

Public Pension Systems: Plan Designs and Efficiencies

State of Minnesota Legislative Commission on Pensions and Retirement

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Diane Oakley
Executive Director



NATIONAL INSTITUTE ON
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Reliable Research. Sensible Solutions.

About NIRS

- Nonprofit, nonpartisan research organization founded in 2007.
- Credible research and education programs regarding retirement security with focus on pensions – public and private sector.
- Reports, primers, commentary, conferences, media interviews, testimony and more.



Public Pension Stakeholders

Purpose of providing retirement plan is to achieve stakeholder objectives.

- **Employers** who seek to attract and retain qualified workers needed to perform essential public services and have orderly workforce turnover.
- **Taxpayers** who seek the provision of public services at a cost that is fair and reasonably stable and predictable; also seek to minimize dependence on public assistance..
- **Employees** who seek compensation that is competitive and a retirement benefit that promoted retirement security.

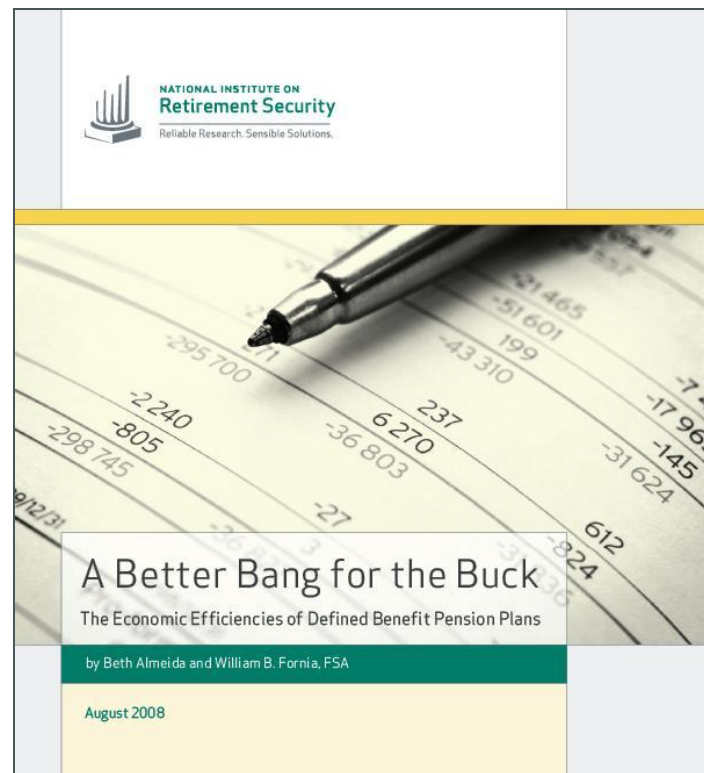


Important to Keep Focus on Retirement Policy

- Retirement security benefits everyone.
- Employer-sponsored retirement benefit is a workforce management tool, old-age poverty insurance, and stabilizing factor in the economy.
- As a stable employer, government is well-suited to sponsor pensions.
- Core elements of pension promote retirement security:
 - Mandatory participation
 - Employee-employer cost-sharing
 - Benefit adequacy
 - Pooled assets invested by professionals
 - Lifetime benefits



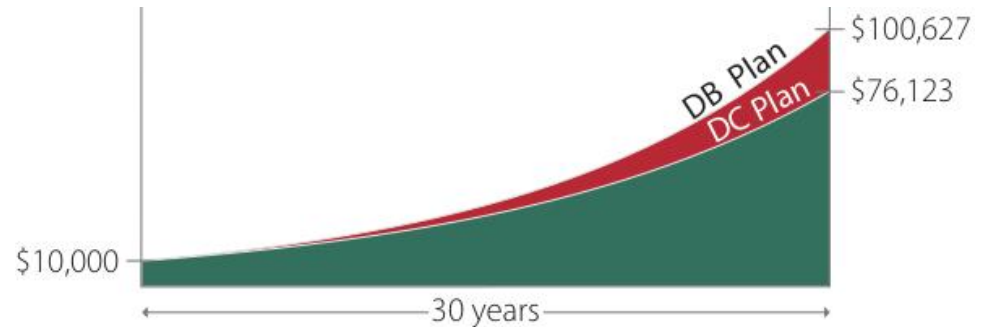
Economic Efficient: DB Plans Deliver the Same Benefit for Less



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DB More Economically Efficient

**How \$10,000
Invested Grows
over 30 Years**



Longevity Risk Pooling

- Manage the chance of running out of money in retirement
- Avoid the “over-saving” dilemma and do more with less

Maintenance of Portfolio Diversification

- Take advantage of enhanced investment returns from an ongoing balanced portfolio

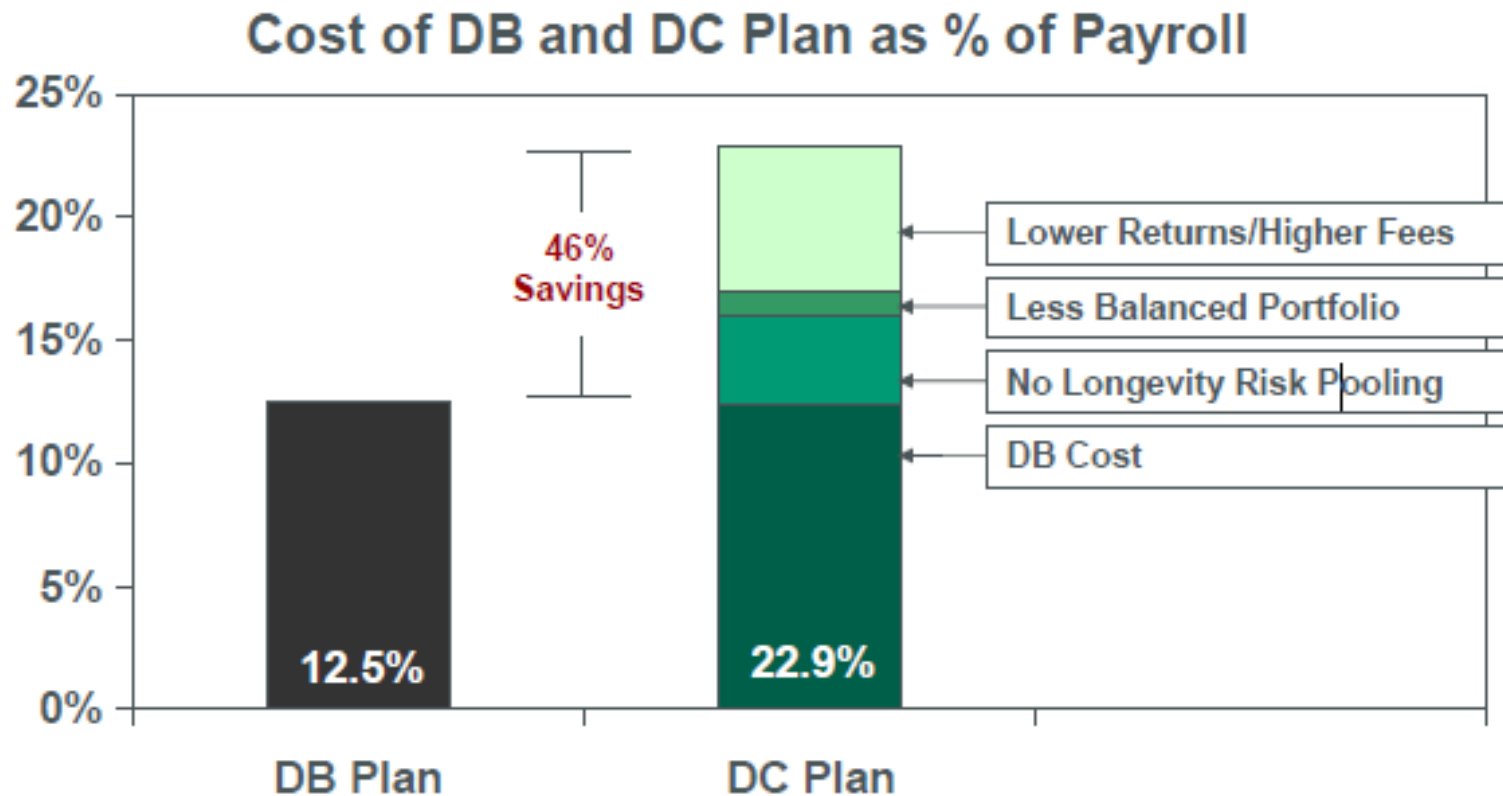
Superior Returns

- Achieve greater investment returns vs. individual accounts



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DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plans



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Pensions Are Sustainable

Lessons from Well-Funded Pensions

Studied Six Well-Funded Public Pension Plans:

**New York,
Delaware, Idaho,
Illinois Municipal,
North Carolina,
Texas**



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Lessons from Well-Funded Pensions

Annual Required & Normal Cost Contributions

Paying the full ARC each year maintains a well-funded plan with stable contributions.

