



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Public pensions' unfinished business

Just five years ago, Oklahoma's public pension plans ranked among the very worst in the nation with unfunded liabilities totaling more than \$16 billion and no foreseeable schedule to meet its obligations.

After decades of ignoring the long-term consequences of politically expedient policy, Oklahoma lawmakers recognized the gravity of the state's pension problems and enacted a series of reforms that, combined with strong investment returns, have improved the systems. Today, the state's pension debt has dropped below \$10 billion and the state's worst-funded plan is expected

to be fully funded in less than 20 years. The state's second-largest pension plan – the Oklahoma Public Employees Retirement System – is nearing 90-percent funded and is poised to launch a new retirement plan designed to meet the needs of its future workforce while preventing new pension debt from accumulating.

While these improvements are worth celebrating, Oklahoma's work on pensions is not yet finished. A collective funded status of 72 percent today is far better than the 58 percent in 2010, but it's still below the funding goal of 100 percent and the minimum suggested

funding level of 80 percent. And while Oklahoma's plans are finally on track to be fully funded, that all can change with another economic downturn or poor policy decisions.

Already, some lawmakers and interest groups have called for a return to the practices that contributed to the state's decades-old pension problem: dipping into funds or delaying payments in order to grant benefit and salary increases. Those efforts failed to advance this past session, but the pressure to put off future payments for today's demands will continue.

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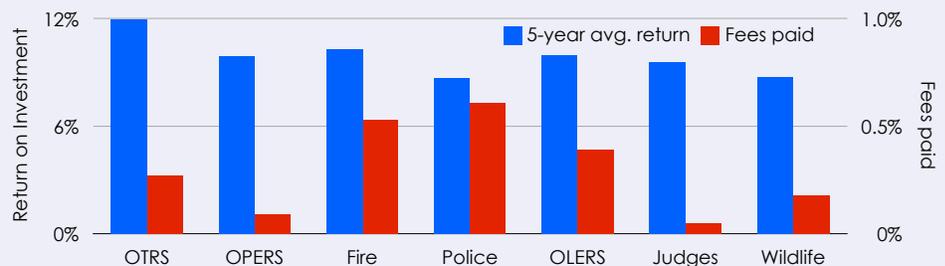
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Oklahoma Pension Performance/Expenses



	Portfolio (in millions)	5-year return	Fees (bps)	Fees (in millions)
OTRS	\$14,400.00	11.98%	27	\$32.44
OPERS	\$8,700.00	9.89%	9	\$7.37
Fire	\$2,240.00	10.27%	53	\$10.19
Police	\$2,230.00	8.68%	61	\$12.25
OLERS	\$889.80	9.94%	39	\$2.68
Judges	\$304.40	9.57%	5	\$0.14
Wildlife	\$100.40	8.73%	18	\$0.16

Sources: NEPC Feb. 18, 2015 Summary of Actuarial Reports, NEPC Aug. 20, 2014 Fee Analysis Report



Treasurer's Commentary

By Ken Miller, Ph.D.



Revisiting pensions

When I first entered public service, a former Oklahoma congressman shared this wisdom with me: the principle of compromise is necessary for a functioning representative democracy, but the compromise of one's principles is surely not.

There's probably no better public policy issue than pensions where this wisdom is required. The recent session was rather calm in regards to this hotbed issue, a welcomed relief to all.

The respite was made possible by past reforms and current investment returns. The 2011 reform requiring cost of living adjustments be funded, combined with extraordinary, yet unsustainable, investment returns have each of the state's seven pension plans moving in the right direction with a collective funded status now at 72 percent and all but two above the 80-percent soundness threshold.

This is very good news, but not a reason to rest on our laurels. We ought not to wait for a crisis to make things better. It's time to resume the conversation of governance and plan design.

Here are my thoughts on the ideal in these two key areas:

Governance

I continue to believe that Oklahoma's current pension governance with its seven independent boards and administrations is inefficient, costly and unnecessary. Our pensioners have to foot the bill for \$100 million in administrative bureaucracy before one dollar is spent on actual benefits.

