TESTIMONY ON ASSEMBLY BILL 190 (Kirner)

Testimony of:
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Chairman Ellison and members of the committee, thank you for the opportunity to offer testimony today as you consider Assembly Bill 190 regarding pension reform.

My name is Lance Christensen, from Reason Foundation – a 501c3 free market think tank – where I direct our Pension Reform Project. I coauthored the "Pension Reform Handbook" that outlines the options and process for reform for those who are interested and willing. Using the information in the handbook, I travel the country and consult – for free – with state and local elected officials on viable pension reform options either in response to major fiscal distress, service insolvency or in anticipation of overburdened obligations on the jurisdiction's general fund to pay for retiree benefits and unfunded liabilities.

As you know, pension costs are a major problem for states and municipalities' balance sheets throughout the country. Indeed, Nevada faces challenges with its pension system. According to the latest Public Employees' Retirement System of Nevada (NVPERS) actuarial valuation report, the plan is 71% funded for the Regular employees and 74% for the Police and Fire, with $10.1 billion and $2.3 billion unfunded actuarial liabilities, respectively.

NVPERS regularly predicts an 8% rate of return, but in looking over the last 10 year average, the plans – both the Regular and Public Safety – have averaged only a 6.22% actuarial average. Lower than expected returns are significant when considering that, when dealing with investments, investors are also dealing with compound interest. If there are steep losses one year, it requires more than simply meeting the planned rate the year after – NVPERS must make up the lost ground from the previous year as well as hit the coming year's investment goals.

Given the current trajectory of the system and the massive liabilities and financial risks they pose to the state, it is past time to reform the pension system in Nevada to make it more sustainable. It took years to get into this problem and it is going to years to dig out of the problem; Nevada must start now. AB 190 represents an important start to that process.

While this bill language is similar to a bill the legislature considered last year, there are nuanced changes to the current legislation. Reason Foundation is in the process of assembling an objective actuarial analysis that would more clearly delineate the problem Nevada is facing and what kind of money the taxpayers could expect to save if AB 190 is enacted. We are more than happy to share that analysis with the committee as we complete it.

Periods of economic recession can affect investment outcomes considerably, yielding lower than expected returns on pension system investments. To balance the investment losses, policymakers who overestimate return rates must then increase funding into the pension system during hard economic times. Often, due to tight budgets, they fail to do so, leading to even greater shortfalls.

If your system is not fully funded, without reform, you are compounding your debt and increasing your costs. Unfunded liabilities are always underwritten by the taxpayer.

Fifteen states have shifted at least one of their state plans from overburdened defined benefit systems to some form of a mandatory defined contribution style plan, with 10 of those reforms occurring since 2008 at varying rates of success. Most involve prospective changes to their systems as recently seen in Utah, Rhode Island, Kentucky and Oklahoma, with defined contribution, cash balance, or hybrid systems, the latter being what AB 190 would set forth in Nevada.

In pursuing pension reform, we have 3 principles to guide our efforts. Pension reform should establish:
•A retirement savings system that is affordable, sustainable, and secure.
•A fair, workable plan to pay down the accumulated pension debt as quickly as possible.
•Processes and practices that ensure governments adequately
fund their retirement promises.

AB 190 follows these principles and would institute solid, but modest reforms. AB 190:

1. Is an affordable, sustainable and secure plan.
2. Caps hemorrhaging costs, reduces unfunded liabilities and does not impact the pensions for anyone already in the system.
3. Manages and mitigates risk—for both workers and taxpayers. As a hybrid plan, with a baseline DB component, this type of pension system enables government to predict its contribution to pensions, it does not create unfunded liability.

4. Ensures a productive and stable workforce for government while liberating wages otherwise subsumed in additional pension contributions by them or their employer.
5. Provides fair benefits for government workers with a high standard of income replacement upon retirement while maintaining fair controls for taxpayers.
6. Provides for pension benefits that are portable and secure. Today's young people who pursue government jobs are far less likely to want lifetime employment by the same employer than even a decade or two ago.

Often there are criticisms that pension reform has struggled in other states. After looking closely at those arguments, we find that most challenges coming out of post-reform jurisdictions are consequences of the old systems for which budget decisions still control the funding of those systems and – this is a critical point – the problems would still exist absent reform. No matter what happens, states must continue to pay their full annual required contribution (ARC) or they will sacrifice more money to debt payments that could go to other core government functions or budget priorities, rather than growing debt and interest payments.

This bill addresses some of the other common criticisms of reform. For instance, by restrict loans from the system may reduce leakage, and the annuity option provides for mortality pooling. The additional 6% contribution on new payroll is designed to pay down the current unfunded liability. There can be further discussion on if this is the right number, but an attempt to pay down the debt is fiscally responsible policy.

Nevada is no stranger to defined contribution systems as demonstrated by the options provided for those working in higher education for decades.

What this bill <u>does not</u> do…

- It does not close down the current defined benefit system;
- It does not cut benefits already guaranteed to retirees/pensioners or current employees already in the system;
- It does not raise taxes;
- It does not lead to riskier investment decisions;
- It does not require a shortened amortization period.

Again, it is important to note that Assemblyman Kirner's bill is only one tool for reform and is not a panacea. While legislators must keep their commitments to those already in the system, pension reform legislation protects future generations of taxpayers and will ultimately free up funds for core priorities like improving infrastructure improvements, increasing education funding in the classroom and enhancing public safety.

In conclusion, AB 190 would place Nevada on a path for retirement security for its public employees, is fiscally sound and provides for a more transparent and sustainable pension system. Reason Foundation welcomes the opportunity to be of further assistance to this committee, so please feel free to call upon us.