Members Only Webinar

The Great Recession: Pressures on Public Pensions, Reforms & Employment Relations

Members Only Webinar
November 9, 2012
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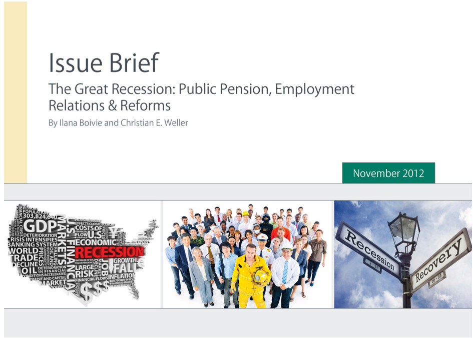

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Agenda

- Welcome and Overview
- Report Overview
- Detailed Findings
- Conclusions
- Q&A

Speakers

- **Diane Oakley**
  Executive Director, NIRS
- **Christian Weller, PhD**
  Professor of Public Policy, University of Massachusetts-Boston, & Senior Fellow, Center for American Progress
- **Ilana Boivie**
  Research Economist, Communications Workers of America, & former Director of Programs, NIRS

Why This Study

- Increased attention to public pensions since 2008. In the wake of the financial crisis:
  - Pensions, like most investors, saw a substantial decline in funded levels.
  - State budgets experienced fiscal challenges due to declining revenues.
- Some have argued to replace public DB plans with cash balance or DC plans.
- Review evidence of DB effect on labor relations, and likely effects of switch.

Key Findings

- Public employers would attract a different labor force if they switched retirement benefits away from DB plans.
- Employee turnover would increase under DC and cash balance designs.
- When given a choice, public employers and employees choose to stay with DB plans.
- In the event of a switch, employers and employees would face higher costs.

DB Plans are Powerful Labor Management Tool

- DB plans prevalent in the public sector, make up 6.5% of total compensation.
- Roughly 30% of public employees not covered by Social Security, making the DB benefit all the more important.
- DB plans make up a smaller share of total compensation earlier in employees' careers than later.

Annual Wealth Changes for New Teacher, Relative to Earnings

Figure 1:
Annual Wealth Changes of Teacher Entering in 2011 Relative to Earnings, Under DB Plan, Cash Balance Plan, and DC Plan, Constant Normal Cost

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Alternative Plan Designs

Table 1: Characteristics of Typical Pension Plans, by Plan Type

Characteristics	Defined Benefit Plan		Defined Contribution Plan
	Traditional	Cash Balance	401(k)/403(b) plans
Participation	Automatic	Automatic	Voluntary
Contribution	Employer and employee	Employer and employee	Employee with occasional employer matches
Investments	Determined by employer	Determined by employer	Typically determined by employee
Withdrawals	Annuity	Annuity or lump sum	Lump sum
Rollovers Before Age 65	Not permitted	Permitted if lump sum option exists	Permitted
Benefit Guarantee	Often Constitutionally guaranteed	Often Constitutionally guaranteed	None
Early Retirement Benefits	Common	Uncommon	Unavailable
Vesting	Up to a decade Or more	Typically shorter than in traditional pension plans	Typically immediate for employee contributions and often immediate for employer Contributions

Note: Cash balance plans typically do not exist in the public sector. The description thus relies on typical characteristics of private sector cash balance plans. Also, defined contribution plans are generally supplemental retirement savings plans in the public sector and thus tend to be voluntary.

Alternative Plan Designs

- Employees face more risk under DC plans
  - Longevity risk
  - Investment risk
  - Inflation risk

- Cash balance plans are a "hybrid" of sorts
  - Technically DB plans
  - Pooled and professionally invested assets, like DB
  - Notional (hypothetical) account, like DC

- Both accrue benefits as a fixed earnings share, higher in earlier years than later, unlike traditional DB plans.