“This isn't about politics and personalities; it's about sound financial practices.”

Ideal reform: Reduce the number of pension systems from seven to two by establishing one for public safety employees and one for non-public safety employees. This would provide the greatest reduction in administrative costs and investment expenses.

Combining the state's non-public safety plans would cut administrative costs, but more importantly would offer large investment economies of scale. Together the plans represent more than 80 percent of Oklahoma's total pension assets. Millions would

be saved each year by packaging them together for investment, while keeping the funds separate for legal and accounting purposes.

I'm sure that for every million dollars in potential savings there will be a million excuses from defenders of the status quo for why it can't work. Well, it can and it does. For just one example of a well-executed pension system, check out the Tennessee Consolidated Pension System. For economies of scale deniers, check out the fees of OPERS and OTRS relative to our smaller plans. And for those who wish to "caution" of potential reductions in investment earnings due to converging strategies, compare the historical returns of our seven plans.

Possible compromises would include consolidating only OPERS and OTRS and their combined \$20 billion in assets under management to realize both administrative and investment fee savings. Another compromise

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Commentary

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would be establishing a unified pension investment board to realize investment fee reductions, by far the more significant of the savings.

In any case, whether boards are consolidated or not, the state treasurer should serve on them. The treasurer is directly accountable to the people and constitutionally assigned to manage state investments, so it makes zero sense for the position to be excluded from the state's largest investments. Since this logic is impossible to dispute, opponents will surely label it a "power grab." To ensure this reform stays focused on sound financial practices rather than politics and personalities, I propose adding the treasurer to the pension boards be made effective after my term.

Plan design

Beginning this November, all new state employees under OPERS will participate in a defined contribution pension plan, due to legislative

changes passed in 2014. Left unchanged was the plan design for teachers. But it remains my belief that defined contribution for at least some teachers makes sense, not because of ideology, but reality.

Oklahoma's low teacher salaries need to be raised, but that takes money – and lots of it. With state revenue growing at a slower pace than core expenditures, and education's share not likely to increase, something has to give to make salary hikes possible.

Past conversations about changing teacher pension plan design should have focused on total compensation, not just retirement. I will do a better job with this in the future.

Ideal reform: Offer a defined-contribution pension plan to newly hired teachers with all cost savings directed toward a multi-year strategy to raise teacher pay.

I understand many would prefer higher take home pay *and* a defined benefit plan, and argue to hold out

for both. But that is impractical given today's political and financial environment. All are familiar with Einstein's definition of insanity – reality dictates the need to do something different to improve teacher compensation.

To argue that the current defined benefit system is needed to attract teachers requires ignoring the fact that those leaving the teaching field are taking higher-paying private sector jobs that offer 401(k) pensions. I believe many would prefer higher pay with a defined contribution pension plan, but perhaps a compromise would be to allow them a choice.

Funded status for our pensions has improved, but normalized investment returns are sure to resume. Actuarially required contributions will again be difficult to pay and state revenues will continue to be strained. With shared goals and vision for a greater state, let's continue the conversation to build smarter pension systems and a better functioning democracy.

Pensions

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It is important to recall how Oklahoma's pension plans got in such poor shape, protect and build on the gains that have been made, and examine how the state can meet the needs of its future workforce.

COLAs

The reform with the greatest impact to

the fiscal health of the state's retirement systems was stopping the practice of granting cost-of-living-adjustments (COLAs) without also providing funding to cover the cost of the benefit. Previously, an average annual two percent increase was calculated into each plan's assumptions, driving up future liabilities. When lawmakers eliminated unfunded COLAs, Oklahoma's collective unfunded liability

immediately dropped by more than \$5 billion.

Pensioners worry there may not be funds available for cost of living adjustments, but options exist. Policymakers could consider allowing a pension system to self-fund this benefit if doing so does not reduce the plan's funding status below an acceptable amount. Or savings

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Pensions

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from additional reforms could be put aside in a dedicated account to pre-fund a benefit increase across all plans.

