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S&P: U.S. State Pension Funding: Strong Investment Returns Could Lift Funded Ratios, But Longer-Term Challenges Remain.

U.S. state pension funded levels continue to decline but have likely bottomed out as the effects of the 2008 and 2009 equities market downturn make their way out of the valuations, according to Standard & Poor's Ratings Services' 2014 annual survey. Strong market performance in 2013 and 2014 coupled with a shift to market valuation of assets will probably contribute to improved funded ratios in the near future. Although this is likely the low point, which is good news, we believe pension funded level recovery could be slow and uneven and sizable funding gaps will remain for most states. While reform efforts continue, which will help over the long term, we see continued pressure related to market volatility, increased competition for limited state financial resources, and changes in actuarial assumptions.

In our view, factors that will contribute to significant fluctuations to pension funded ratios include:

- Potential for increased market volatility as we reach the fifth year of a bull market in equities and record highs in the S&P 500 Index and the Dow Jones Industrial Average;
- Greater investment risk-taking to compensate for previous market losses, which could lead to greater asset performance volatility;
- Implementation of Governmental Accounting Standards Board (GASB) Statements 67 and 68;
- Changes to assumptions based on economic conditions and experience studies;
- Ongoing pension reform efforts; and
- For states with weaker funded systems, a problematic funding environment as growth in pension contributions consumes a larger part of their budgets.

Read the full Report.