Overview of Public Retirement Issues

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Keith Brainard, Research Director
National Association of State Retirement Administrators

Retirement Benefits Comparison

Private Sector

- One-third of the private workforce has no access to an employer-sponsored retirement plan
- One-fourth of those eligible do not participate
- One-half participate in an employer-sponsored plan; one-half do not
- Fewer than one in five have a traditional pension (DB) plan
- Social Security coverage is universal

Public Sector

- Nearly all have access to an employer-sponsored retirement benefit
- 85%+ participate in a traditional pension (DB plan)
- 70%-75% participate in Social Security

Latest Findings on Retirement Readiness

- 56 percent of US workers say they have less than $25,000 in savings and investments, excluding the value of their primary residence and any defined benefit (pension) plans.
- 31 percent of workers say they will need less than $250,000 to afford a comfortable retirement.
- 45 percent are not too or not at all confident they and their spouse will be able to save as much as they think they need, and 70 percent say they are a little or a lot behind schedule in planning and saving for retirement.
- 42 percent say they determined their retirement savings needs by guessing.

2011 Retirement Confidence Survey, Employee Benefits Research Institute

The Wall Street Journal on retirement insecurity

"The biggest, but most underreported, financial story in America is the looming retirement disaster. Eighty million baby boomers are approaching retirement, and most have absolutely no idea what's going to hit them. For them the financial crisis isn't over. It's just about to begin."

Wall Street Journal Editorial Board, June 11, 2010

Achieving Stakeholder Objectives

The purpose for providing a retirement plan is to achieve key stakeholder objectives. Who are the stakeholders in public pension plans?

- **Employers**, who seek to attract and retain qualified workers needed to perform essential public services
- **Taxpayers**, who seek the provision of public services at a cost that is fair and reasonably stable and predictable over time
- **Employees**, who seek compensation that is competitive and a retirement benefit that promotes retirement security

Distinguishing features of the public sector workforce

- A public employee is almost twice as likely to have a college degree than a private sector worker
- More public employees work in professions that involve physical risk: law enforcement, firefighting, corrections, hazardous materials
- Many public sector positions are career-oriented: education and public safety
- Public sector worker median tenure is 7.0 years, compared to 3.5 for the private sector

Distinguishing elements of public pension plans

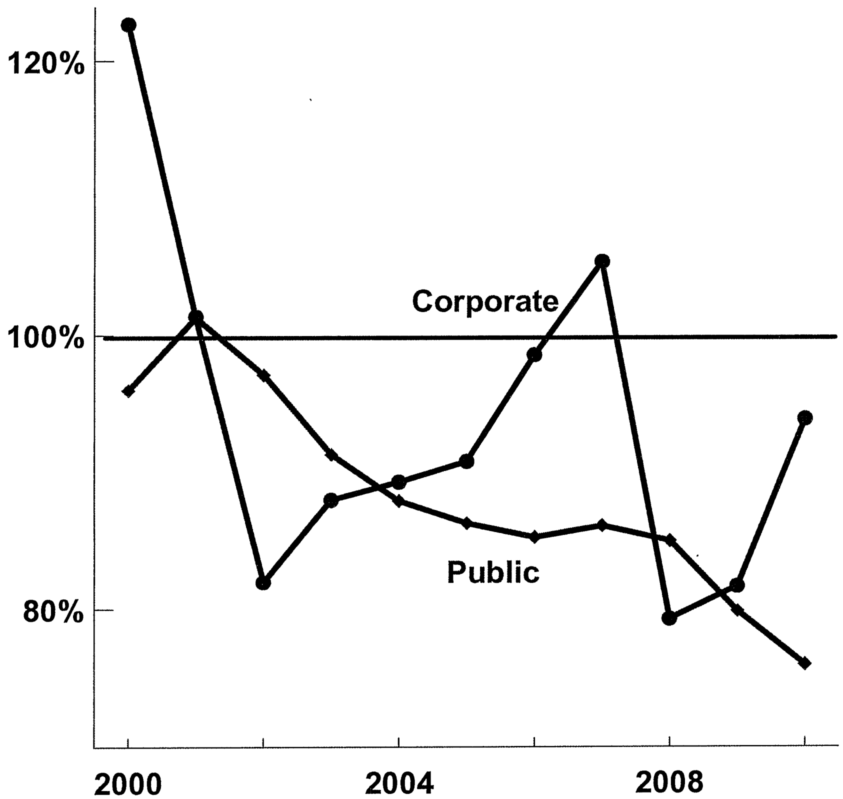
- Mandatory participation
- A benefit that reflects the worker's salary and length of service
- Employee-employer cost sharing
- Assets that are pooled and professionally invested
- A benefit that cannot be outlived