However, any attempt to grant blanket COLAs without either funding or establishing a minimum threshold for a system to pay for them will undo the gains of recent years.

Funding gap

Historically, Oklahoma has not contributed the full annual payment required to ensure its retirement systems are 100 percent funded over a reasonable period of time. For example, in FY-10, the state and municipalities contributed just 66 percent of the funding called for by actuaries across all plans. In a dramatic shift, contributions in FY-11 totaled 104 percent of what was required. FY-14 marks the fourth

consecutive year the actuarially required contribution (ARC) has been met or exceeded. This four-year span is also the only years the ARC has been met in at least two decades.

If Oklahoma reverses this trend and makes contributions below the amount required for actuarial soundness, the funding gap will grow the liabilities and extend the time needed for the state's pension plans to become fully funded.

Budget realities

While retirees are seeking cost of living adjustments, current workers are calling for salary increases. Both would require millions more in funding than the state is likely to have anytime soon. The state must find ways to better allocate limited dollars for employee compensation if it is to address these needs.

In FY-14, the state contributed more

than \$700 million into its seven public pension plans. If Oklahoma were to eliminate its unfunded liabilities, it would lower the ARC and the savings could instead be used to improve total compensation for public employees.

Future workforce

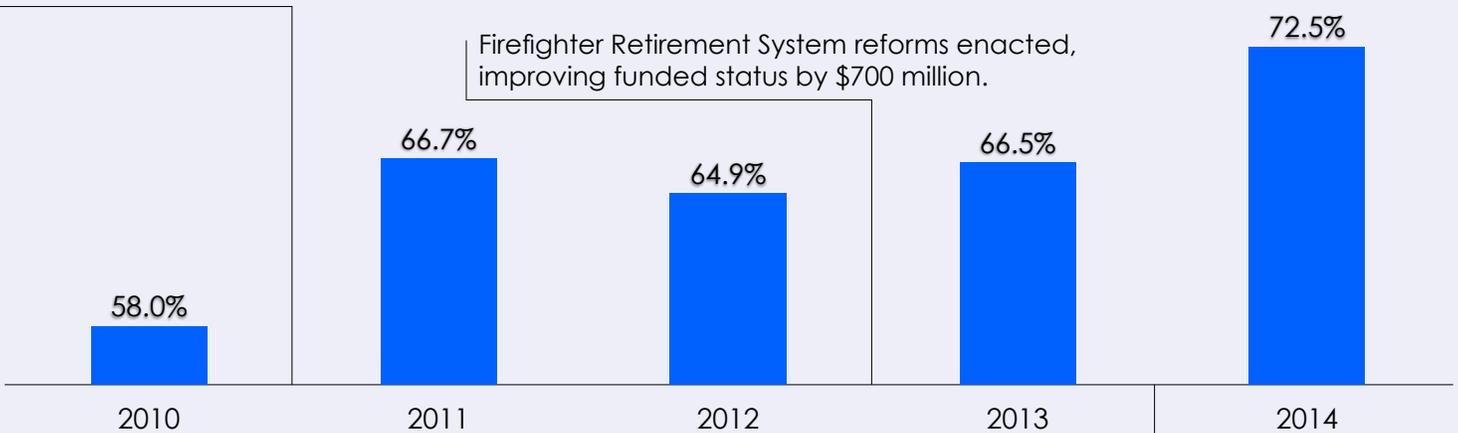
States that have adopted 401(k)-style, or pay-as-you-go, retirement plans often do so for two reasons: to contain costs and to appeal to a younger and increasingly mobile workforce.

Public pension benefits have long been considered a recruitment and retention tool, heavily weighting compensation on the back end of a career. However, many younger workers are not enticed by this model of deferred compensation and the decades-long work commitment needed to fully realize a pension benefit.

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Reform Timeline and Combined Funded Status of Oklahoma Public Pensions

"Truth in Funding Act" enacted requiring cost-of-living adjustments be funded, resulting in \$5.5 billion assumed liability reduction.



