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Pension Model Developed by the Rockefeller Institute of Government Finds Los Angeles Fire and Police Pension Fund has Little Risk of Severe Underfunding, but Risk Remains for the City

Report finds that even with volatility in annual returns, the risks of severe underfunding for pension funds are greatly reduced if contribution policy is conservative and participating governments pay full actuarially determined contributions in all years

Albany, NY—The Rockefeller Institute of Government released a report examining risk associated with the Los Angeles Fire and Police Pension Fund (LAFPP). The study, led by Donald J. Boyd, the Institute's director of fiscal policy, found:

- If the Los Angeles Fire and Police Pension Fund's current investment-return assumption of 7.5 percent is correct over the long run, the plan has little risk of becoming severely underfunded in the next 30 years, even if investment returns vary significantly from year to year.

- Yet even if the assumed returns are correct in the long run, the City of Los Angeles could face large contribution increases relative to payroll and to its general fund revenues. There is, for example, a nearly two-in-three chance that the city's employer contribution will rise sharply, increasing by more than 10 percent of payroll in at least one consecutive five-year period over the next 30 years.

In addition, the Rockefeller Institute of Government examined what might happen if California voters were to approve a previously proposed initiative that would cap employer contributions for new hires and require new employees to bear investment risk above the cap. The report finds that the initiative would have little impact on employer contributions over the next 30 years, but the impacts could be large for new employees. In the long run, after such a policy is fully in effect, there would be a large transfer of risk from the city to its employees, with a substantial chance that employee contributions would become prohibitively high. Should voters adopt such an initiative, the report recommends that it would be important for the plan and the city to communicate these risks clearly to the public and potential future employees of the City of Los Angeles.

Institute researchers selected the LAFPP as one of five plans to model because it is one of the nation's largest public safety plans and has many characteristics common to other public safety plans, including relatively young retirement ages, high benefits, and substantial costs of funding these benefits.

The broader lesson from this analysis is that if a plan has a relatively good funded status and a conservative contribution policy, and if participating governments pay full actuarially determined contributions in all years, the plan has minimal chance of facing a funding crisis even if investment returns are quite volatile. However, the participating governments face a risk of substantial contribution increases, and those contributions can be large relative to a government's budget, particularly if the plan benefits are relatively expensive.

This is the sixth report of the Pension Simulation Project at the Rockefeller Institute of Government of SUNY. The project examines the potential consequences of investment-return risk for public pension plans, governments, and stakeholders in government. In addition to Donald J. Boyd, the study was co-authored by Yimeng Yin, programmer and research analyst, and significant contributions were made by the project team including Kathleen Tempel, researcher and project manager, and Lucy Dadayan, senior policy researcher. The project is supported by the Laura and John Arnold Foundation and The Pew Charitable Trusts.

This analysis is independent of LAFPP, and is neither sponsored nor approved by LAFPP, although the report's authors have communicated with their staff.

To read the report, go to www.rockinst.org/pdf/government_finance/2017-02-22-LA_Fire_Police_Pension.pdf.

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