TIAA-CREF Institute

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Public Sector Pension Reform: Addressing Pressing Fiscal Realities from a Long-Term Perspective

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Executive Summary

State and local governments remain bastions of retirement plan sponsorship for public sector employees — 99 percent of full-time public sector employees have access to an employment-based retirement plan.[1] Primary coverage in the sector is typically through a defined benefit (DB) pension plan. However, state and local pension funds experienced large declines in asset values during the 2008-09 recession and financial markets crash. The recession also reduced tax revenues, making it difficult for many governments to fund the annual contribution associated with their DB plan.[2] State and local governments and the plans they sponsor continue to face financial challenges in the recession's aftermath.[3]

Budgetary pressures, evolving workforce demographics, and longer-term pension plan finance and benefit trends have led almost all states[4] and many local governments[5] to consider and implement various reforms of the plans they sponsor. The degree of reform ranges from adjustments to contribution requirements and benefit levels in existing DB plans to more fundamental changes that would incorporate defined contribution (DC) elements into the primary plan structure. Changes have typically focused on reducing the costs and risks to governments of plan sponsorship. Yet other values are also at stake. Public employee pensions are an important part of the overall system of retirement security in the U.S. and the economy.[6] Furthermore, the design, financing, and credibility of public pension plans may greatly affect the quality and composition of the state and local government workforce.

The importance of public sector pension plans, combined with the stresses and changes they are experiencing, led the TIAA-CREF Institute and the Nelson A. Rockefeller Institute of Government to sponsor the forum, *Public Sector Pension Reform: Addressing Pressing Fiscal Realities from a Long-Term Perspective*, in December 2012. The forum featured introductory remarks by Carl McCall, chair of the Board of Trustees of the State University of New York and former New York State comptroller; Roger Ferguson, president and CEO of TIAA-CREF; and Donald Boyd, senior fellow at the Rockefeller Institute. A panel of current or former state and local officials then discussed their experiences in managing fiscal

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crises involving public sector pensions, including reforms they have advocated and in some cases have implemented. Former U.S. Representative Earl Pomeroy followed the panel with a federal perspective on pension reform and retirement income security issues. Finally, a diverse panel of experts discussed their expectations for the future composition of the public sector workforce and how that should interact with retirement plan design.

Several important findings and themes emerged from the forum discussions:

1. Financial stress in state and local public pensions is widespread, yet the depth and expected duration of the challenges vary greatly. A small number of states account for a disproportionate share of aggregate unfunded liabilities. Underfunding in these states — such as Illinois, New Jersey, California, and Pennsylvania — is partly the result of past failures to make regular and adequate annual contributions. Other states, including many with traditionally well-funded systems, have also seen large increases in their unfunded liabilities and annual required contributions, but their problems are less severe and stem from sharp declines in the value of pension fund investments during the recent recession.

2. There are persistent fiscal and demographic challenges in most states. The public sector workforce is aging as the baby boom cohort moves towards and into traditional retirement ages. Budgetary pressures at the state and local level make it difficult to increase plan funding and maintain the size of the public sector workforce. Assumed investment returns have been called into question by the experience of severe recent downturns in financial markets. In fact, public sector plans are assuming increasing levels of investment risk, often at higher levels than private pension funds, in pursuit of greater long run returns.

3. While financial stress has led many states and localities to change their employee pension plans, governments must consider other values and issues in the process if they hope to devise lasting and effective reforms. One essential consideration is retirement security, about which many public employees are uncertain and uneasy. This lack of retirement confidence reflects more than potential concern regarding the status of their retirement plan, it reflects in part a widespread problem — the lack of financial education and informed retirement planning among U.S. workers, including, but not limited to, public sector employees.

4. Pension reform can take different directions. Most recent changes have been marginal and focused on cost and risk reduction for governments. Examples include San Jose's proposal to require employees to contribute more toward their current retirement benefits or accept lower benefit levels. Another example is New York's recently enacted Tier Six plan for future employees; it included an increased normal retirement age, a decreased benefit multiplier, a cap on overtime, and other elements intended to reduce future costs to the state.