Why Have Pension Plans Largely Gone Away in the Private Sector?

- Studies and surveys consistently show that the leading cause of private employers' decision to close or freeze their pension plan is due to the uncertainty and volatility of employer costs
- Private employer pension costs are determined by federal regulation, which ties contributions to interest rates
- This method for determining costs results in extreme volatility and uncertainty from year to year

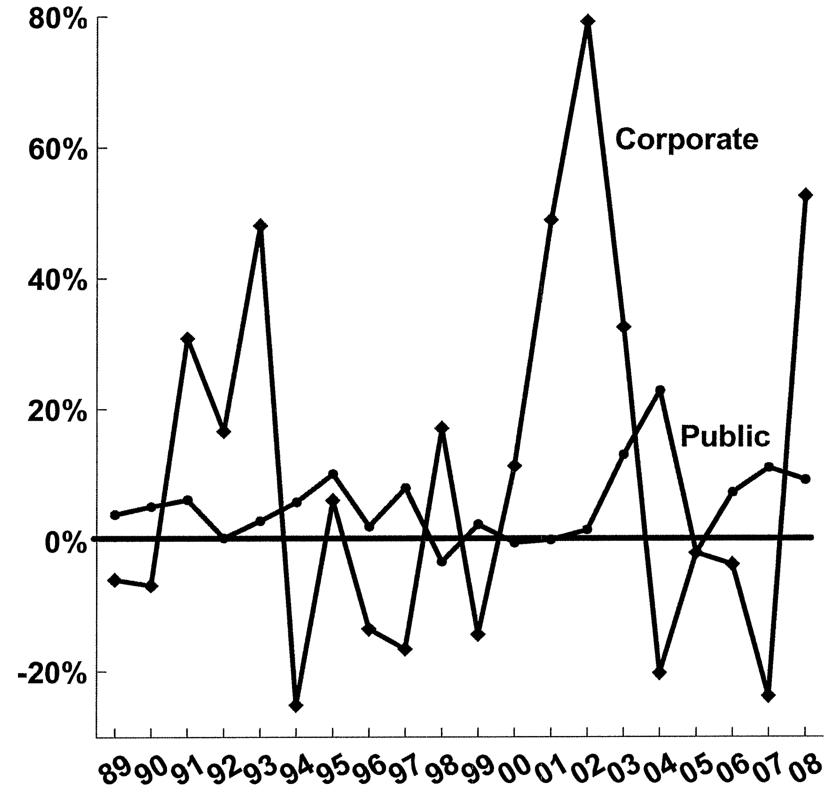
Corporate vs. public pension funding levels and costs

Corporate and public pension funding levels, 2000 to 2010



Milliman and Public Fund Survey

Change from prior year in corporate and public pension contributions, 1989 to 2008



US Dept of Labor,
US Census Bureau,
Milliman

Challenges presented to employees when a defined contribution plan is the primary retirement benefit

- **Leakage** – assets leaving the retirement account before the account holder reaches retirement age
- **Fees** – the cost of a typical defined contribution plan exceeds one percent of assets annually
- **Lower investment returns** – DC plans underperform professionally managed retirement pools by around one percent annually
- **Timing** – an employee who retires during a down market will suffer relative to those who retire during an up market
- **Longevity risk** – a retiree could outlive their assets

"A Better Bang for the Buck"