- **Texas TRS:** Constitution mandates payment.
- **Illinois MRF:** Statute mandates local government payment.
- **Idaho PRF:** Statute mandates state government payment.

Paying the normal cost rate (NCR) leads to stability.

- **Idaho:** The employer rate cannot fall below the NCR.
- **Illinois:** Only when the funding ratio is substantially above 100% can the excess amount be used to reduce the NCR.
- **Texas:** Requires that the employer contribution rate cannot fall below a certain level.

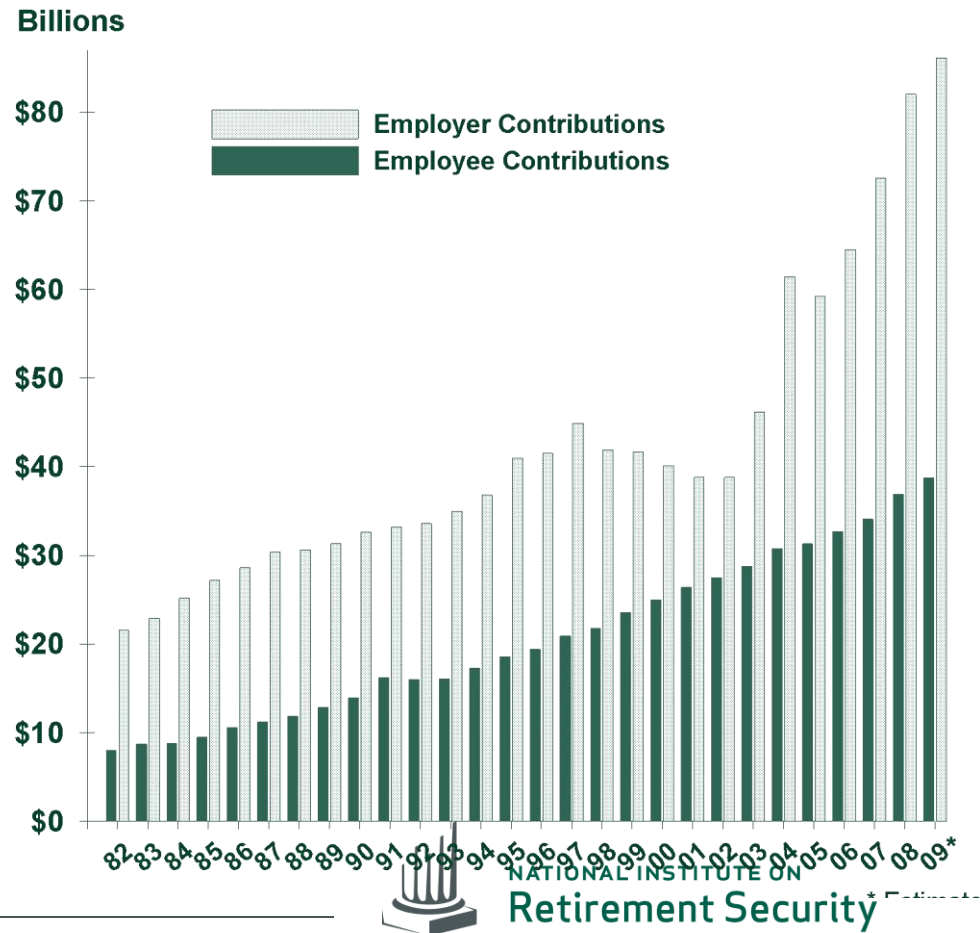


Lessons from Well-Funded Pensions: Shared Responsibility Improves Funding

Employee contributions to help share the plan cost:

- In Idaho employees contribute 60% of the Employer rate.

Employee and Employer Pension Contributions, 1982 to 2009



Other Lessons Learned...

- **Benefit improvements that are actuarially valued before adoption and properly funded;**
- **COLAs granted responsibly;**
- **Anti-spiking measures that ensure actuarial integrity, transparency;**
- **Economic, actuarial assumptions that can reasonably be expected to be achieved long term.**



Investment Assumption of a 5% Real Return over 30 Years Not Exceptional

Real Returns on a Hypothetical Pension Portfolio
58% Equity/42% Fixed Income
Rolling Periods, 1926-2010

Time Frame (Years)	Number of Periods	Compound Annual Real Returns	
		Average (Mean)	Worst Observed Outcome
1	85	6.28%	-24.60%
5	80	7.30%	-4.56%
10	75	6.59%	-1.47%
20	65	6.14%	1.24%
30	55	5.71%	3.76%
40	45	5.42%	3.91%
50	35	5.47%	4.02%

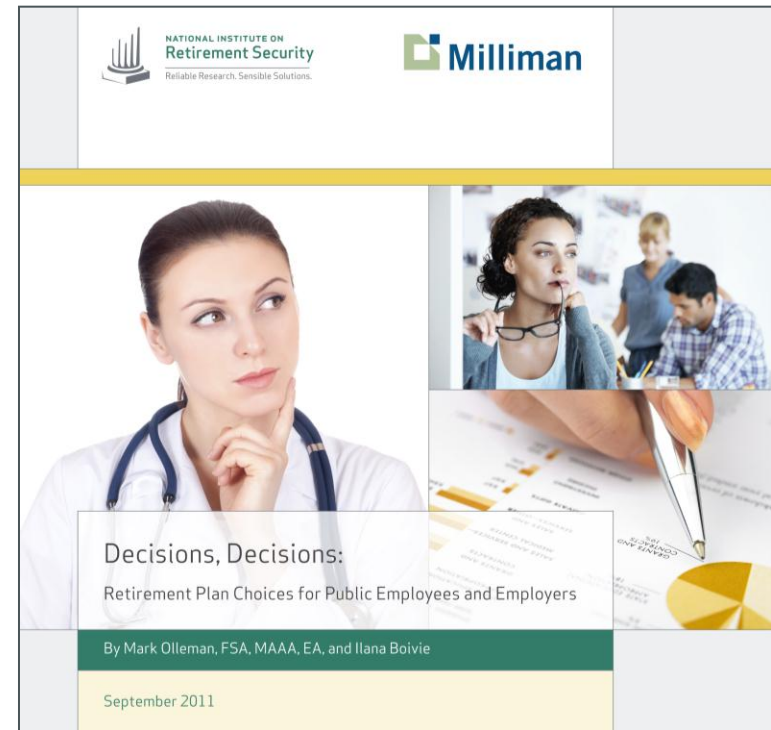


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Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers

A Key Finding

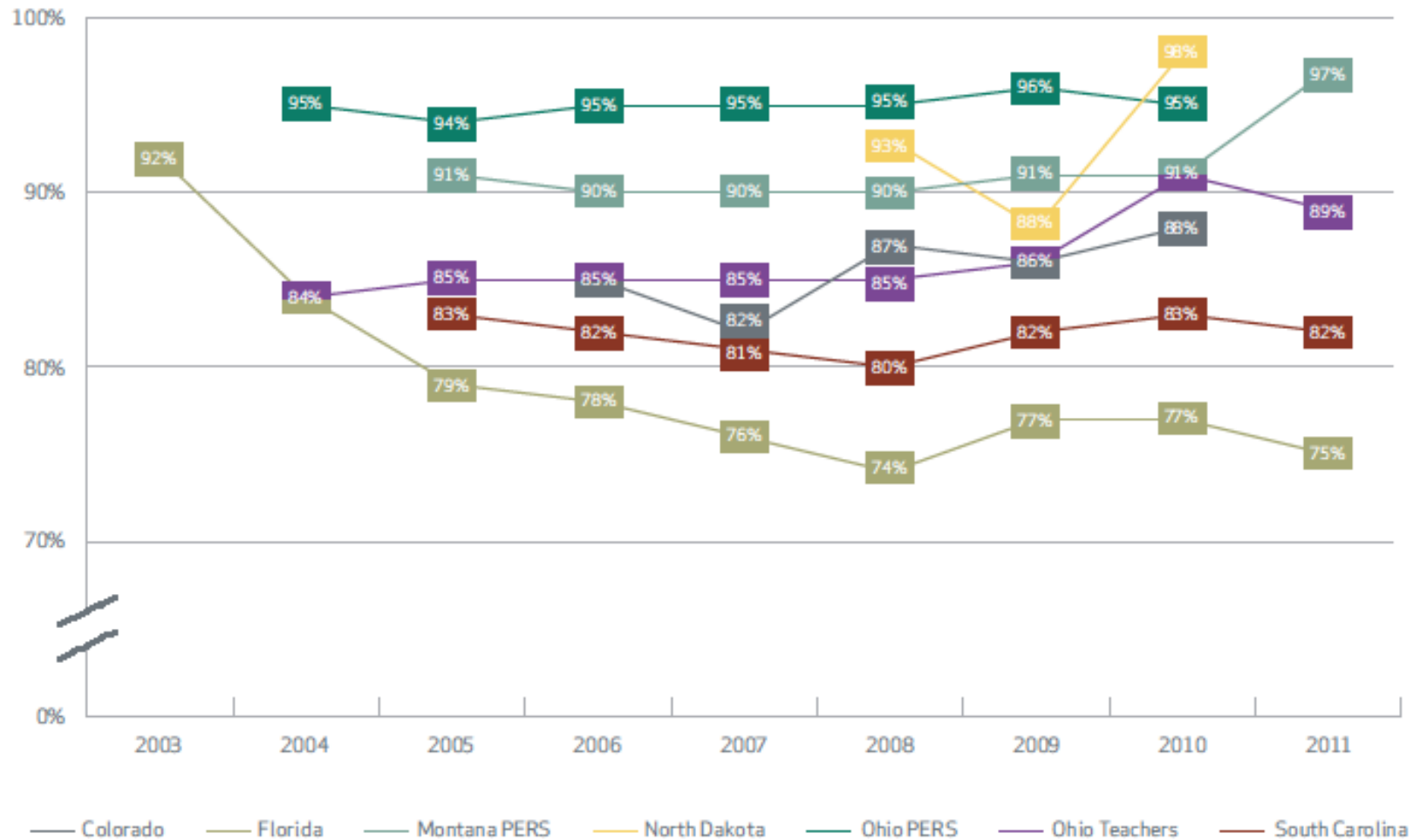
When given the choice between a primary DB or DC plan, public employees overwhelmingly choose the DB pension plan.