5. Some state and local governments are considering or have enacted reforms that move from DB to DC designs. This can involve hybrid arrangements consisting of complementary DB and DC plans. DC plans are not inherently less able than DB plans to provide retirement income security for public sector workers. Appropriate DC design incorporating best-practice plan elements can address retirement income objectives, financial constraints, and the allocation of risk.

6. Reform should not only consider short-term fiscal challenges, but also long-term trends and objectives regarding the public sector workforce. While many DB plans were premised on a career employment model, that model does not fit the experience of many current employees in the public sector and is even less likely to apply in the future.

7. Governments employ a highly skilled and educated workforce, with knowledge often developed in the private sector, and will need to do so to an even greater degree in the future. So governments need to compete with private employers for such talent, and they will need to accommodate greater mobility into and out of public service. From that perspective, retirement plans need to be flexible, transferable, and attractive, even to employees with relatively short stays in government. At the

same time, it would also be desirable to tailor retirement plans to particular professions, such as teaching, where long careers are more the norm and often desired for effectiveness in the classroom.

8. Public sector pension reform should also consider the context of federal programs, particularly Social Security and Medicare, given their large role in ensuring retirement security for covered individuals. Benefit cuts and/or payroll tax increases are inevitable as the federal government addresses long-term fiscal deficits.

9. The politics of pension reform are challenging along multiple dimensions. One common dimension is convincing the public — voters, taxpayers, employees, and even policy makers — that a problem exists. Funding challenges are long term and based on calculations and assumptions that can be hard to understand or simply disputed.

Introduction

The fiscal stresses and challenges in public sector pension plans now being addressed by state and local governments was the impetus for the TIAA-CREF Institute and the Nelson A. Rockefeller Institute of Government to sponsor a forum on the issue in December 2012. The forum served as an opportunity to reconsider basic ideas about the role, structure, and underlying assumptions of public pension plans in the U.S. Drawing on the experiences of state and local officials and researchers across the nation, the forum examined the size, incidence, and causes of current funding challenges; the different ways in which governments have addressed pension funding short-falls, both in terms of policy and political process; and the value dimensions they've recognized in reconsidering plan design.

The forum was introduced and facilitated by Garrick Utley, senior fellow at the SUNY Levin Institute and a distinguished television journalist. Utley noted that forum participants came from all across the nation as well as from many positions as researchers, academics, public officials, foundation representatives, and union leaders; they were essentially a cross-section of those involved with public pensions — the reforms, issues, and challenges. Utley added that although the day's discussion focused on pension reform, he expected it would also address "the larger questions that go beyond fiscal responsibility and survival, such as the question of governance: How can government govern in this area?"

Framing the Issue: Public Pensions from Three Perspectives

Utley then introduced the first panel; three speakers selected to lead off the forum by considering public pension reform from different yet complementary perspectives:

- Carl McCall, Chair of the SUNY Board of Trustees and former New York State Comptroller
- Roger Ferguson, President and CEO of TIAA-CREF
- Donald Boyd, Senior Fellow at the Rockefeller Institute of Government.

The Goal of "Retirement Security"

Carl McCall kicked off the forum by voicing unease over the topic. A longtime public servant, he noted that "my sisters and brothers in the public sector" are "concerned when they hear that people are coming together to talk about this whole issue of pension reform." He observed that "a lot of people who had very good, sound pensions are getting together to talk about how [public employees'] benefits can be eliminated or reduced."

McCall stated that he was "not here to talk about pension reform" but "to talk about retirement security, because that's really the issue." McCall reminded the audience that public employees teach our children, take care of our sick, and provide other essential services. When these public servants retire, they should "retire to retirement security." Thus, the "bottom line" of the conference should be, "What do proposed changes do to retirement security?"

McCall recognized that some features in current pension systems "simply don't work" — are "unsustainable" and "unaffordable" — and some changes are necessary. But restructuring pensions does not necessarily address all the values involved. Policy makers must also consider other ways to provide retirement security. He noted that New York offers a "deferred compensation program" that provides an opportunity to save and invest, though fewer than 30 percent of public employees participate in it.

Uncertainty about Pensions and Retirement

Roger Ferguson picked up on McCall's point regarding program participation when he summarized findings from a recent TIAA-CREF Institute study conducted in partnership with the Center for State and Local Government Excellence. The study, based on a survey of 1,200 state and local government employees nationwide (including public educators, police, and firefighters), sought to understand how public sector employees thought about retirement security.