DB Plans Increase Recruitment and Retention

- Strong recruitment and retention effects mean that DBs serve as an effective HR tool:
  - Employees with DBs twice the probability of citing retirement as important factor in taking the job.
  - 69% of employees with DBs say retirement plan is an important reason to stay, versus 37% with DCs.
- This results in lower employee turnover:
  - DB firms have lower turnover rates than non-DB firms, ranging from 20 – 200%.
  - DB coverage increases tenure by 4 years compared to no plan, by 1.3 years compared to a DC plan.

DB Plans Increase Productivity

- Recruitment and retention effects translate into productivity gains due to DB plans:
  - Research finds productivity gains linked to DBs.
  - Firms moving from DB to DC experienced productivity losses relative to firms that kept DBs.
- DB plans encourage "efficient retirement":
  - Employees withdraw from the labor force as their productivity declines.
  - DBs can—and are—designed to facilitate appropriate and optimal retirement decisions.
  - Efficient retirement is crucial during economic downturns; no "job lock" with DBs.

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DB Role in the Public Sector

- Public workers prefer DBs when given a choice:
  - 4% of Ohio employees opt for DC plan.
  - 68% of Washington employees choose the DB plan over the default combined DB-DC plan.
  - 75% of young teachers in West Virginia opted out of their DC plan and back into the DB plan.
- DBs may improve public sector productivity:
  - More likely to value their work than private workers.
  - Tend to invest more in their skills.
- Moving to a DC design could affect recruitment, retention, productivity among this workforce.

States Fiscal Challenges

- State revenues have declined:
  - 2012 Q1, revenues 5.5% below pre-recession levels.
  - $425 billion cut from budgets 2007-2011.
  - 2013 budget gap of $55 billion, closed.
- Pension funding levels have declined:
  - Wall Street losses affected all investors.
  - Funding levels fell from 85% in 2008 to 77% in 2010.
  - Estimated that additional contributions of 2.2% of payroll over 30 years can close funding gaps.