Lawmakers approve defined contribution, 401(k)-style retirement system for OPERS employees hired on or after November 1, 2015. New system will accrue no debt.



Pensions

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Best employment practices suggest continually assessing the workforce and its compensation needs to ensure the state is able to compete for the best talent.

Potential reforms

All states face the same pension challenges: ensuring its retirement systems remain fiscally sound and able to keep the promises made to public workers.

Over the past five years, Oklahoma has made tremendous progress toward these goals and can continue the forward momentum.

More can be done to ensure the financial health of the state's retirement systems and to offer better compensation packages that will attract and retain quality employees responsible for delivering crucial state services.

Even with no further changes to benefits for public workers, there is room for Oklahoma to improve the fiscal management of its pension systems.

A 2013 analysis revealed that Oklahoma's pension plans could annually save a minimum of \$12 million in investment fees through the economies of scale that would be realized by packaging the funds into one investment pool. Additionally, streamlining the administration of just the state's two largest pension systems is estimated to save approximately \$1.2 million each year.

These savings may be a small percentage compared to total pension funds, but are still millions that could be

dedicated in part or whole to an account to pre-fund COLAs for retirees of the systems.

To ensure better management of its largest liability and to protect the state's credit rating, Oklahoma should join the majority of states that have the state treasurer serve on either a centralized board or on the boards of individual plans. Oklahoma's state treasurer, who is independently elected, is charged with managing the state's investments. Yet the treasurer has no active role in the management of pension assets – currently valued at \$29 billion – or the plans' liabilities, which compose the largest debt on the state's balance sheet.

In 36 of the 48 states that have a treasurer, he or she serves in an active management or fiduciary role over pension funds. For example, in North Carolina – the second best-funded plan in the nation at 95.4 percent – the state treasurer administers all public retirement systems and employee benefit funds. Oregon's pension funds, also among the best-funded, are managed by the state treasurer's investment division.

Some states, like North Carolina, have the treasurer as the sole fiduciary, while others place the treasurer on respective plans' board of trustees. But a commonality is that most states have the state treasurer involved in the management of this substantial part of the state's assets and liabilities.

Oklahoma's pension plans have gone from critical to stable, but there are still opportunities to improve the health of the plans, ensure that every promise made will be kept, and respond to the needs of public workers, retirees and taxpayers.

New report details Oklahoma GDP growth in 2014

Real Gross Domestic Product (GDP) in Oklahoma increased by 2.8 percent during 2014, the tenth largest increase among the states, according to data released in June by the U.S. Bureau of Economic Analysis (BEA).

Oklahoma's two bordering states with higher growth rates were Texas, with GDP growth of 5.2 percent, and Colorado, with 4.7 percent growth.

Bordering states trailing Oklahoma were Kansas, at 1.8 percent, New Mexico, at 1.0 percent, Missouri, at 0.9 percent, and Arkansas, at 0.8 percent.

Oklahoma's GDP was listed at \$162.4 billion, up from \$157.9 billion in 2013.

According to the BEA figures, Oklahoma's economy contributed 1.1 percent of the overall U.S. economy of \$17.3 trillion.

The energy sector provided the biggest boost to the state's economy last year, according to the BEA.

The fastest-growing states, including North Dakota, Texas, Wyoming, Colorado and West Virginia, also benefited from a strong energy sector.

U.S. GDP growth was reported at 2.2 percent during the year, up from 1.9 percent in 2013.

The BEA defines real GDP as an inflation-adjusted measure that reflects the value of all goods and services produced in a given year, expressed in base-year prices.



Gross Receipts & General Revenue compared

May Gross Receipts to the Treasury totalled \$843.7 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received \$402.7 million, or 47.7% of the total.

The GRF received between 35.7% and 54.5% of monthly gross receipts during the past 12 months.