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Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers

Figure 1. Total DB Elections over Time



The Utah Retirement System

	All Employees Hired Before July 1, 2011	Employees Hired after July 1, 2011: Hybrid and DC Options	
	Tier 1 DB	Tier 2 Hybrid Plan	Tier 2 DC Plan
Employer Contribution	Employer pays total cost with no cap	Always 10% of pay	Always 10% of pay
Employee Contribution	0% of pay into DB plan	Automatic payroll deduction required if DB contributions are greater than 10%	Employees may contribute, but contributions are not mandatory
DB Normal Cost Rate	11.71% of pay	7.50% of pay	N/A
DC Account Contribution	1.5% of pay	10% of pay less required DB contribution	10% of pay
Final Average Salary Period	3 years	5 years	N/A
Percent of Final Average Salary Replaced per Year of Service	2.0% multiplier	1.5% multiplier	N/A
Unreduced Benefit	Age 65, or 30 years of service, age 62 at 10 years of service with actuarial reductions, or age 60 at 20 years of service with actuarial reductions	Age 65 or 35 years of service	N/A
Cost of Living Adjustment	CPI up to 4%	CPI up to 2.5%	N/A
Vesting Period	4 years of service	4 years of service	4 years of service



DB-DC Choice Adopted in Utah Pension Reform: Early Outcomes

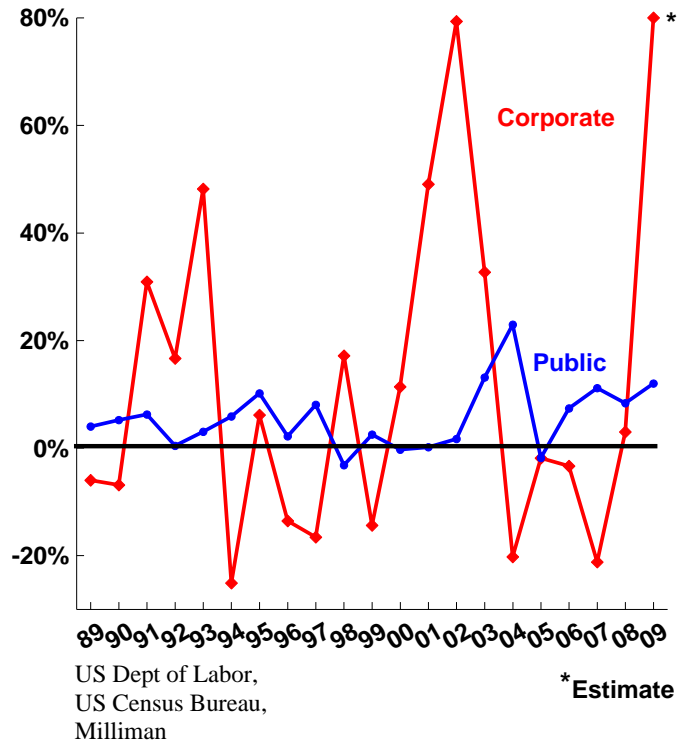
- New employees (7/1/11) can choose between DC plan or DB hybrid, and 82% chose the DB plan, according to URS.
- 10% employer contribution; participants in DB plan responsible to fund shortfalls.
- Switch to DC/hybrid did not solve funding, and employers contribute ____% to reduce unfunded liability across all employees.



On the Right Track

Private and Public Sector Pensions

Comparison of change from prior year in corporate and public pension contributions, 1989 to 2009



- DB pensions persist among largest private sector employers.
- Federal regulations, funding volatility killed Private Sector DB Plans, NOT Costs



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Switch to Individual Accounts Not a Viable Solution

Issue Brief

On the Right Track?
Public Pension Reforms in the Wake of the Financial Crisis
By Nari Rhee, PhD and Diane Oakley

December 2012



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- Closing/freezing DB plans and switching to individual accounts does not address underfunding, entails significant costs.
- Majority of states ensure long-term sustainability by modifying DB plans.
- Pensions balance compensation, boost retention and productivity, and enable quality services for a lower cost.
- Hurt recruitment and retention of skilled workers, or lead to higher compensation, while undermining retirement readiness.



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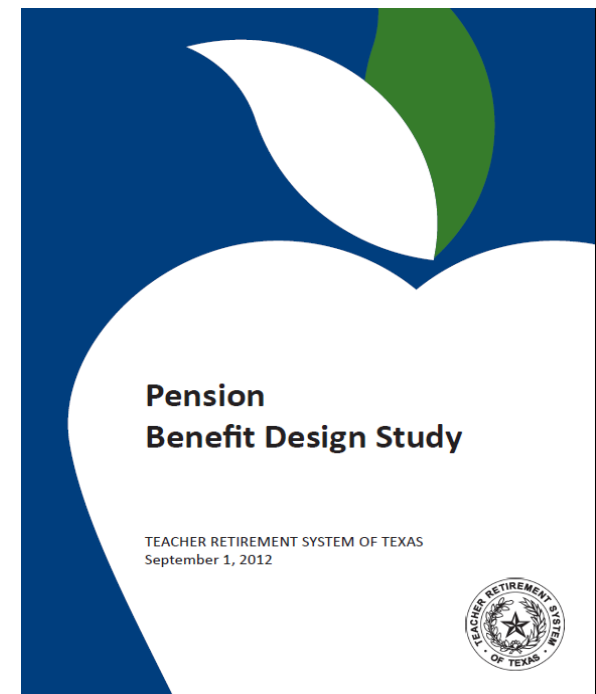
WV TRS Lesson: Switch from DB to DC Plan Did Not Solve Underfunding

- WV closed its Teachers Retirement System and teachers hired after 7/1/91 had a DC plan.
- In 2005, a study found teachers near retirement had on average \$25,000 in their DC accounts.
- Meanwhile TRS was 20% funded and the plan had nearly 2 retirees for each active employee.
- Reopened TRS and today 36,000 employees & 32,000 retirees are in TRS that is 58% funded, almost 200% improvement and on track for 2034.