Ferguson discussed several particularly important findings. Two underlined the need for more education. First, the study found considerable unease about retirement income security. Despite nearly universal pension coverage in the public sector, only 19 percent of current full-time workers were very confident that they'd have enough money to live comfortably throughout their retirement years. Only 22 percent were very confident that they would have enough money to take care of medical expenses during their retirement, in part because many expected the value of Medicare benefits to fall in the future.

Second, the study found little evidence of systematic retirement planning by individuals. Although public sector workers are more likely to save for retirement than other full-time American workers — 84 percent compared to 73 percent — few are sure that they are saving enough. Only half have tried to estimate how much they'll need to save for a comfortable retirement. And many may be underestimating what they'll need. While experts typically suggest that individuals need to replace at least 70 percent of their income during retirement, survey respondents generally thought that 60 percent sufficed — and 17 percent of workers thought they needed to replace no more than 50 percent.

Lessons from TIAA-CREF's Experiences

Ferguson offered some positive information as well. He noted that 75 percent of TIAA-CREF participants, largely in the higher education sector, are confident that they will have enough money to live comfortably in retirement. TIAA-CREF offers what could be described as a "risk managed" defined contribution (DC) model that incorporates key defined benefit (DB) elements. From the organization's long experience in providing retirement plans, Ferguson drew several lessons.

He noted that "defined contribution" does not necessarily equal "401(k)." For example, the 403(b) model in higher education is fundamentally different than the typical private sector 401(k) plan. In addition, it is possible to have hybrid arrangements that include complementary DB and DC plans. TIAA-CREF has also learned that no plan type is perfect, nor should any be demonized. DC and DB both have beneficial elements. Ferguson suggested that the goal of the forum was not to advance "wealth accumulation," but rather to promote "income replacement in retirement or a guaranteed income for life."

Ferguson stressed that advice and education must be key components of a retirement plan. Even in the public sector, "folks don't really know how much to save. They do need advice." And they need to be "driven towards planning." This is especially important when employees and retirees share the risks of retirement income security; he said we must "provide for financial literacy" to make shared risk a viable option.

Ferguson also noted that plans need to adjust to changing conditions. For instance, it needs to be recognized that mobility is part of the workforce experience; "the population at large is much more mobile now than it was when retirement plans were first conceptualized." The average tenure in a state job is only 6.4 years, so it's "not lifetime employment anymore." Ferguson said that "we need to provide a plan that is efficient, flexible enough to recognize changing lifestyles, changing work patterns." Public sector retirement plans cannot provide full retirement security for people who don't spend a full career in government employment. But we still need to provide opportunities for them to save and experience a reasonable outcome after a lifetime of working across society."

In the question and answer session, concern was expressed regarding the returns and costs of DC plans. One questioner asked, what is the appropriate percentage of pay that needs to be contributed to a DC plan in order to reach a 70 percent benchmark for income replacement? Ferguson replied that a combined employer and employee contribution rate of 10 to 15 percent of salary is needed. The questioner then asked about the average contribution of employers to DC plans. Paul Yakoboski of the TIAA-CREF Institute noted in response that typical employer matches in private sector 401(k) plans will be 50 or 100 percent of worker contributions, but only up to 4 or 5 percent of the individual's salary. That does not get to the range recommended by Ferguson. In other sectors though, such as higher education, employees and employers are both often required to make contributions that typically total 10 percent or more.

Another participant prefaced his question by saying that DC plans typically produce lower returns than DB plans and have higher costs. He then asked whether the higher costs of DC plans can be reduced to be closer to those of DB plans. But Ferguson cautioned against such "broad generalizations." He noted that the costs of a DC plan can be low and a diversified portfolio can perform well too. Jeff Brown of the University of Illinois (and a member of the TIAA Board of Trustees) said that DC plans can compare well in this regard when "you design a plan which minimizes the amount of portfolio churning" and the funds are professionally managed.

