

Lost Value of Equities in U.S. State and Local Government Pension Plans: Now \$1 Trillion

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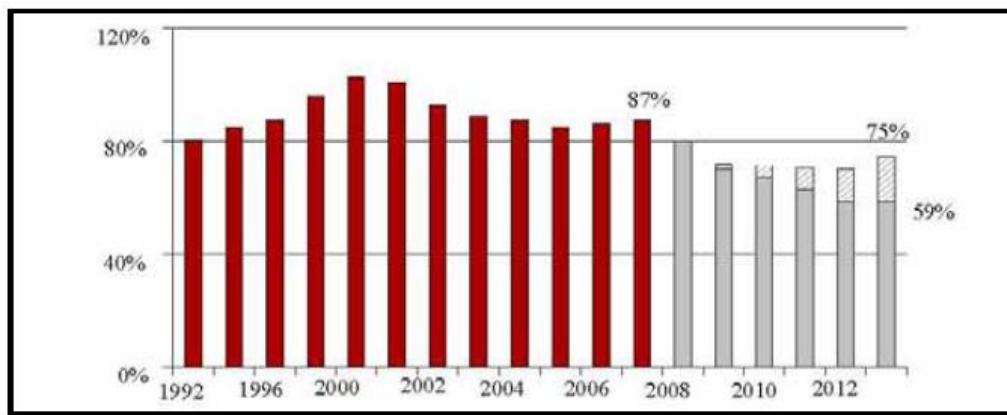
In the U.S., the pension plans of state and local governments have a large portion of their assets in equities. Due to this high exposure to equities, the plans suffered severe losses as the markets fell hard until March this year.

The average asset allocation of the typical U.S. Define Benefit (DB) plan has 60% in equities, 30% in fixed income and 10% in other assets.

“Public pension plans of U.S. State and local authorities also suffered severe losses due to high equity exposure and substantial leverage. The financial crisis has reduced the value of equities in State and local authorities’ DB plans by about US\$1 trillion. These changes will become evident over time because State and local authority plans smooth both gains and losses by averaging the market value of assets over a five year period. However, they will be large as public plans in the United States have on average 60 percent of assets in equities. In addition, they leveraged themselves to fund liabilities. In general, state and local plans had an average funding ratio of 87 percent in 2007 which, by October 2008 would have declined to 65 percent if assets were valued at market values (Munnell et al. (2008) (the impact of smoothing is shown in Figure 13). In the optimistic scenario that assets level return to the 2007 values, funding ratios are projected to increase to 75 percent in 2013. Under the pessimistic scenario that asset values remain at the level of end 2008, funding ratios are expected to further decrease to 59 percent. In both scenarios, liabilities are assumed to grow at 5.7 percent per year.”

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Figure 13. Funding Ratios of U.S. State and Local Plans



Source: Munnell et al. (2008).

Source: 'How the Financial Crisis Affects Pensions and Insurance and Why the Impacts Matter' by Gregorio Impavido and Ian Tower, IMF Working Paper.

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