# Public Pension Plan Design Policy Considerations


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# Retirement Policies and Stakeholder Objectives

- **Employers** – need a tool to retain qualified workers to perform essential public services, limit turnover and training costs, and provide for orderly workforce attrition.
- **Taxpayers –** need a tool to provide better delivery of public services at a cost that is reasonable, predictable, and stable; and reduce reliance on taxpayer-supported public assistance.
- **Public employees** – need a competitive total compensation package, including the provision of income security in retirement.

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# Guiding Principles for Retirement Security and Plan Sustainability

NASRA resolution supports the following guiding principles for retirement security and public plan sustainability:

- Participation of all relevant stakeholders
- Policy-driven decision making based on objective and pertinent information
- Tailored solutions, achieved by affected stakeholders working through the state and local legislative and regulatory processes
- **Retention of core, indispensable elements of public plan design, namely mandatory participation, shared financing, benefit adequacy, pooled investment and longevity risks, and lifetime benefit payouts**
- Removal of federal policy barriers to the preservation of these central retirement plan design features and adoption of federal policies that encourage inclusion in the private sector.

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# Considering Plan Design Holistically, Balancing Stakeholder Objectives

- Mandatory participation
- Employee-employer cost sharing
- Assets that are pooled and professionally invested
- Lifetime benefit payments
- Benefit adequacy

# Mandatory Participation

- Private sector
  - Just one-half of the workforce participates in an employer-sponsored retirement plan, a factor identified as a major cause of the nation's growing retirement insecurity.
- Public Sector-
  - Nearly all employees of state and local government, retirement plan participation is mandatory.

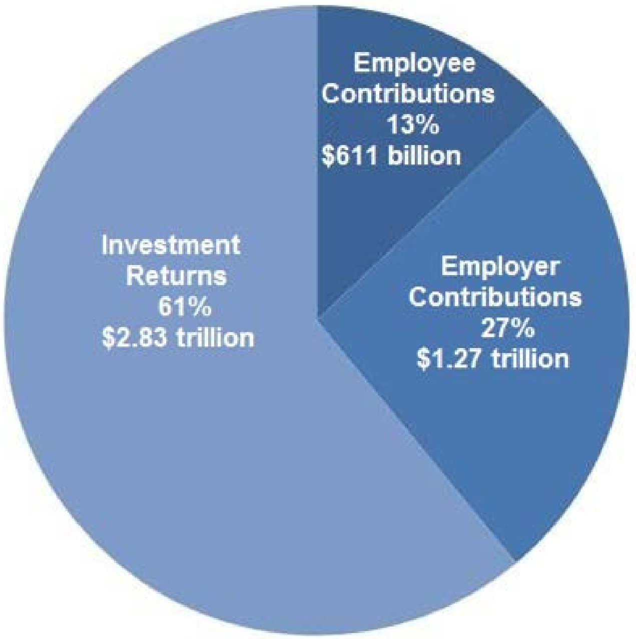
# Cost-sharing Between Employers and Employees

- Public Sector:
  - Nearly all pensions in the public sector require employees to contribute toward the cost of their retirement benefit.
  - Trend has been for increasing cost sharing to the employee
- Private Sector:
  - DB plans have no employee contributions
  - Many DC plans include employer/employee match

# Cost-sharing Between Employers and Employees

- Nearly all state and local governments require employees to contribute toward the cost of their pension
- Typically between 4% - 8% of salary
- The majority of recent state pension modifications have included an increase in the employee contribution

Public Pension Revenue 1982-2010




*Source:* U.S. Census Bureau

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# Pooled and Professionally Invested Assets

- Combined portfolios have a longer investment horizon, which allows them to be better diversified and to sustain market volatility.

- Professional asset management and lower administrative and investment costs in pooled arrangements result in higher investment returns.

# Lifetime Benefit Payments

- Most public sector plans require some or all of the pension benefit to be paid in installments over one's retired lifetime, rather than a lump sum.
  - Prevents leakage
  - Better ensures participants will not exhaust retirement assets
  - Reduces costs by distributing longevity risk across participants.

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# Benefit Adequacy

- Most public plans seek to replace a targeted percentage of income, accounting for the presence or absence of income from Social Security
- Most plans have COLAs in one form or another.
- Survivor and disability benefits are integrated
  - cost-effective way to provide these benefits, particularly for many hazardous public positions, such as first responders and others