Competing Imperatives for Governments

Donald Boyd examined pension reform from the perspective of state and local governments, especially with regards to how they've balanced risk and long-term concerns in managing their pension funds with their responsibilities to provide current services. In many cases, they have given little weight to long-term factors. Boyd said that state and local governments are "the ultimate in short term planners. They look a year ahead. Sometimes they look two years ahead. Sometimes a little bit more." But retirement commitments are long-term promises that are often constitutionally protected. Thus, he noted a disconnect "between the way the governments like to plan and what they need to do." Governments may fail to make the contributions necessary to ensure the sustainability of their pension plans — in part because contributions are real and immediate, while liabilities are abstract and long-run.

For the nation as a whole, unfunded liabilities in state and local government pensions totaled approximately $1 trillion in 2011 — or about 75 percent of what is needed to fully fund pensions according to actuarial estimates. Some economists, using low-risk discount rates, estimate a much larger liability, as much as $3-4 trillion, which would mean that pension funds are only 45 to 50 percent funded.

But national estimates do not convey the enormous variation across the country. The most poorly funded pensions include those for Illinois state employees, Kentucky public employees, Illinois universities, and Indiana teachers. Actuarial estimates indicate that Illinois' employees pensions are funded at 35 percent, the lowest in the nation among large plans. At the other end of the spectrum are plans funded at 90 percent or more, including those for New York State teachers, New York state and local police and firefighters, and New York State employees.

Though the latter plans are comparatively well funded, they can and do still face financial stress. "So the notion that the sky is falling or the sky is falling everywhere is simply not true." The truth is "somewhere in between. In some places the sky is falling and in other cases…plans are very well-funded."

To put pension liabilities in perspective, Boyd compared them to long-term bonded debt. To be sure, pension liabilities are not greater than general debt obligations, which amount to around $2.8 trillion according to Census Bureau data. Yet few people see the sky as falling due to debt. The difference in response may be due to differences between debt and pension liabilities. Debt is paid off in known, predictable, fairly level payments. Also, debt supports assets that are still delivering services.

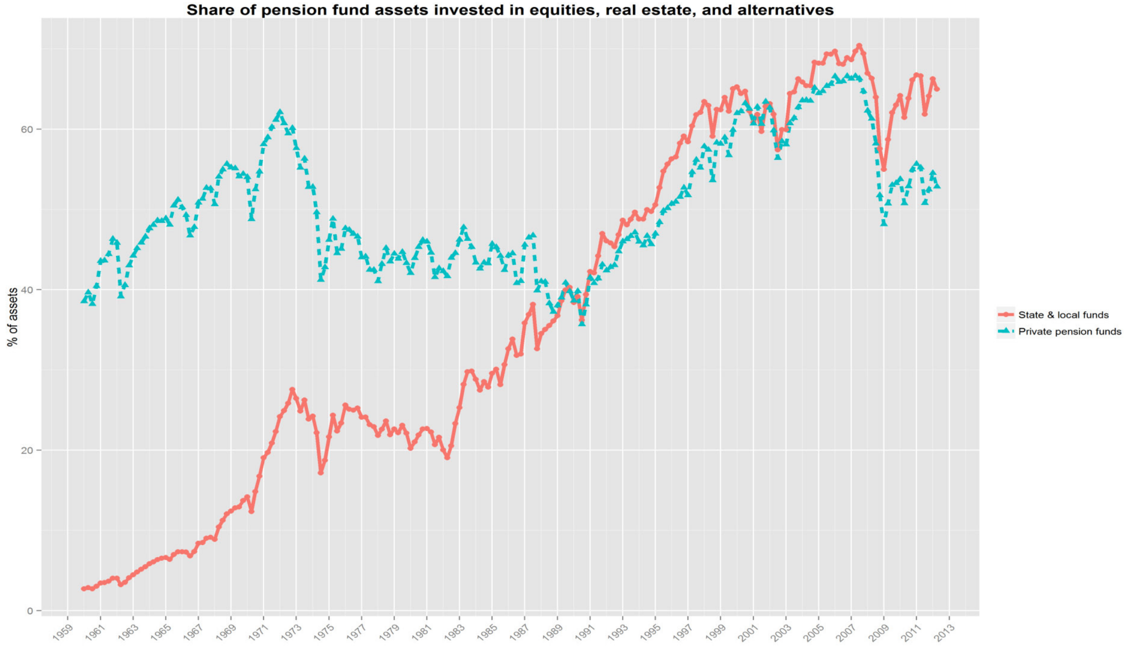
Boyd observed that contributions to pension funds, by contrast, are more volatile. They are now $96 billion, an 11 percent increase year over year. In Kentucky, the year-to-year increase was 61 percent; in New York, 35 percent; and in California, 20 percent. Contributions can also be large relative to tax revenues. Nationally, pension contributions are about 7 percent of annual taxes, though again, the variation is enormous. Contributions are 12 percent of taxes in Nevada, 20 percent in San Diego, and 27 percent in San Jose.