From May gross receipts, the GRF received:

- Personal income tax: 50.7%
- Corporate income tax: 64.7%
- Sales tax: 45%
- Gross production-Gas: None
- Gross production-Oil: 61.8%
- Motor vehicle tax: 24.2%
- Other sources: 60.2%

May GRF allocations were below the estimate by \$43.7 million or 9.8%. Year-to-date revenue is short of the estimate by \$48.1 million or 0.9%.

May insurance premium taxes totaled \$3.65 million, up by \$270,000, or 7.9%, from the prior year.

Tribal gaming fees generated \$10.79 million during the month, up by \$817,000, or 8.2%, from last May.

May Gross Receipts to the Treasury fall below prior year

Oklahoma’s Gross Receipts to the Treasury report for May shows the impact of lower oil and gas prices likely impacted other revenue streams, said State Treasurer Ken Miller.

“Low market prices for crude oil and natural gas spilled over into the broader economy as energy companies curbed their spending during the month. On balance, gross receipts were more than

Receipts in three of the state’s four major revenue streams – gross production, sales tax, and motor vehicle tax – were less than in May of last year. Only gross income tax collections showed growth, but of that, personal income

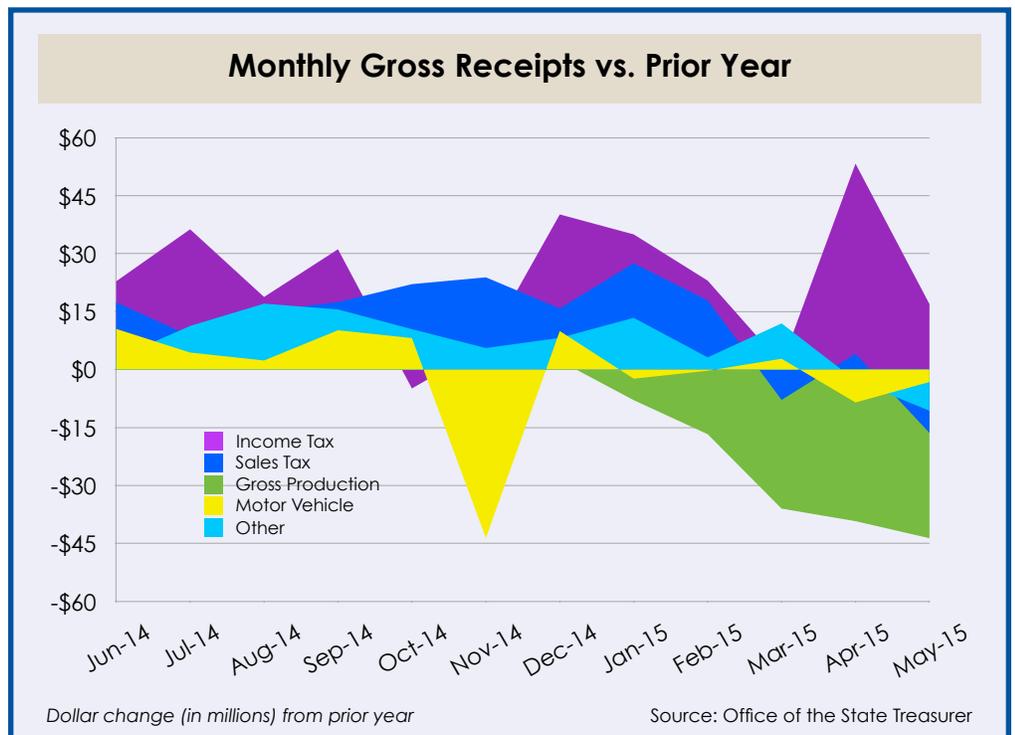
“ Though the news is not positive this month, our hope is that we’ll soon see improvement as (energy) prices rebound.”
– Treasurer Miller

six percent lower than this time last year,” Miller said. “Though the news is not positive this month, our hope is that we’ll soon see improvement as prices rebound.”

tax receipts were also lower than the prior year. Only corporate income tax collections were more than receipts of May 2014.