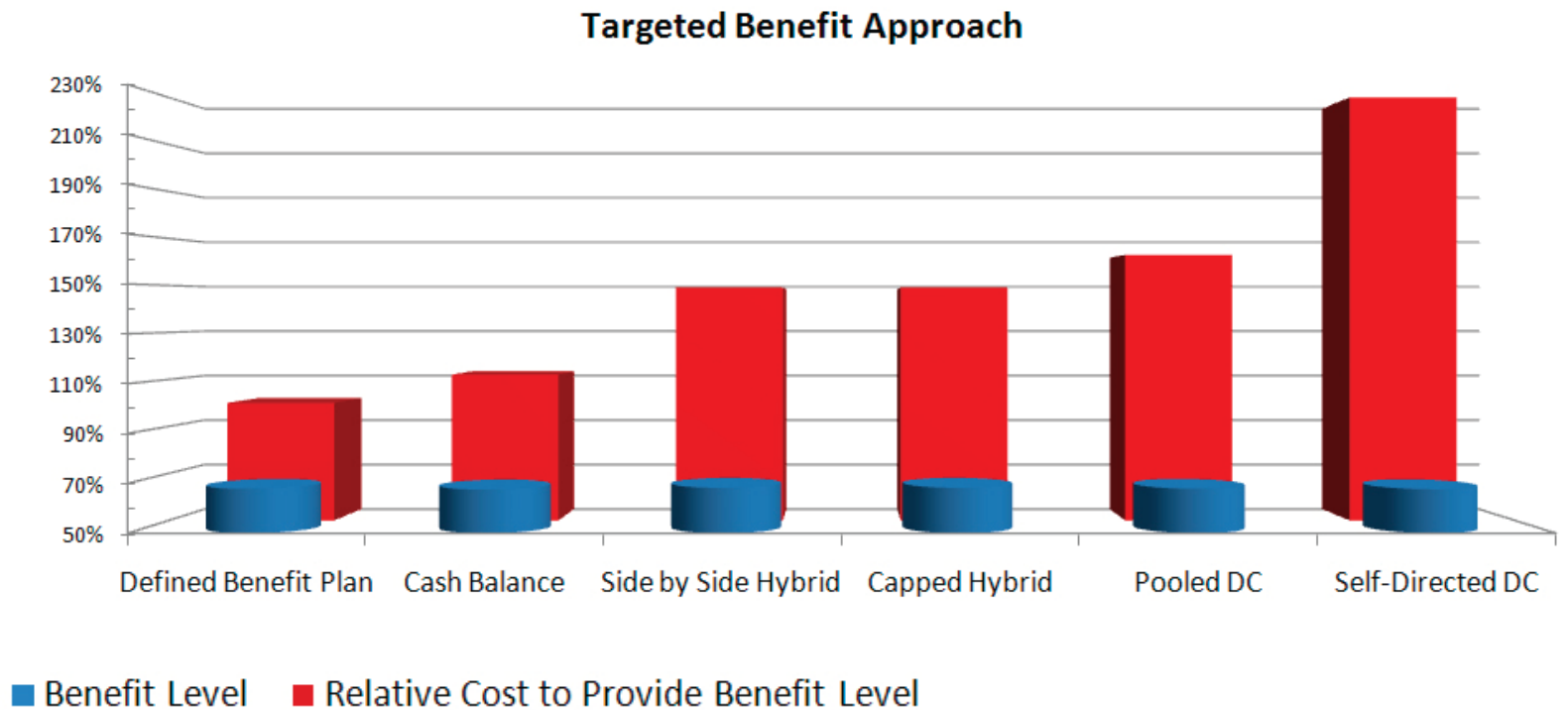
Texas Teachers Retirement System Benefit Design Study

- \$11.7 billion/49% increase in closed DB plan liability due to a more liquid asset allocation
- Cost comparison of multiple plan design options
 - DC most expensive
 - DB least expensive



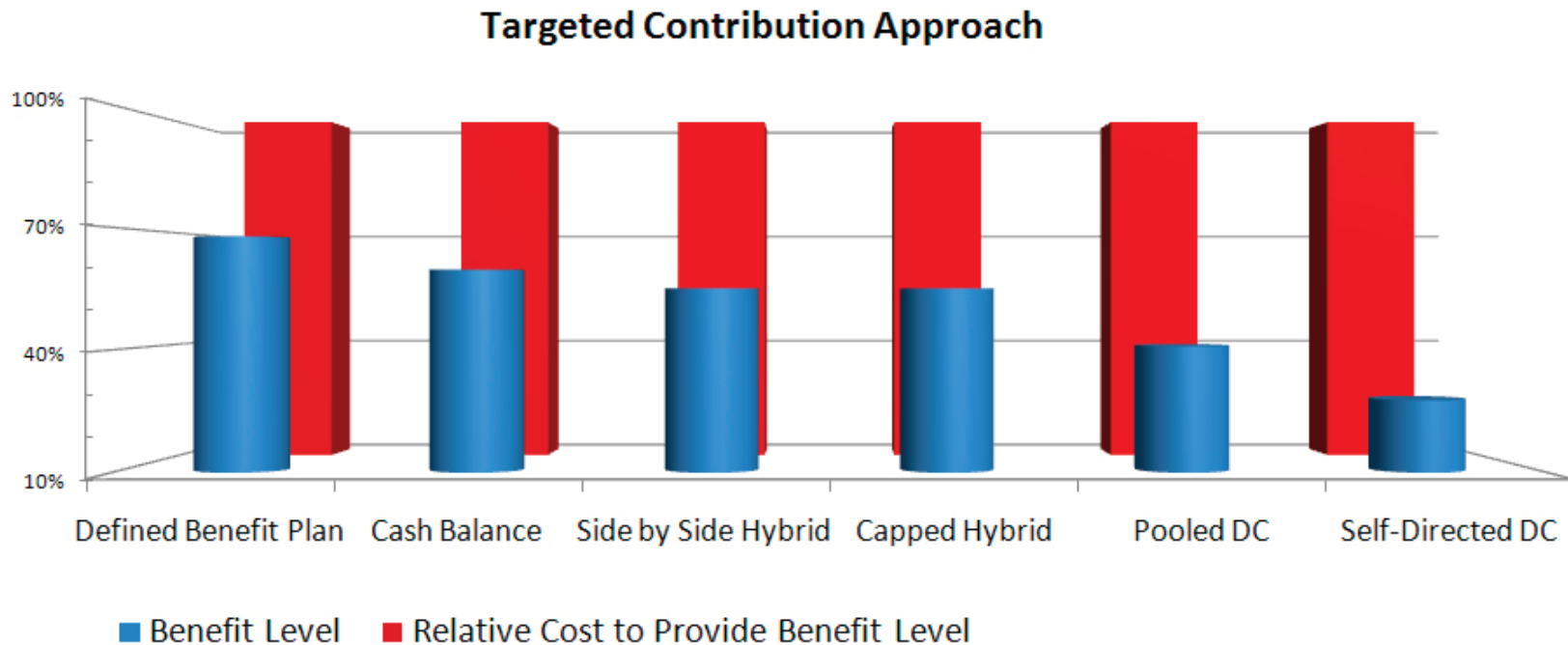
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Pension Benefit Design Study



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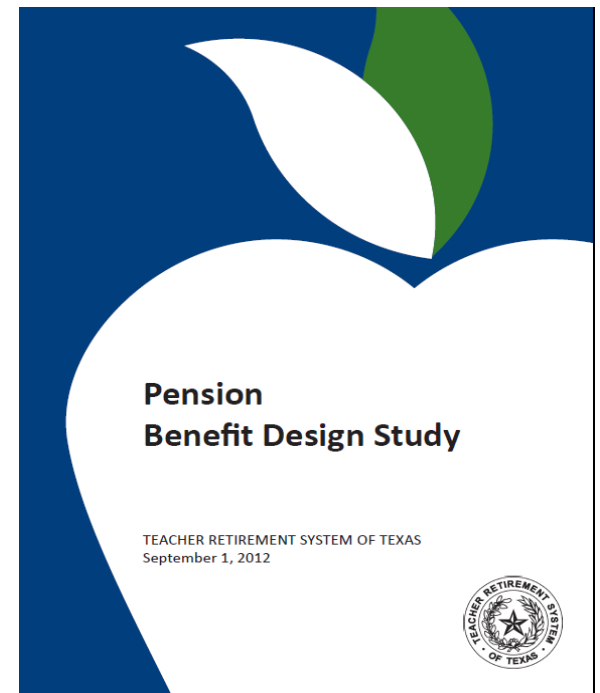
Pension Benefit Design Study