Although most governments are relatively good at paying what actuaries calculate as needed, state and local contributions to pension funds were about $17 billion below that amount in 2011. Economists' estimates of appropriate contributions are even higher, with state and local governments falling far short of their estimates. Boyd's point was that even when contributions to pension funds are less than many deem necessary to meet future liabilities, large sums are still being contributed as compensation for services delivered in the past. These large contributions are "grabbing out of current services."

Boyd explained that unfunded liabilities are particularly large in governments — such as California, New Jersey, and Illinois — that failed to make up investment shortfalls by increasing their subsequent contributions. Boyd noted, however, that "even well-funded plans can cause fiscal stress." An example is New York's employee retirement system. The state uses a conservative method for determining "aggregate cost" and state courts mandate the contributions. When investment returns fall short under these rules, mandated state contributions increase dramatically, over 180 percent in New York between 2010 and 2014. Boyd noted that "It's good for the plan and a good thing for the retirees, but not so good for some governments."

Removing risk from plan investments may smooth out future contributions, but Boyd does not consider governments likely to do so. In fact, governments have increasingly invested in riskier assets in recent years and now have more than two-thirds of their holdings in equity-like investments. If return assumptions are met, many plans will be fine. The problem occurs if assumptions are not — and Boyd

Share of pension fund assets invested in equities, real estate, and alternatives



Source: Federal Reserve Board, Flow of Funds Accounts

Boyd also discussed risk from the perspective of workers and retirees. He noted that even though legal protections are typically strong on paper in many states, the position of employees is greatly weakened when underfunding is extreme, as in Illinois. Then there is substantial pressure to cut benefits, as demonstrated in Rhode Island and New Jersey, though he noted there is much litigation ahead in response.

Boyd asked, "Who is the proper bearer of risk?" and suggested that risk should be shared: "everybody has to assume part of it." He observed that risk has been pulled away from New York workers in recent years, but feels it should be more equally distributed between government and individuals (workers and retirees).

Finally, Boyd predicted that large contribution increases could be over by 2015 for many plans, if they hit their actuarial assumptions. That is, they won't see "ever increasing contributions from here forward."

Session 1: Making Reform a Reality

After the opening overview presentations, the first panel session provided depth and detail regarding ongoing change in public pension plans. The session was moderated by Thomas Gais, director of the Rockefeller Institute of Government, and the panelists represented two cities and two states:

- Daniel R. Liljenquist, former Utah State Senator
- Chuck R. Reed, Mayor, City of San Jose, California
- Lawrence Schwartz, Secretary to the Governor, State of the New York
- Lois Scott, Chief Financial Officer, City of Chicago

Their presentations reinforced Boyd's point that unfunded pension liabilities are widespread, yet quite varied in their severity and causes. All four governments have been searching for ways to extricate themselves from their pension funding problems and establish new rules or plans that can be sustained in economic, political, and governmental circumstances that are potentially very different from current experience. The two states represented in the panel, Utah and New York, managed their funds responsibly in many respects, yet even they were profoundly affected by the downturn in equity markets in 2008 and early 2009. The two cities, San Jose and Chicago, were in worse financial shape and had to take more dramatic actions.

Their responses to their situations were also quite varied, underlining Roger Ferguson's observations about the wide range of options that plans can use to meet new conditions. It was clear that they often gave considerable weight not only to their long-term underfunding challenges, but also to concerns about retirement security, as Carl McCall strongly recommended.