Gross production taxes on oil and natural gas, reflecting oilfield activity from March, generated \$38 million, down by more than \$43 million from monthly receipts last May. In March, the spot price of

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State jobless rate rises to 4.3 percent in May

Oklahoma's seasonally-adjusted unemployment rate rose by 0.2 percentage points to 4.3 percent during May, according to the Oklahoma Employment Security Commission.

The number of unemployed rose by 4,480 from April, but decreased by 2,480 from last May when the jobless rate was set at 4.6 percent. In May, six of the state's nine supersectors reported job losses, with Mining & Logging, including the energy sector, posting the largest drop.

The national unemployment rate was set at 5.5 percent in May.

Oklahoma Unemployment Report				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
May '15	4.3%	1,863,210	1,783,080	80,130
Apr '15	4.1%	1,851,000	1,775,360	75,650
Mar '15	3.9%	1,832,610	1,761,550	71,060
Feb '15	3.9%	1,812,700	1,742,500	70,210
Jan '15	3.9%	1,794,860	1,725,430	69,430
Dec '14	3.9%	1,782,240	1,712,320	69,920
May '14	4.6%	1,779,380	1,696,770	82,610

* Data adjusted for seasonal factors Source: OESC

Revenue

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West Texas Intermediate crude oil was

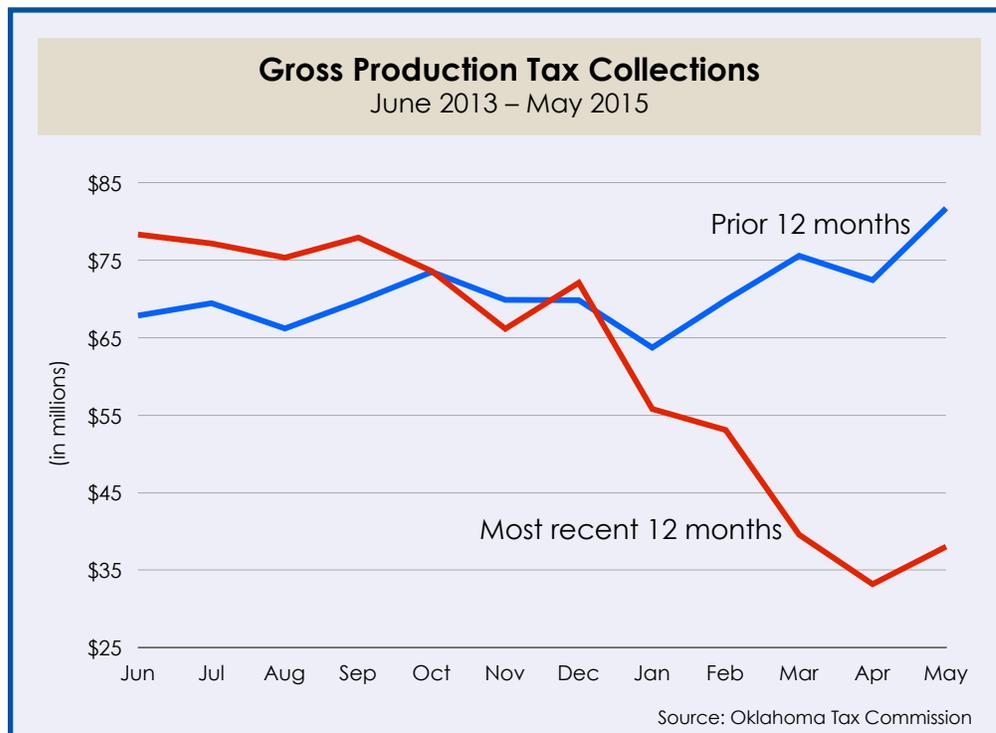
\$47.82 per barrel. Natural gas sold for \$2.91 per thousand cubic feet at the Henry Hub in Louisiana during the same month.

Sales tax collections in May were down by more than 4 percent, while motor vehicle tax collections were off by more than 5 percent and personal income tax collections dipped by 1 percent. On the other hand, corporate income tax collections were up by more than 200 percent. However, corporate collections often vary widely from month to month and are not necessarily indicative of any economic trend.