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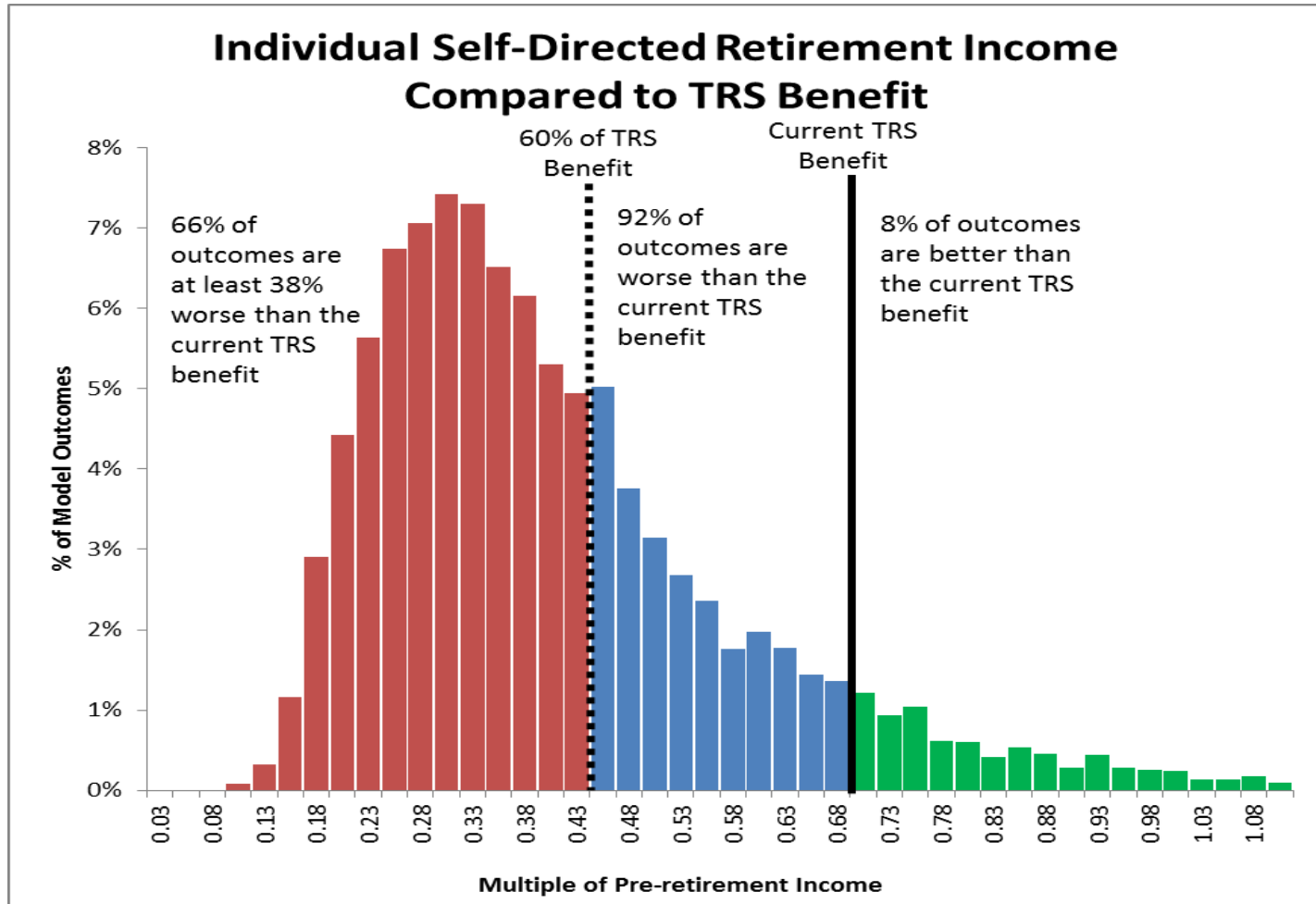
Texas Teachers Retirement System Benefit Design Study

- Simulations to realistically measure probable outcomes for workers in DC system:
 - lower returns
 - higher fees
 - market volatility
- Workers would have only a **50% chance** of reaching **60% of the benefit** provided by the DB plan, **at the same cost.**



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Pension Benefit Design Study



Employer Challenges When an Individual Account is Primary Benefit

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



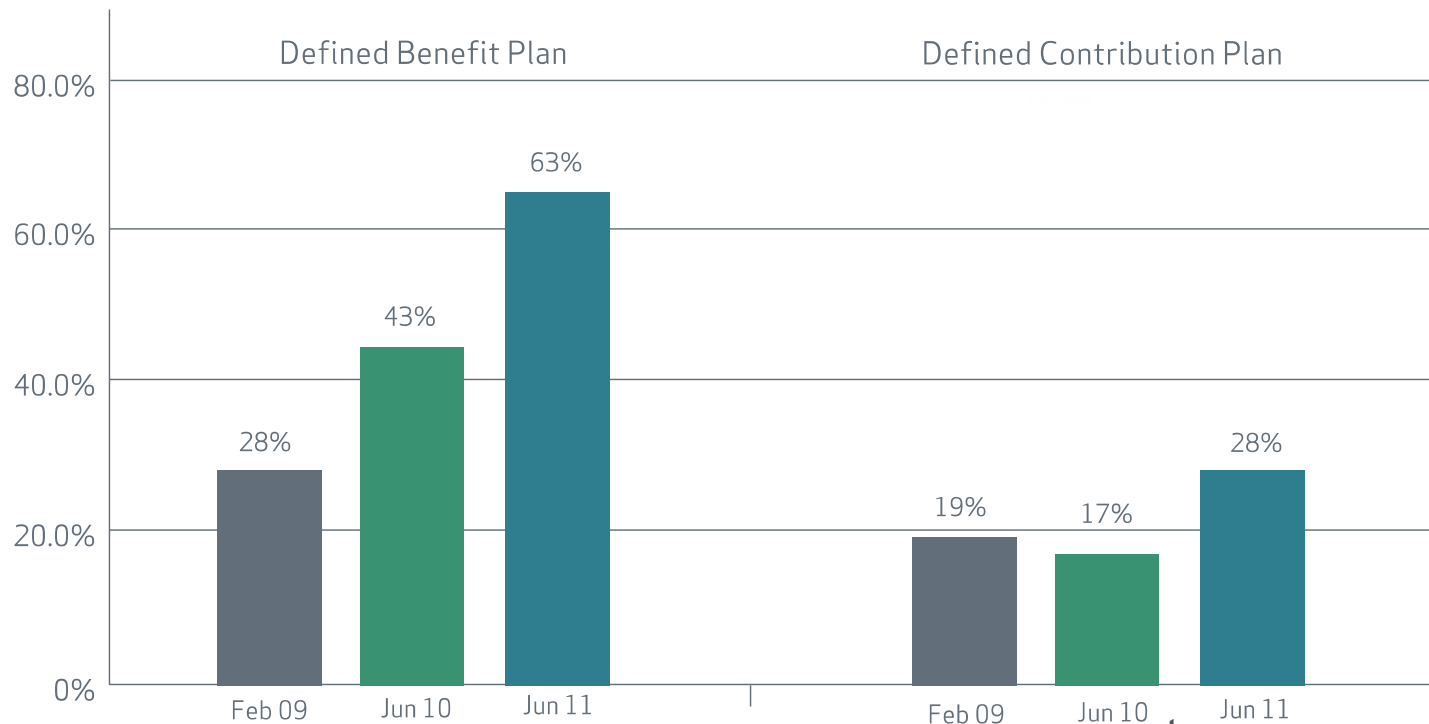
Distinguishing Features of the Public Sector Workforce

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



Importance of Retirement Plans to Attract Workers Under Age 40

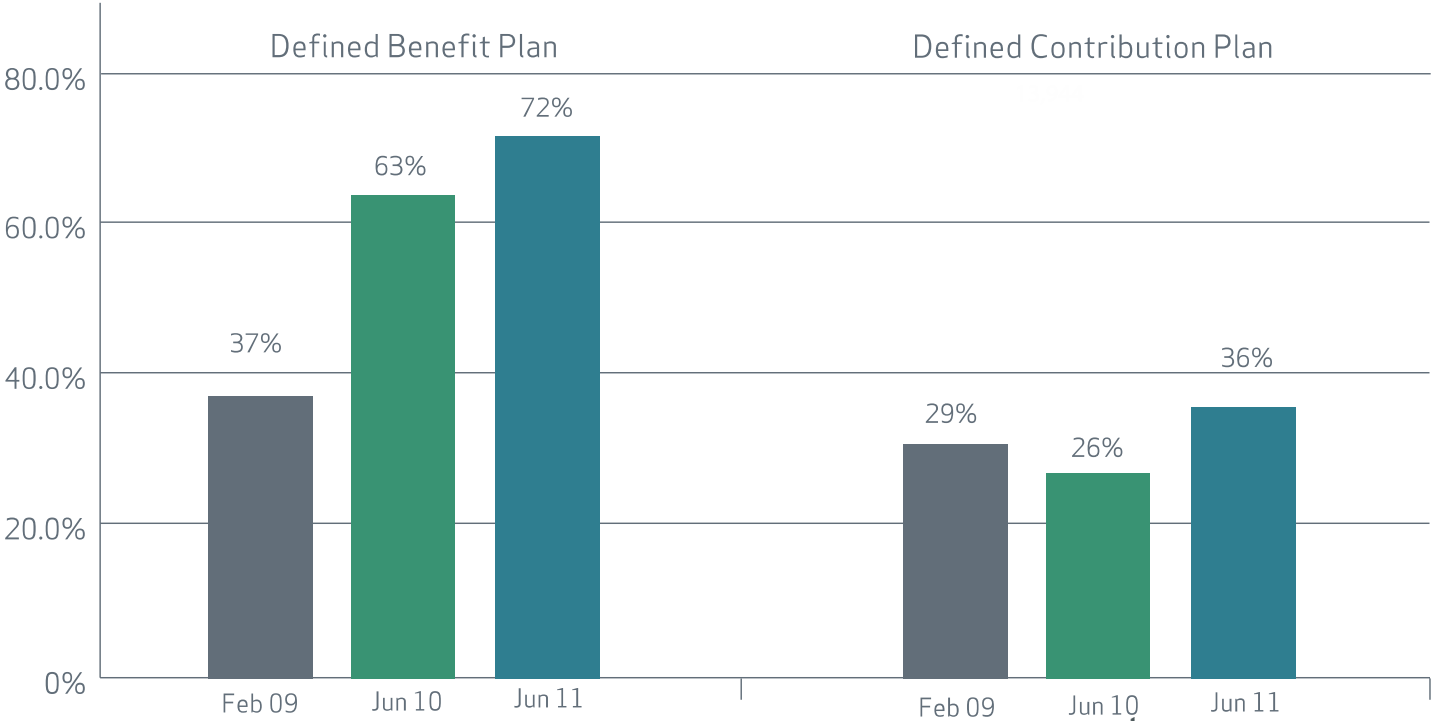
My company's retirement program is an important reason I decided to work for my current employer



