Retirement Crisis: Defending Defined-Benefit

Houston Firefighters’ Relief and Retirement Fund

March 2016
DEFINED BENEFIT PLANS ARE IN THE BEST INTEREST FOR BUSINESSES, THE ECONOMY, AND RETIREMENT SECURITY OVERALL

- Cost Advantage
- Supports Economy
- Retirement Security
- Public Support
- Affordable and Sustainable
DEFINED BENEFIT PLANS HAVE STRUCTURAL COST ADVANTAGES COMPARED TO DEFINED CONTRIBUTION PLANS

- Longevity Risk Pooling
  - Lifespan and lifetime annuities are averaged to ensure benefits can be provided to all individuals

- Diverse Portfolio
  - Longer investment horizons with low investment expenses, defined benefit plans can ride out the fluctuating market leading to higher gross returns based on asset allocation

- Professional Management
  - Higher risks that yield higher investment returns
DEFINED BENEFIT PLANS HAVE STRUCTURAL COST ADVANTAGES COMPARED TO DEFINED CONTRIBUTION PLANS

- NIRS study found that for any given level of retiree income, a typical defined contribution plan costs 91% more than a defined benefit plan.

- NIRS 2014 *Still a Better Bang for the Buck* study shows defined benefit plans have 48% cost advantages compared to defined contribution plans.
PENSION BENEFITS ARE AFFORDABLE AND SUSTAINABLE

- Pensioners agree to a lower annual salary with the promise of secure benefits during retirement.

- Firefighter pensions are an important recruitment tool that constitutes only 2.1% of Houston’s total budget.

- The average pension benefit is about $20,000 a year.
PENSIONS ENHANCE THE GOVERNMENT’S ABILITY TO ATTRACT QUALIFIED EMPLOYEES

• Defined benefit plans encourage employees to remain with an employer longer than defined contribution plans
  - With vesting periods and financial incentives to continue working based on accruals of continued service, defined benefit plans provide strong incentives for these dedicated and skilled workers to remain in these high risk roles

• Switching to a defined contribution plan would limit this ability, possibly exacerbating labor shortages in key service areas by increasing employee turnover rates
  - Higher turnover rates, in turn, could lead to increased training costs and lower levels of productivity, possibly resulting in the need for a larger workforce
BENEFITS PAID BY PENSION PLANS SUPPORT ECONOMY ACTIVITY

• Retiree expenditures support $23.7 Billion in total economic input in the state of Texas

• NIRS Pensionomics 2014 shows that the total income to state residents supported by pension expenditures was $7.5 Billion and supported 146,387 jobs

• Every $1.00 put into pension benefits yields $1.51 in economic output
• NIRS Retirement Security 2015 states that 86% Americans agree the Nation faces a retirement crisis with 82% supporting pensions for its success in providing stable income that will not run out

• NIRS 2012 The Pension Factor study finds that poverty rates among senior citizens without pensions were almost 9 times higher than with pensions

• The Government Accountability Office reports that as many as half of Americans over the age of 55 are financially unprepared for retirement
MYTH: SWITCHING FROM A DEFINED BENEFIT PLAN TO A DEFINED CONTRIBUTION PLAN IS A WAY TO RELIEVE AN ORGANIZATION FROM FUTURE LIABILITIES TO SAVE MONEY BY CONTROLLING FUTURE EXPENSES WHILE PROVIDING THE SAME LEVEL OF BENEFITS

- NIRS research says defined contribution plans are 20% less efficient when delivering benefits

- West Virginia’s teacher retirement plan switched from defined benefit to defined contribution and found they had significantly higher costs to taxpayers

- Alaska’s public pension adopted a mandatory defined contribution plan for employees in 2005 and the unfunded liabilities doubled by 2013
LEGISLATIVE INITIATIVES TO CURB PUBLIC EMPLOYEE PENSION BENEFITS ARE INEFFECTIVE

• These do not address immediate financial crises of local governments and merely cut the already modest retirement benefits of public employees

• Pensions are only a small percentage of local budgets, with the City of Houston only paying 16% of the benefits going to retirees and the remaining 84% coming from the Trust and firefighters themselves
FUNDING GAPS ARE MOSTLY DUE TO GOVERNMENTS NOT MAKING FULL PAYMENTS TO THE ANNUAL REQUIRED CONTRIBUTION (ARC)

- Highlights the fact that the problem is government budgets and the results are pensions being underfunded
- In 2012 pensions nationwide averaged only 83% of the ARC being paid to public pensions
Empirical data from 1980s-2000s shows that when defined benefit plans covert to defined contribution plans, income inequality rises and economic growth declines.

- The higher the income inequality, the lower the economic growth.
- More so, the higher the number of negative pension changes made by a state government, the higher the increase of income inequality in that state.