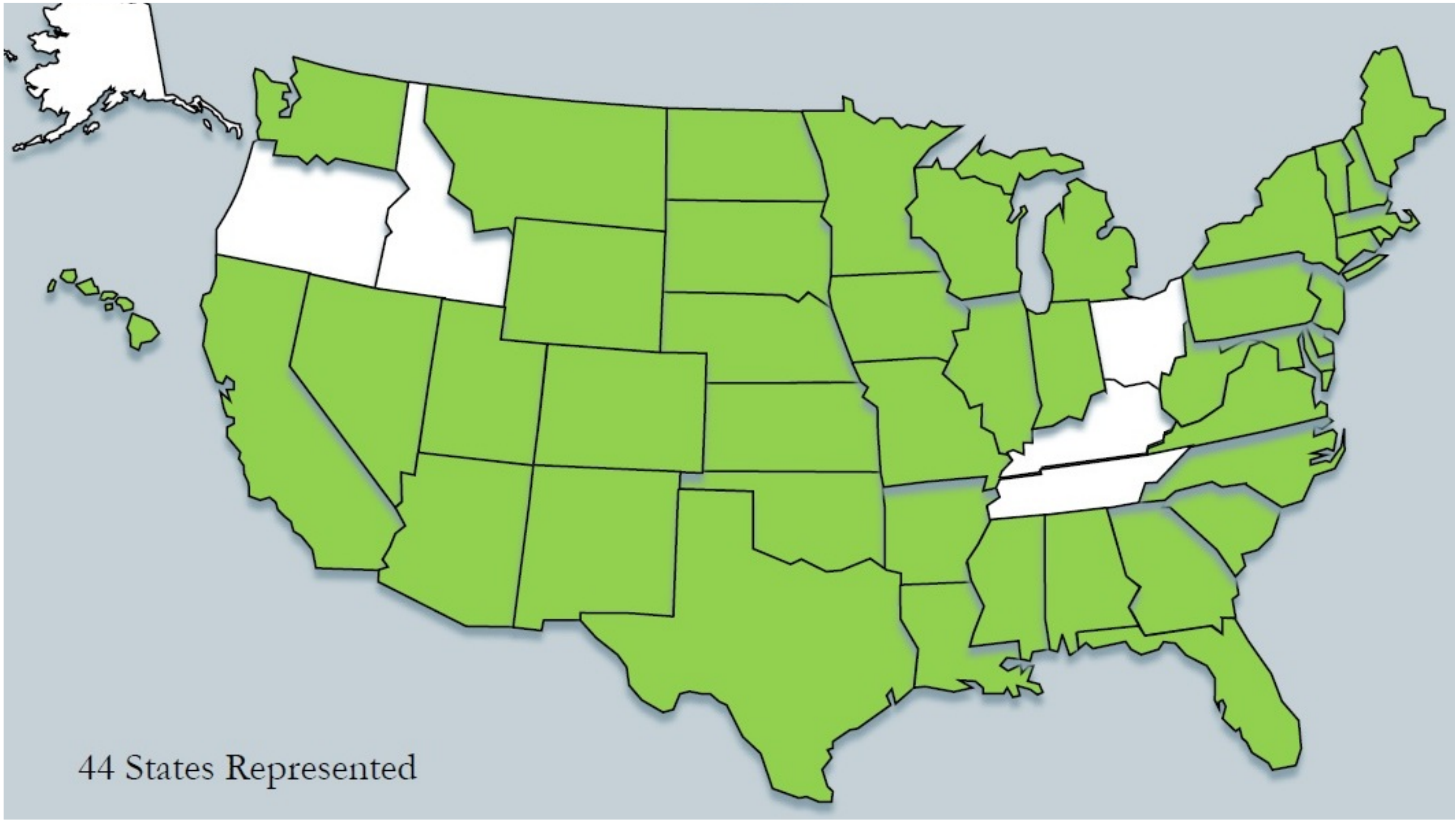
The Political Environment

- Political challenges to DBs often based in ideology:
  - Research finds that ideological orientation plays larger role that than pension/state finances.
  - States with Republican governments more likely to introduce DC bills.
- Recent political challenges include:
  - Tea Party, ATR, and other anti-tax groups.
  - 6 Republicans elected in 2010 introduced DC bills.
  - Federal interest includes the Public Employee Pension Transparency Act and the "No Pension Bailout" campaign.

States Responses to Challenges

1. States continue to make pension contributions:
   – 92% of Annual Required Contributions were made between 2001-2010.
2. 45 states have undergone significant pension reforms:
   – Increased employee contribution rates.
   – Lowered benefits: increased age/service requirements, increased vesting periods, reduced COLAs, longer FAS calculation period.
   – Some changes just for new hires, but many for active employees and retirees.

