S&P U.S. State Pension Roundup: Recent Court Rulings and Reform Slowdowns Make Active Management Essential.

Despite six years of favorable economic expansion, a majority of states face budget gaps in either fiscal 2015 or fiscal 2016, or both years. Although Standard & Poor's Ratings Services views the majority of these gaps as manageable and no immediate threat to a state's credit quality, they could test a state's pension funding commitment. Furthermore, a state's commitment to funding its actuarially determined contribution (ADC) and how substantive and volatile these contributions are relative to the total budget remain key credit considerations in Standard & Poor's assessment of a state's credit quality. (See "U.S. State Budgets Face Lean Margins Despite Mature Economic Expansion," published April 27, 2015, on RatingsDirect.) Pension liabilities are not just long-term potential sources of credit pressure. We continue to differentiate states' credit quality by the status of their long-term liability profile in general, and the management of their pension liabilities in particular. States with relatively low ratings or negative outlooks have several characteristics in common, not the least of which is a track record of underfunding their annual pension contributions from an actuarial standpoint.

Overview

- We view pension obligations as long-term liabilities that must be funded over time and a state's commitment to funding its contributions is a key credit consideration.
- Public pensions clearly are in a period of transition based on accounting and actuarial changes, funding commitments, and the recent court decisions that deemed certain states' enacted reform efforts unconstitutional.
- Standard & Poor's expects pensions to remain a significant public policy and funding challenge for many state governments, and a continuing source of expanding liabilities for most.

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