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## States Should Re-Evaluate Their Assumed Rates Of Return.

The assumed rate of return is one of the major actuarial assumptions underlying pension fund valuations. It influences the calculation of a plan's total liabilities and drives the required annual contributions to the plan. A high assumed rate will result in lower levels of estimated liabilities and allow politicians to appropriate lower annual contribution to the pension systems. This portends disaster when the assumed rates of return are higher than actual returns. Even small differences in these two numbers can cause a plan's unfunded liability to balloon.

An example of this type of problem occurred over the last decade with the Pennsylvania Public School Employees' Retirement System (PA-SERS). In the early 2000s, PA-SERS had a published funding ratio of over 100%, meaning its assets fully covered its liabilities. But over the course of the last fifteen years, the funding ratio fell to just above 60%. Amanda Kass and Jared Reynolds from the Center for Municipal Finance at the University of Chicago, link much of this precipitous decline to an assumed rate of return higher than what the plan actually earned. In other words, by using an unrealistic assumed rate of return two decades ago, but receiving a "fully funded" atta-boy, the politicians did not have to put in tons more money . Essentially, they cheated.

Kass and Reynolds found that while the average assumed rate of return in this period was over 8%, the average realized rate was 6%. Further, between 2001 and 2015, PA-SERS only managed to exceed its assumed rate of return on three occasions.

The situation with PA-SERS is illustrative of the larger issue surrounding the assumed rate of return and actuarial assumptions across the nation. Using politically advantageous assumed rates of return was deemed to be "the most important assumption" when it comes to valuing pension plans, by a study conducted by the Center for Retirement Research at Boston College. This same study concluded that even if the median rate of return over a 30 year period managed to equal the assumed rate, many plans would still be unable to meet full funding requirements, due to the sheer variability in investment returns.

State and local governments need to examine all of their assumptions, including the assumed rate of return, to ensure that they are market-driven, and reflective of reality and not politically motivated or wishful thinking. This is the first step to ensuring that taxpayer and beneficiary alike, will have the transparency necessary to fully understand their plan's liabilities, and offer the best chance for a full and accurate assessment of unfunded liabilities.

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