

In Minnesota, legislators last year reduced cost-of-living adjustments for retired public workers until the funding level of the pension system improves. Lowering the rate of return could lower the pension system's funding level and potentially delay when the cost-of-living adjustments are restored. Some state lawmakers say lowering the rate will benefit the system over the long haul. "A new day has dawned," said Morrie Lanning, chairman of the Legislative Commission on Pensions and Retirement in Minnesota, who wants to lower the return target. "It may have made sense in the past, but it's not realistic anymore."