NATIONAL LEVEL ANALYSIS SHOWS RELATIONSHIP BETWEEN INCOME INEQUALITY AND ECONOMIC IS HIGHLY CO-RELATED WITH THE CONVERSION OF DEFINED BENEFIT INTO DEFINED CONTRIBUTION PLANS.
MOST ALL DEFINED BENEFIT PLANS PROVIDE DISABILITY AND SURVIVOR BENEFITS WHEREAS TYPICAL DEFINED CONTRIBUTION PLANS DO NOT

- The switch to a defined contribution plan would force employees to obtain these benefits through a third party, likely at a higher cost
  - 95% of government employees in defined benefit plans have disability coverage and 90% have survivor benefits
  - Few defined contribution plans provide disability benefits and survivor benefits are limited
PUBLIC SUPPORTS DEFINED BENEFIT PLANS OVER DEFINED CONTRIBUTION PLANS

• 67% of Americans indicate they would take a pay decrease in exchange for guaranteed income in retirement – a defined benefit plan

• When TRS re-opened their pension system after switching from defined benefit to defined contribution in 2008, over 78% of teachers chose to go back to the traditional defined benefit plan
THE ECONOMIC CRISIS IS A THREAT TO RETIREMENT SECURITY

• Both public and private sector employees face a retirement threatened by the economic crisis

• Making a drastic change to pension benefits would only drive more retirees into poverty and put even more of a strain on the local economies

• Legislators could still face additional pressure to increase defined contribution retirement benefits and provide additional financial assistance for retirees in order to maintain benefits provided through traditional defined benefit plans
CASE STUDY: WEST VIRGINIA

• Situation:
  • To address a historically underfunded system, in 1991 the West Virginia Teacher’s Retirement System (TRS) closed the fund and switched all new hires into a traditional defined contribution plan.
  • Teachers in the defined benefit plan were given a one-time choice to move to the new defined contribution plan.
CASE STUDY: WEST VIRGINIA

• Result:
  • With the plan closed, TRS paid pension benefits to almost 27,000 retirees with less than 18,000 employees contributing to the Fund
  • Funding level was at 25%
  • Members who opted to transfer from defined benefit to defined contribution found it difficult to retire after 2000
  • In 2005, the average account balance was only $41,478
  • Lower investment returns were seen in the defined contribution plan than before with the defined benefit plan
  • In 2005, West Virginia decided to go back to the defined benefit plan
CASE STUDY: MICHIGAN

• **Situation:**
  
  * In 1997, the Michigan State Employees Retirement System (MSERS) closed its traditional defined benefit plan to new hires and opened a defined contribution plan in hopes of long-term cost savings.
  
  * Current employees were given a one-time choice to move to the new defined contribution plan.
  
  * Upon the defined benefit plan closure, MSERS was overfunded at 109%.
CASE STUDY: MICHIGAN

• Result:
  • Funding level drastically decreased from 109% to 60.3% in just 15 years
  • Required contributions increased nearly 3 times from about $230 Million to $611 Million
  • By 2011, the average DC benefit would provide $8,200 per year, while the average defined benefit for people retiring was $20,000
  • By 2013, about two-thirds of employees were in the defined contribution plan with their retirement prospects looking dim
CASE STUDY: ALASKA

• **Situation:**
  
  • In 2005, Alaska adopted a mandatory defined contribution retirement program for all new hires to address unfunded liabilities.
  
  • Alaska experienced devastating actuarial errors that subsequently amounted the state facing $5.7 Billion in unfunded liabilities.
  
  • The actuarial miscalculation did not recommend the appropriate contribution increase needed to keep the plan financially sound.
CASE STUDY: ALASKA

• Result:
  • Alaska continued the same underfunding practice by not paying the full cost necessary – just 47% of the ARC
  • By 2006, the unfunded liability reached $6.9 Billion
  • By 2013, the unfunded liability reached $12.4 Billion
  • In 2014, Alaska’s government agreed to make $3 Billion in contributions to combat the underfunding issue that was doubled over ten years due to the switch from a defined benefit plan to a defined contribution plan
FINAL TALKING POINTS

• Public employees work hard to earn modest retirement benefits and deserve what was promised to them
  • Like all public employees, firefighters sacrifice and risk their lives everyday and in return expect a secure retirement
  • Firefighters do not receive Social Security and rely solely on their pension benefits
  • HFRRF firefighters contribute into their own pension plans and have already made sacrifices to solve budget challenges in Houston
We should deliver retirement security to more people, not force retirees into poverty.

- The retirement benefits are a part of the total compensations package given to public employees who have earned them.

- To strip away the pension benefits of the firefighters who risk their lives daily to keep their communities safe is not the right solution to a budgeting issue.

- Policy makers should consider proposals that strengthen existing defined benefit plans and promote this type of savings plan approach, as it is a win-win for employees, employers, and taxpayers.
FINAL TALKING POINTS

• The real crisis in retirement is the limited incomes that offer few or no financial resources to implement retirement
  • Even with a defined contribution plan, some workers cannot afford to contribute to their retirement accounts even if employers match contributions

• Saving money is closely related to one’s income
  • 45% of non-retirees plan to work during retirement to cover expenses

• According to a Pew study, over half of non-retirees with a defined contribution plan are “not confident” in their ability to make proper investment and retirement saving decisions
PENSION RESOURCES

- NCPERS: *The Top 10 Advantages of Maintaining Defined Benefit Pension Plans*
- NIRS: *Still a Better Bang for the Buck*
- NIRS: *America’s View of the Retirement Crisis*
- United States Government Accountability Office: *Retirement Security – Most Households Approaching Retirement Have Low Savings*
- NIRS: *Pensionomics*
- NCPERS: *A New Pension System Will Be Costly & Chaotic*
- NCPERS: *Income Inequality – Hidden Economic Cost of Prevailing Approached to Pension Reforms*