Major Pension Legislation: 2009 - 2012



Source: The National Conference of State Legislatures

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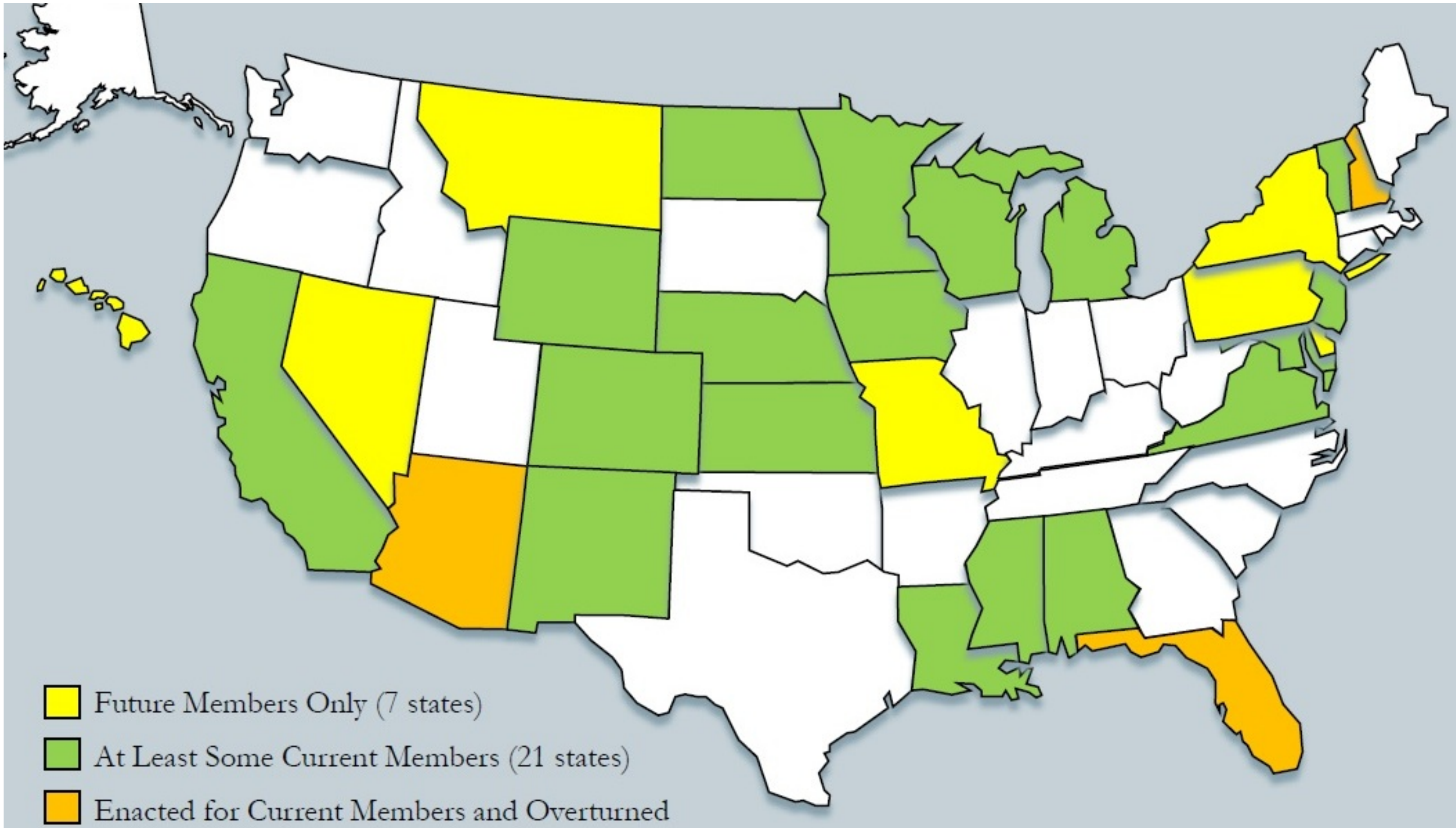
Employee Contribution Increases, 2009-2011



Source: The National Conference of State Legislatures

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Few States Have Moved from DB Structure

- "Hybrid" designs (low level DB with DC):
  - Michigan School Employees: DB portion has lower benefit, higher age/service, lower FAS, and no COLA.
  - Utah lets employees choose between hybrid and DC-only plan. The employer contribution is a flat 10% of pay to either plan.
  - Rhode Island and Virginia also have hybrids for new employees.
- Cash balance designs implemented in Louisiana and Kansas.

Conclusions

1. Public employers would attract a different labor force if they switched retirement benefits away from DB plans.

   Employees would be less committed, and invest less in skills crucial to effective government.

2. Employee turnover would increase under alternative designs.

   With compensation no longer deferred into the future, employees have fewer economic incentives to stay.

Conclusions

3. In the event of a switch, employers and employees would face higher costs.

   Due to both ending the existing DB plan and because of higher investment and administrative costs in the new plan.

4. When given a choice, public employers and employees choose to stay with DB plans.

The Bottom Line

- The vast majority of states have stayed with DB pensions, even as they have undergone major pension reforms.

- DB pensions meet the dual goals of recruitment and retention for employers and economic security for employees.

- The Great Recession presented challenges, but governments have shown willingness to address these so that they can effectively compete for skilled employees in the future.


Q&A