- 2008 study by the National Institute on Retirement Security
- Key finding: A traditional pension can deliver the same retirement income at 46% lower cost than an individual defined contribution (DC) account.
- This is due to lower pension plan administrative and investment costs, higher investment earnings, and pooled assets that spread risk over long periods and many lives

Challenges presented to employers when a defined contribution plan is the primary retirement benefit

- Loss of a human resources management tool
- A pension plan is particularly helpful for retaining qualified workers needed to perform essential public services
- Retention is key for certain groups: teachers, law enforcement personnel, and members of other career-oriented groups
- A pension plan promotes the human resources management objective of orderly turnover, i.e., retirement, or ability to retire, at an appropriate age
- Orderly turnover facilitates workforce management objectives and can promote lower salaries

Challenges presented to taxpayers when a defined contribution plan is the primary retirement benefit

- General loss of retirement security: 12+ percent of the nation's workforce is employed by state or local government and 85% have a pension plan
- Loss of economic benefits emanating from pension payments
- Public pension benefits reach literally every city and town in every state
- Pensionomics*: Each dollar contributed by Kansas taxpayers to public pension plans supported $5.74 in economic activity in the state
- The economic effects of public pensions are particularly pronounced in rural areas

* *National Institute on Retirement Security*

What has been the experience of DC plans as the primary retirement benefit in the public sector?

- Nebraska found that its defined contribution plan for state and county workers was resulting in workers reaching retirement financially unprepared
  - Switched to a cash balance plan in 2003
- West Virginia switched its teachers to a DC plan in 1993, then back to the pension plan in 2005
  - Experience with a DC plan went badly
- Michigan state workers hired since 1997 have only a DC plan
  - DB plan cost has risen to ~17 percent of pay to amortize the UAL
  - The state is saving because of low participation in the new DC plan
- Alaska closed its pensions to all new hires in 2006
  - DB plan cost has risen sharply since

Primary causes of public pension unfunded liabilities and growing costs

- Failure to pay required contributions
- Establishment of benefits without ensuring a sustainable funding source
- Failure to manage liabilities, such as through costly benefit provisions
- Failure to maintain appropriate actuarial assumptions
- Investment losses since 2000
- *All of these factors except the investment losses are within the control of the plan sponsor*
- *Plans that have avoided these factors are in good condition*

The universal retirement benefit equation:

$$C + I = B + E$$

In any retirement plan, contributions plus investment earnings equal benefits plus expenses.

A defined benefit plan is not necessarily more expensive or more risky than a defined contribution plan.
It all depends on how the plan is designed.

Incorporating pension elements into DC plans

"DC plans should adopt automatic enrollment, automatic deferral increases, lifecycle funds as default options, annuity and guaranteed income options, and investment advice."

Abby Johnson, Principal at Fidelity Investments, 2006 (paraphrased)

Many states have established hybrid plans in recent years

- Nebraska provides a cash balance to its state and county workers, as do the Texas municipal and county & district plans
  - benefits are flexible
  - plans are in solid funding condition
- Combination DB/DC plans, featuring a reduced DB component combined with a DC plan
  - Georgia
  - Indiana
  - Michigan
  - Ohio
  - Oregon
  - Utah
  - Washington

Collective Defined Contribution Plans

- Pension plan in which the one fixed element is the employer contribution
- If actuarial experience strays from assumptions, a combination of employee contributions and benefits are adjusted to restore actuarial balance
- Illustrates the flexibility available in a pension plan and that a pension plan is not necessarily expensive

Final Thoughts

- Retirement security benefits everyone
- Core elements of public pension plan design promote retirement security:
  - mandatory participation
  - employee-employer cost-sharing
  - pooled assets invested by professionals
  - annuitized benefits
- An employer-sponsored retirement benefit should serve as a workforce management tool and old-age poverty insurance
  - Not a wealth-generating vehicle
- As a large and stable employer, government is well-suited to sponsor such a benefit

Contact Information

- Keith Brainard
- Research Director
- National Association of State Retirement Administrators
- keithb@nasra.org
- 512-868-2774