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Importance of Retirement Plans to Retain Workers Under Age 40

My company's retirement program is an important reason I will stay with my current employer



Source: Towers Watson, *Attraction and Retention; What Employees Value Most*

Most Important Factors in Attracting Employees Younger Than 40 to Company

	Younger than 40 with DB plan		Younger than 40 with DC plan only
1.	Job security	1.	Job security
2.	Base pay	2.	Base pay
3.	Health care benefits	3.	Health care benefits
4.	Retirement benefits	4.	Vacation/paid time off
5.	Vacation/paid time off	5.	Organization's reputation as a great place to work
6.	Career development opportunities	6.	Length of commute
7.	Organization's reputation as a great place to work	7.	Career development opportunities
8.	Promotion opportunities	8.	Challenging work
9.	Incentive pay opportunity	9.	Retirement benefits
10.	Length of commute	10.	Promotion opportunities



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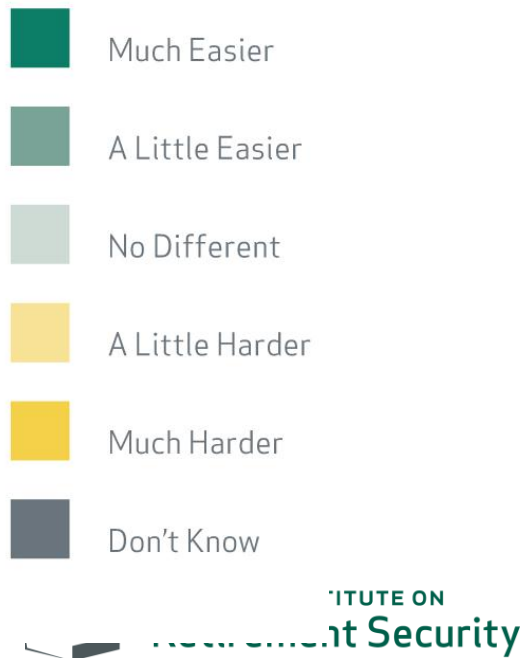
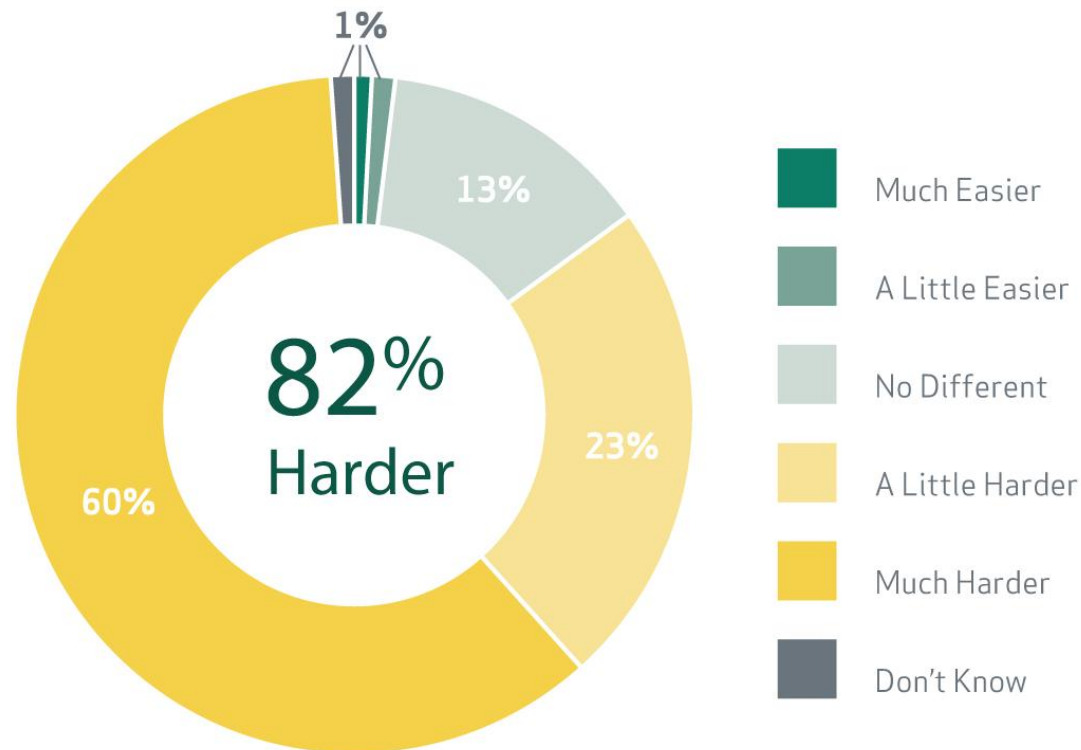
Most Important Factors in Attracting Employees Age 50 and Older to a Company

	Age 50+ with DB plan		Age 50+ with DC plan only
1.	Job security	1.	Health care benefits
2.	Retirement benefits	2.	Job security
3.	Health care benefits	3.	Length of commute
4.	Base pay	4.	Base pay
5.	Challenging work	5.	Vacation/paid time off
6.	Vacation/paid time off	6.	Challenging work
7.	Organization's reputation as a great place to work	7.	Organization's reputation as a great place to work
8.	Length of commute	8.	Retirement benefits
9.	Career development opportunities	9.	Physical work environment
10.	Organization's product(s) or service(s)	10.	Organization's product(s) or service(s)



It's Only Getting Harder to Prepare for Retirement

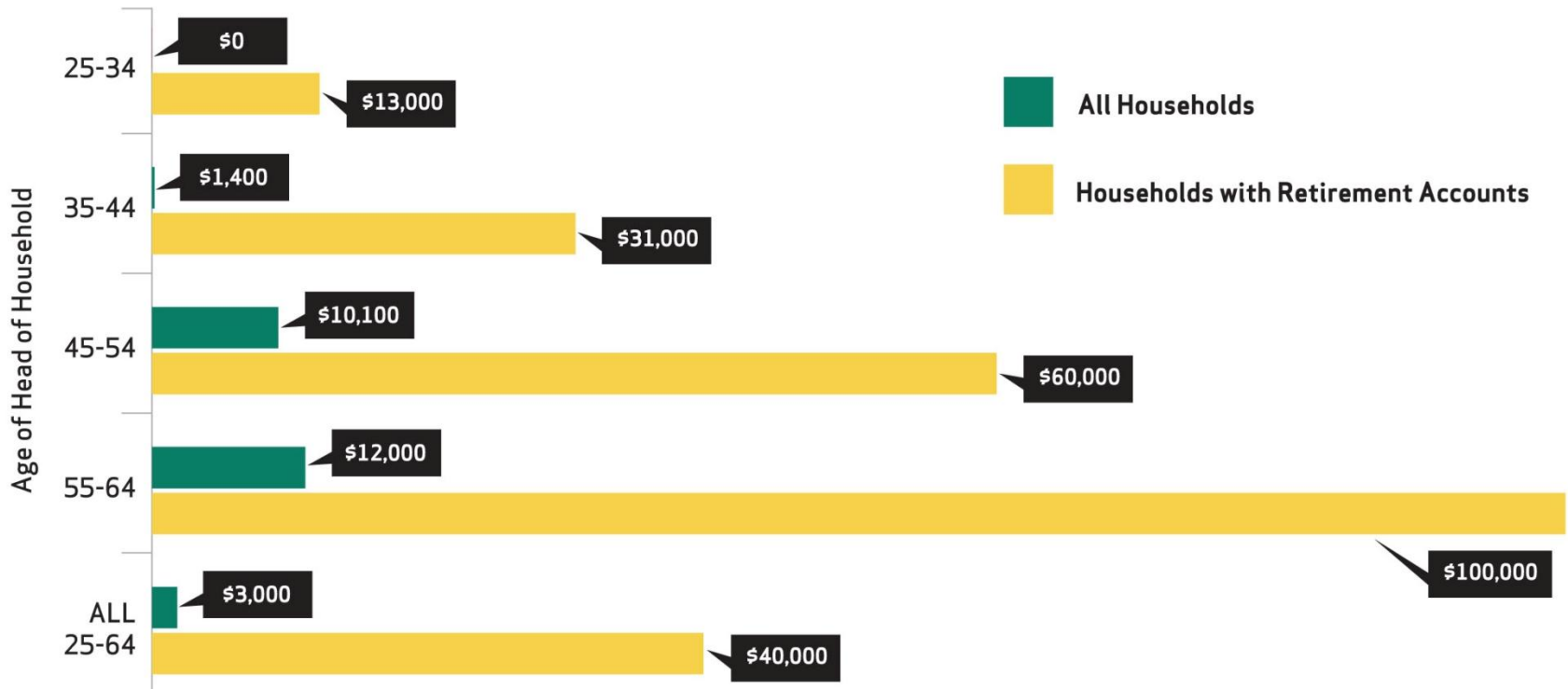
Do you feel that – compared to today – it will be easier or harder for Americans to prepare for retirement in the future, or will there be no difference?



