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FACT SHEET

# The State of U.S. Public Pensions (2022)

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**MEDIA INQUIRIES:** Sam Shaw | Vice President of Public Relations, Equable Institute | Sam@equable.org

The calendar year 2022 was not a great time to be managing pension fund assets, as public funds have weathered a bear market, geopolitical conflict, and record inflation. Despite these economic headwinds, Equable Institute's annual report finds that there has been a net positive funding trend over the last three years. Even with notable negative returns this year, state and local pension funding at the end of 2022 will likely be better than it was at the end of 2019.

## PUBLIC PENSION FUNDING TRENDS

- U.S. state and local public pension funds have yet to fully recover from their modern low point in 2009 following the Great Recession, when funded ratios declined to 62.4%.
- The national funded ratio average is projected to decline from 83.9% in 2021 to **77.3%** in 2022.
- The total pension funding shortfall will increase from $986 billion in 2021 to **$1.45 trillion** in 2022.
- Preliminary 2022 investment returns show a **-6.14% return** on average for state and local plans, a significant reversal from 2021's **24.8%** average return.
- Most state and municipal pension plans in the United States are **distressed** or **fragile** based on Equable Institute's analysis of plan funded ratios.
- District of Columbia (103.4%), Washington State (102.9%), South Dakota (100.0%), Tennessee (99.5%). The states with lowest funded ratios are Kentucky (47.3%), Illinois (50.0%), New Jersey (50.1%), and Connecticut (51.5%).
- Asset allocations have continued to shift more heavily into high-risk alternative investment categories in search of higher investment returns. **27.8%** of pension fund investments in 2021 were in alternative categories like private equity and real estate, compared to 9.3% in 2001.
- The average assumed rate of return for state and local pension plans is **6.9%**, down from 8.1% in 2001. Capital market forecasts estimate a **6%** average investment return is likely for the next decade.

## WHAT'S DRIVING THESE TRENDS?

- **Underperforming Investments:** States have consistently overestimated their long-term investment returns. Even when performance has been positive, it has not always kept up with the assumed rate of return. As a result, states and cities taking on more investment risk by shifting pension assets to private equity, hedge funds, and other alternative strategies.
- **Lower Assumed Rates of Return:** One positive response to underperforming investments has been state and local pension plans reducing their assumed rates of return, from 8% around the financial crisis to under 7% as of 2021. This is positive for the long-term sustainability of pension funds, but results in an increase in the estimated value of unfunded liabilities in the short term as states adopt more realistic investment return assumptions.
- **Interest on the Debt:** States and cities have gotten better at paying their full actuarially required contributions, but that has often not been enough to keep up with growing interest on unfunded liabilities.
- **Too Many Separate Pension Fund Managers:** Some states commingle the assets of various statewide pension funds to invest together, but many do not. With more CIOs and Investment managers in the market searching for the best investment opportunities, it creates outsized competition between funds with the largest funds often winning and smaller funds losing.
- **Negative Cash Flow + Low Funded Status:** Maturing pension plans with negative cash flow mean each year there is less additional money being allocated to asset pools. This creates a problem for already poorly funded pension plans as there is less of an asset base than there should be upon which to earn investment returns.

**What's Not Driving These Trends:** Two commonly citied factors are not major contributors to the current state of pension funding: mortality rates and failure to pay pension bills (after years of steady improvement, only a few large states are still paying less than their actuarial requirement). For more on this, see our preliminary analysis of historic actuarial gain/loss data.

## READ THE REPORT

This fact sheet was released in conjunction with Equable Institute's annual report on the status of statewide public pension systems. The report analyzes trends in public pension funding, investments, contributions, cash flows, and benefits for 225 of the largest statewide and municipal retirement systems, covering more than 370 plans, in all 50 states to illuminate the scale and effects of these challenges.

STATE OF PENSIONS 2022