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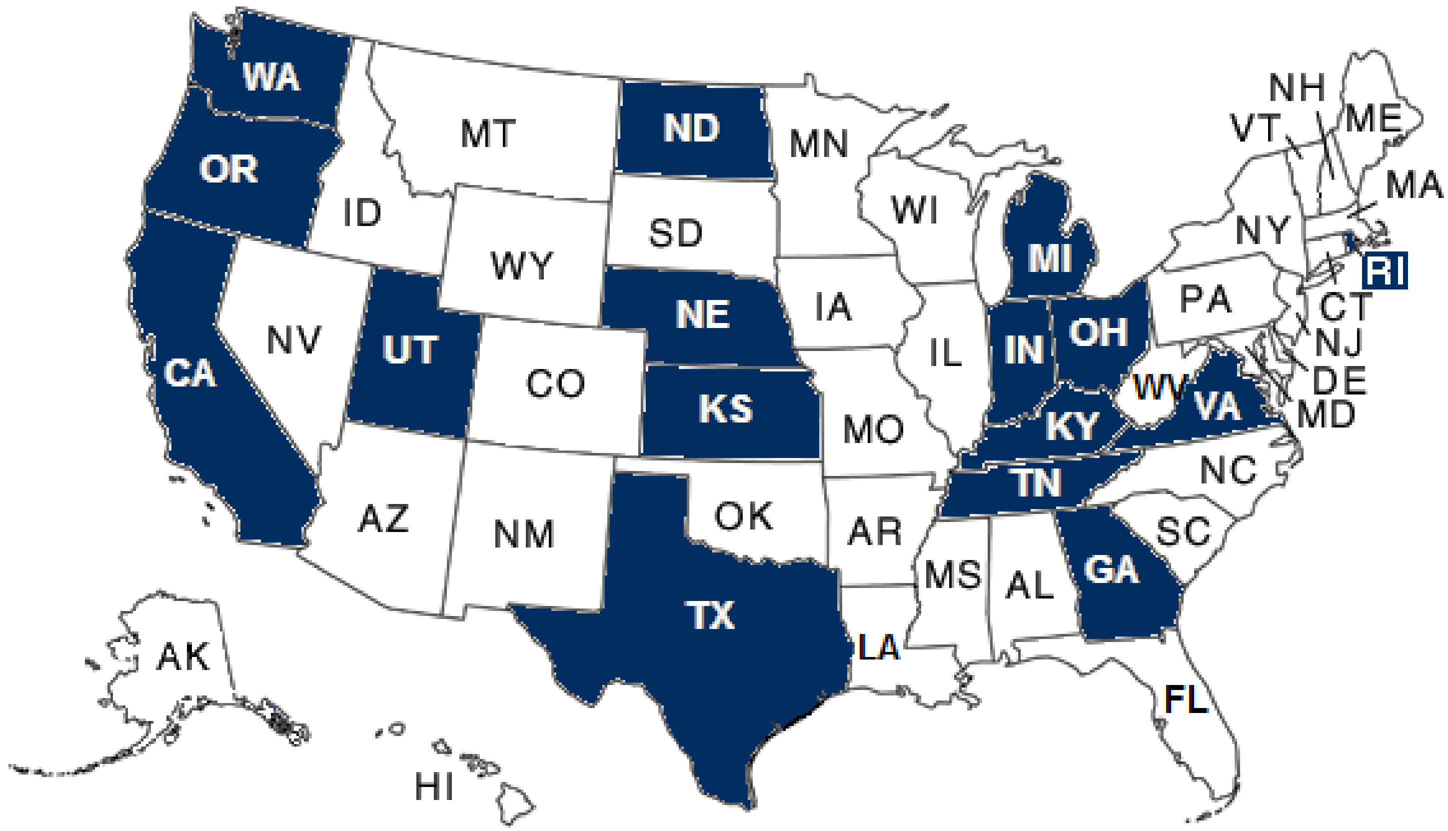
# Using the 5 Core Elements to Determine Appropriate Plan Design

- **No one size fits all design – rather, dependent on human resource goals, jurisdiction, culture, cost and many other inputs**
  – Nearly every state made changes in recent years to public pension benefits.
  – DB plans remain the prevailing model, cash balance and DB+DC plans have been in place for many years in some states, and are new in others
  – Like defined benefit plans, cash balance and DB+DC plans in the public sector vary from one jurisdiction to the next

States that administer CB or DB+DC plans as a mandatory or optional primary retirement benefit for groups of general or K-12 educational employees.




NASRA Issue Brief: State Hybrid Retirement Plans, Sept. 2013

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# GFOA--CORBA Best Practices: Public Pensions

- *A GFOA best practice identifies specific policies and procedures as contributing to improved government management. It aims to promote and facilitate positive change rather than merely to codify current accepted practice.*

- Developing and Implementing Sustainable Pension Tiers (2011)
- Developing a Policy for Retirement Plan Design Options (1999, 2007)
- Essential Design Elements of Defined Benefit Retirement Plans (2008)
- Essential Design Elements of Hybrid Retirement Plans (2008)
- Governance of Public Employee Retirement Systems (2010)
- Guidelines for Funding Defined Benefit Pensions (2013)
- Sustainable Funding Practices of Defined Benefit Pension Plans (1994, 2005, 2008, 2009)

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# Opportunities/Challenges

## Challenges:

- Distinguishing assertions from facts
- Legislating by anecdote
- Short-sighted policies that encourage a “race to the bottom”

## Opportunities:

- Appreciation of core elements of public pension design/policies that are the most cost-effective way to meet stakeholder objectives
- Better understanding of long-term nature of state/local government pension financing
- Political will to establish better benefit and funding policies

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