Source: NIRS Pensions & Retirement Security 2013

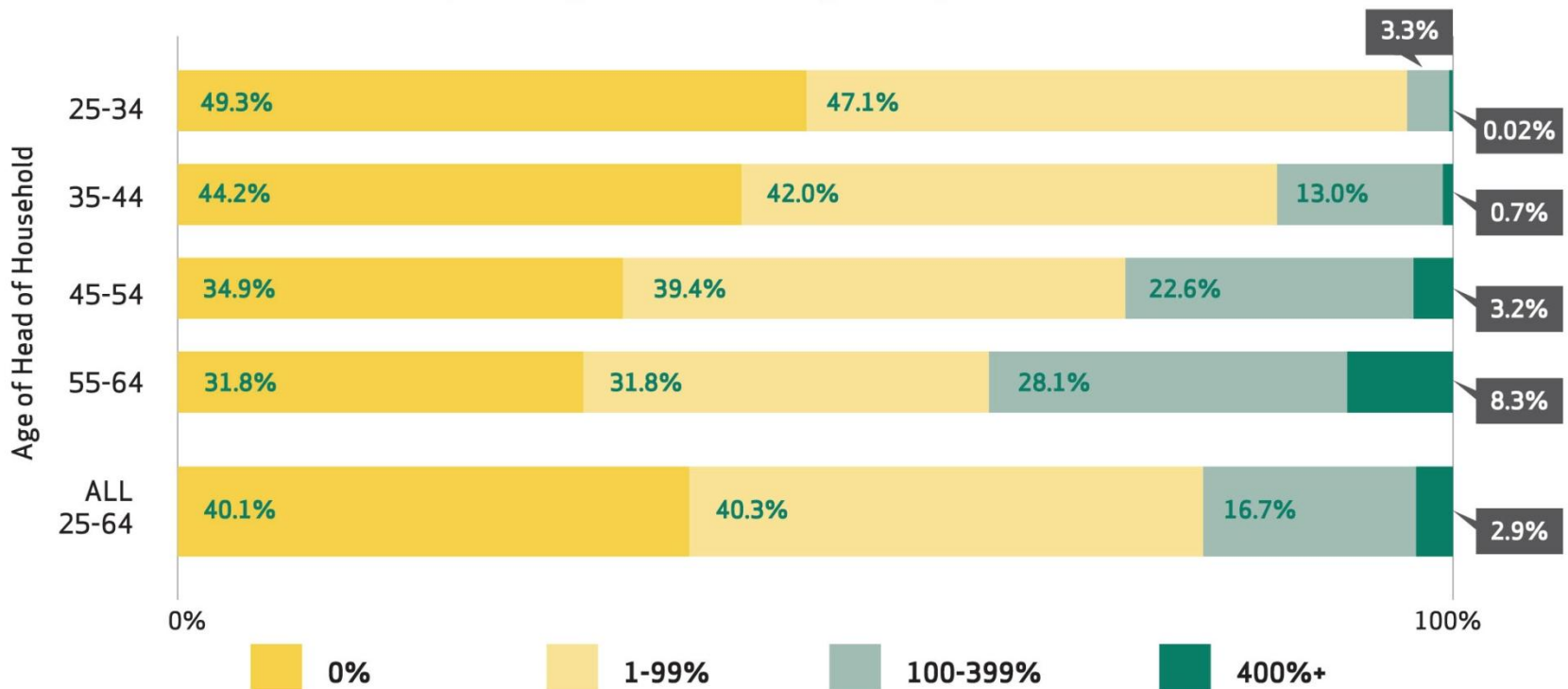
Typical Working-Age Household Has \$3,000 in Retirement Assets; Near-Retirement Household Has \$12,000

Median retirement account balance, households with retirement accounts vs. all households, 2010



4 out of 5 Households Have Less than One Times Their Income in Retirement Savings

Retirement account balance as a percentage of income among working households, 2010



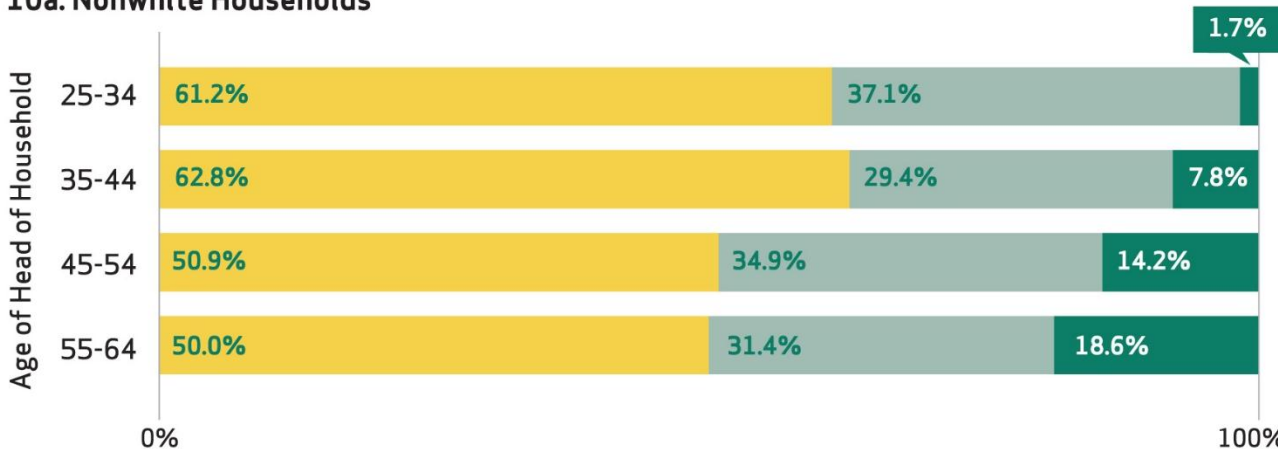
Source: Author's analysis of 2010 SCF. Universe is households with heads age 25-64, with total earnings \geq \$5,000 and $<$ \$500,000 and total income $<$ \$1M.



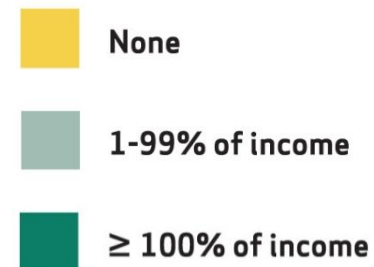
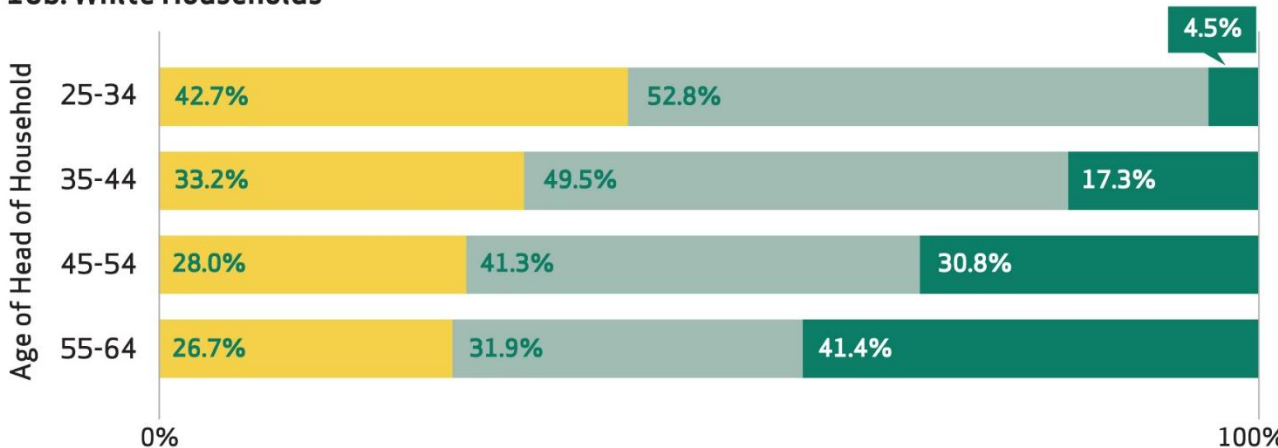
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Households of Color Are Less than Half as Likely As White Households to Have Retirement Savings at Least Annual Income