Combined gross receipts over the past 12 months continue to show growth, but the current growth rate of 3.4 percent is down from a rate of 4 percent seen last month.

About Gross Receipts to the Treasury

The Treasurer's Office issues the monthly Gross Receipts to the Treasury report in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services.

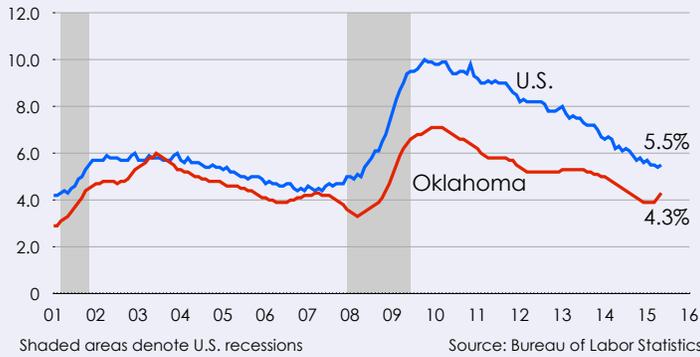




Economic Indicators

Unemployment Rate

January 2001 – May 2015

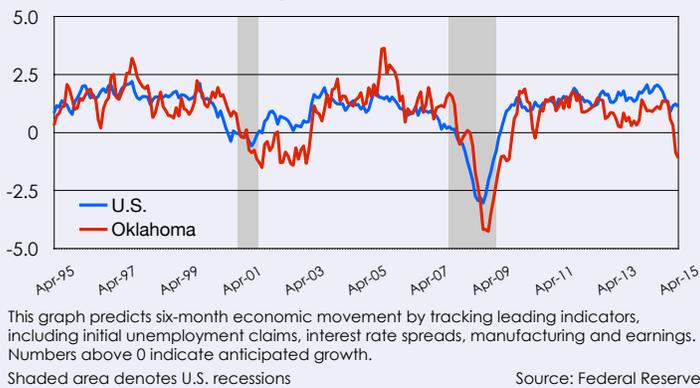


Oklahoma 12-Month Gross Receipts

May 2008 - May 2015
(in billions)

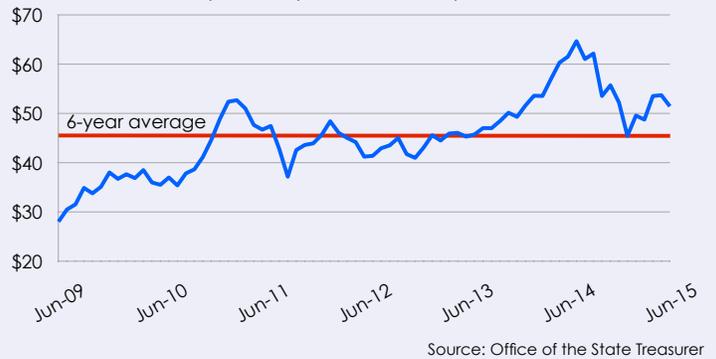


Leading Economic Index

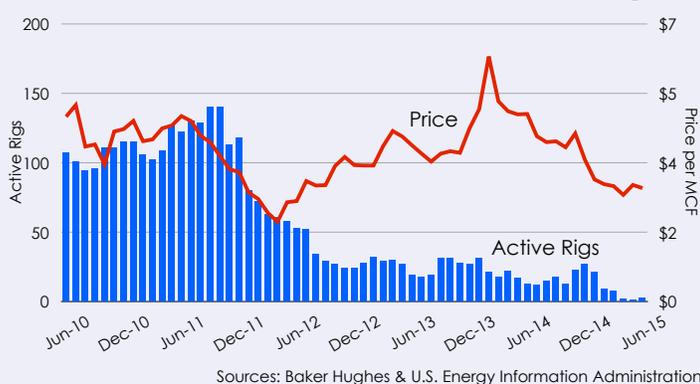


Oklahoma Stock Index

Top 25 capitalized companies



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