The panelists were asked to discuss the severity, character, and causes of the pension problems in their respective governments; the policy options considered; why one or more particular options were chosen; how political support for change was built; and how implementation is progressing. Gais noted the diversity of the panelists underlines the fact that the issue of pension reform is not exclusively a conservative or liberal issue, nor one limited by party, region, or level of government. It was, and is, an American issue, though one that appears and is addressed in different ways.

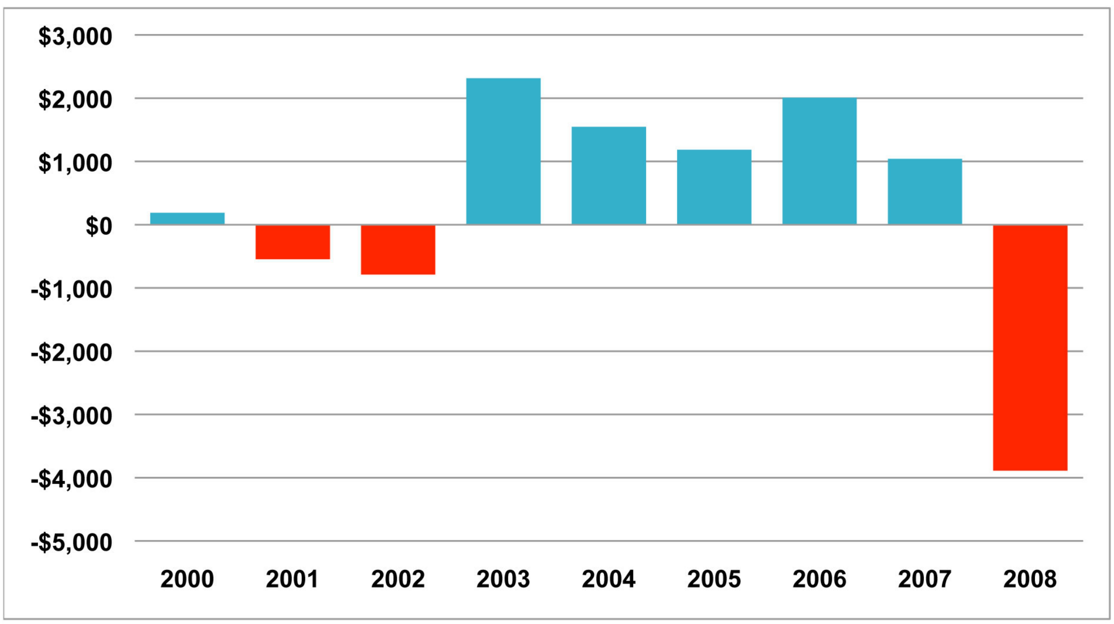
Making the "Long-Run" a Political Reality

Dan Liljenquist shared how he made long-term actuarial projections a lever for reform in Utah. Liljenquist entered state service when the economic crisis hit. He became chairman of the Utah Senate's retirement committee when elected in 2008. Utah had been a consistently responsible steward of its employees' pensions. Liljenquist said, "Utah has always paid the full actuarial contribution every year since its inception." The 2008 financial downturn, however, caused the state to lose 22 percent of its pension funds in one year, an unprecedented loss. State government officials began to question, "What impact do these losses have on Utah now and in the future? How much will we have to put into the system? How long will it take to recover? Would the market do this for us?" And, most importantly, what would happen to the system if there was another year like 2008?

Elected officials asked actuaries to change their focus by requesting modeling that projected forty years forward to examine plan funding. The results surprisingly revealed a massive unfunded liability. A five year smoothing period for make-up contributions had obscured the true long-term costs of the financial downturn. Despite Utah's record of regular and extensive contributions to its public pension funds, its long-term funding had suffered enormously from the 2008 experience.

To compensate for those losses and bring the system back into balance, contributions would have to increase substantially. Liljenquist learned that "market losses in 2008 would increase the state's four year contributions by 75 percent." Utah would have to commit approximately 10 percent of its general fund for twenty-five years to offset one year's worth of market loss. If the state did nothing and continued the same rate of contribution, every model indicated "a structural bankruptcy in the state of Utah."