10a. Nonwhite Households



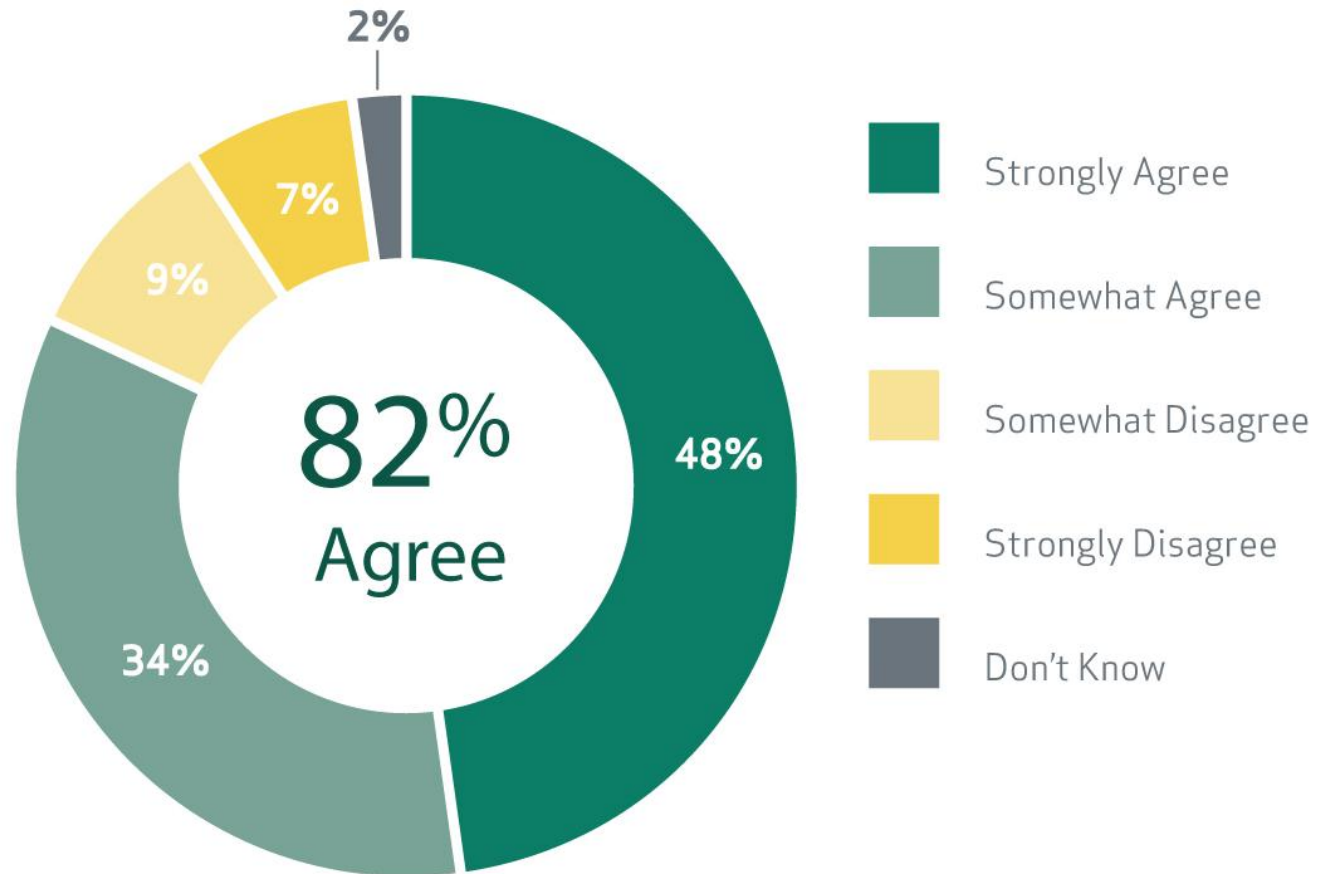
10b. White Households



Source: Author's analysis of 2010 SCF microdata. Universe is households with total earnings > \$5,000 and < \$500,000 and total income < \$1M. Values may not add up to 100% due to rounding.

Americans Want Pensions for All

To what extent do you agree/disagree that all workers, not just those employed by state/local governments, should have a



Taxpayer Challenges When Individual Account is Primary Benefit

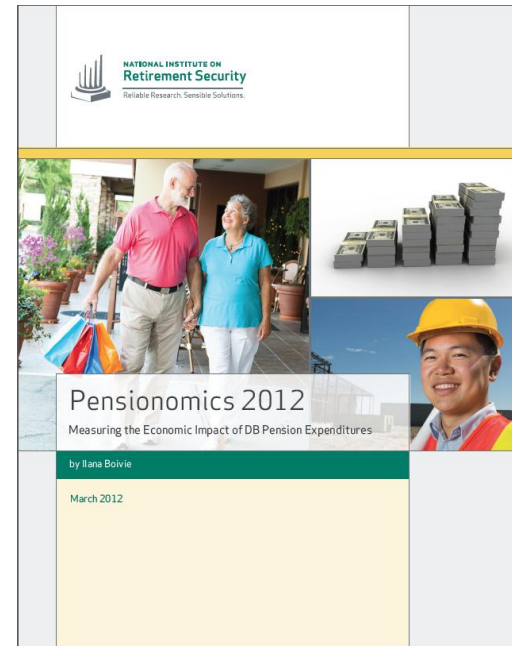
- Public pension funds account for nearly one-half of the nation's venture capital pool.
- General loss of retirement security: 12+ percent of the nations workforce is employed by state or local government and 85% have a pension plan.
- Loss of economic benefits emanating from pension payments.



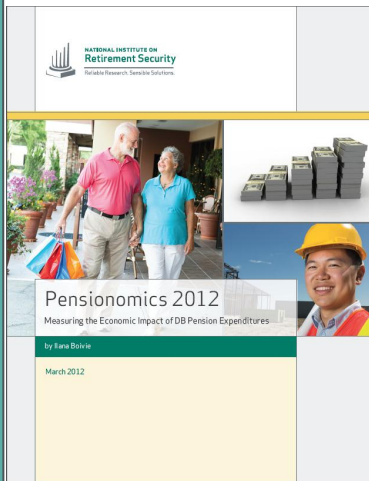
Pensionomics 2012:

Nationally, DB pension plans expenditures in 2009...

- Provided a critical source of reliable income for 18.9 million Americans;
- Supported 6.5 million jobs that paid \$314.8 billion in income;
- Created over \$1 trillion in economic output



Impact of Pension Payments to Minnesota Public Retirees



Expenditures by government retirees provide steady economic stream to Minnesota and its communities. 2009 expenditures supported:

- Nearly **41,300 jobs** that paid \$1.9 billion in wages.
- **\$5.7 billion in total economic output.** Each dollar paid in pension benefits supported \$1.68 in total economic activity.
- \$806 million in federal, state, and local tax revenues.
- **Each taxpayer dollar “invested” in plans supported \$9.62** in total economic activity in the state.



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Pensions Serve Public Stakeholders

Public Pension Plans achieve key stakeholder objectives.

- **Employers** can attract and retain qualified workers needed to perform essential public services and have orderly workforce turnover.
- **Taxpayers** are provided public services at a cost that is fair and reasonably stable and predictable; also seek to minimize dependence on public assistance.
- **Employees** obtain compensation that is competitive and a pension benefit that promotes retirement security.





RETIREMENT SECURITY MATTERS

Nearly half of U.S. workers do not have access to a retirement plan at work. **DO YOU?**

→ TELL US YOUR STORY

FOCUS

Pensions and Retirement Security 2011: A Roadmap for Policymakers



Public opinion research finds an overwhelming majority of Americans believe the nation's retirement infrastructure is crumbling and stock market volatility makes it impossible to predict retirement savings.

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NEWS

Washington Post Compares Pensions



May 22, 2011 -- In a story regarding efforts to curb retirement benefits of federal workers, *The Washington Post* features a NIRS chart comparing pensions. The article also quotes the NIRS executive director Diane Oakley on the benefits of pension plans.

[Read More >](#)

EXCHANGE

Retirement Panic Attack?



Americans are in a state of near panic about their retirement prospects. This is according to NIRS' national [public opinion poll](#) that finds 84% of Americans are concerned that economic conditions are impacting their ability to achieve a secure retirement.

[Read More >](#)

Diane Oakley
202.457.8190
doakley@nirsonline.org