Utah's Pension Fund Lost 22 Percent of Its Value in 2008
(Annual Changes in Value, in Millions of Dollars)



The first challenge for the state was convincing people that there was a real problem. While pensions were 96 percent funded on paper, the system could not sustain another crash like 2008. People needed to understand that experience today has repercussions thirty years later. The state decided to treat the pension problem like a chemical spill. "First and foremost you contain it. And then you work over time to clean it up." No long-term commitments could be made to new employees until the state was confident that it could meet current obligations.

Persuading the public required media coverage, but getting the press to cover pension reform wasn't easy. It was a boring topic, always discussed in numbers. A breakthrough occurred when officials "translated what those numbers meant for actual services in our community." In a state with a large number of children, the cost of inactivity on pension reform was estimated to be 8,000 lost teacher positions. "And once people understood what the tradeoff was — what the opportunity costs were — they woke up." Editorial boards across the state wrote that something had to be done. "Another year like this we're off a cliff."

As already noted, a question raised with the opening presentations was, "Who should bear the risk in public pension plans, taxpayers or employees?" Liljenquist believed that public employees should bear the risk. With a limited pool of money for compensation, retirement benefits consumed a "lion's share" and left little in the state's budget for wages and health care benefits. Liljenquist viewed pensions as "the great PacMan of our budget." Containing future pension costs would allow current employees to get cost of living adjustments (COLAs) and the state to finance other priorities.

Though the action was unpopular, Utah closed its existing pension plan and created a new system for new employees in order to meet the commitment to current employees. "We moved to a defined employer contribution saying we're going to put 10 percent towards retirement." The employee chooses whether that 10 percent contribution by the state goes into a DC plan or towards funding the DB component of a DB/DC hybrid arrangement. With that change, state officials believed that Utah would be in a much better and more predictable financial position in the future.

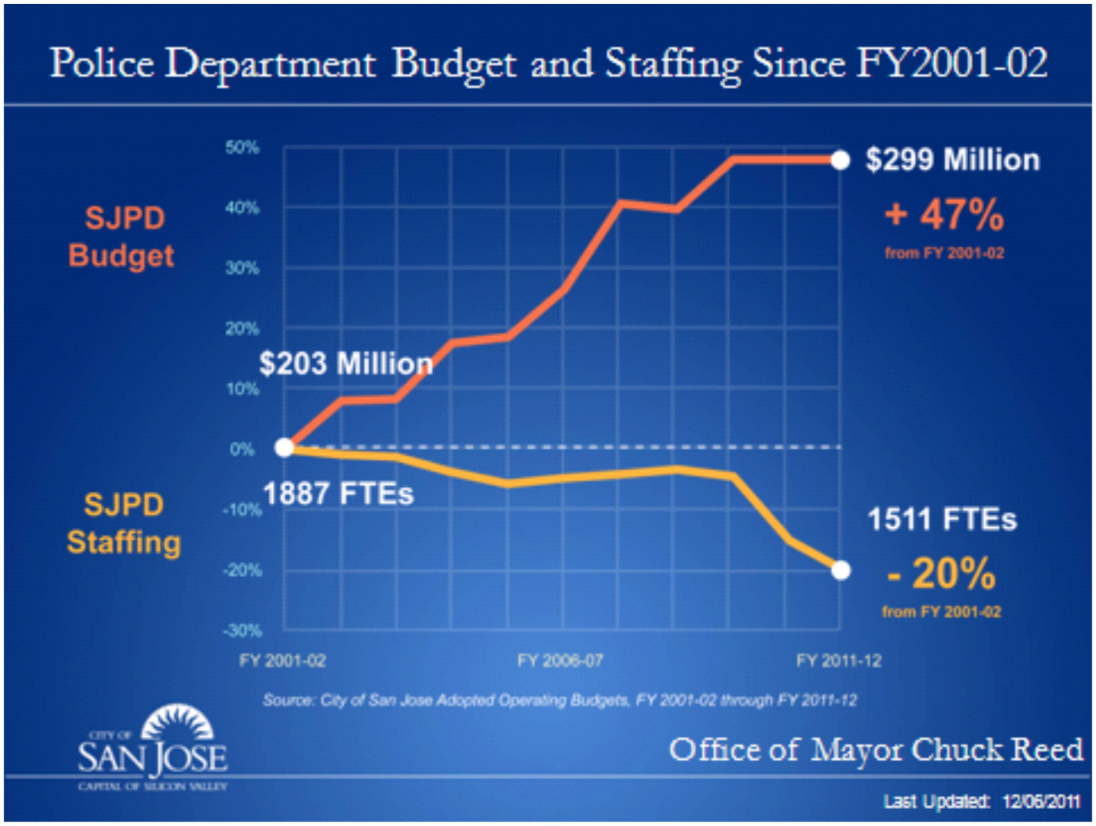
Balancing Pension Benefits and Current Services

Chuck Reed, mayor of San Jose, explained that two objectives had to be met when considering public pension reform: providing employees and retirees the benefits they have earned and providing reasonable services to taxpayers. He noted, however, that balancing these objectives is difficult. "If the retirement benefits are just plain too expensive, the taxpayers can't afford them and the employees can't afford to pay the full cost of the benefits." The only way to resolve this tension is to reduce the cost of the benefits by dealing "with the rate of future accruals, stretching out the retirement age, slowing down the accrual rate." Yet this creates a political paradox. "The sooner you start to address these problems, the easier it is to fix the problem; but the sooner you start to address the problems, the harder it is to convince people that they need to fix the problem."

In the last ten years, the skyrocketing cost of pension funding in San Jose forced a 28 percent reduction in the city's workforce. Nearly 2,000 jobs had to be cut. Despite increased police department funding of nearly $100 million over the decade, the city had fewer officers on the street than ten years earlier. More than 20 percent of San Jose's general funds were going toward retirement costs and actuaries predicted the figure would continue to climb over the next ten to twelve years absent any changes to the plan. Increasing pension and health care costs caused significant increases in the city's unfunded liabilities. Reform was necessary.

With nearly 70 percent in favor, San Jose voters approved ballot Measure B to initiate pension reform and improve retirement security. The measure did not freeze the pensions of current workers or reduce their benefits going forward. Rather, it required current employees to contribute more for funding those benefits. Employees were given the option of a lower cost benefit level. Asking employees to pay more was a burden for them, but it was necessary if San Jose was to remain fiscally sound. The city maintained its defined benefit plan by structuring it so that the city and its employees would share the costs of the unfunded mandate. Eventually, San Jose plans to add a DC plan to supplement the DB plan.

The State of California passed a similar measure requiring employees to pay more, but that action will only solve 5 to 10 percent of the funding shortfall. More needs to be done at the local level. According to Reed, "We need clear authority that we can make adjustments to future benefit accruals, [but] the California Vested Rights Doctrine is not clear about what we can do regarding future accruals." A state constitutional amendment is probably necessary. Employees should be able to choose a lower-cost option, "because if they're going to have to pay more to maintain their current benefits, they should have a choice to just drop down in cost." Eight of the ten largest cities in California signed a letter requesting the state to "give us the power to deal with our problems so that we can negotiate with our unions." Vested rights belong to the individual, not the unions. So the unions and the city cannot negotiate over vested rights. The only options left according to Reed are layoffs, pay cuts, or increased employee contributions for their benefits.



Reform in a Strong Union State

Larry Schwartz talked from his long experience of working on pension reform under two governors in New York State. Schwartz noted that the State Constitution protects the pensions of active employees and retirees; benefits of someone already in the pension system cannot be reduced. The legislature may "sweeten" pensions, but the additional benefits are locked in for life once enacted. So if, during an election year, the legislature wants to curry favor with labor unions by granting additional benefits, those benefits can never be diminished.

There were four tiers in the New York State pension system in 2009. Labor unions were informed that without pension reform, increased pension costs — driven in large part by the need to make up for sharp losses in fund investments — would necessitate 3,000 layoffs. Tier 5 was created in response; changes included member contributions for their entire career and increased service requirements for full benefits. Actuaries projected that Tier 5 would save $30 billion over thirty years, but that was still not enough.

Shortly after Tier 5 was implemented, the push for Tier 6 began. At the same time Mayor Bloomberg was trying to implement pension reform in New York City. (New York State and New York City have separate pension systems.) The state public employee unions and the New York City public employee unions were both in steadfast opposition. The struggle, as described by Schwartz, was determining "how could we create a new tier that would maximize savings but also in a way that you could politically navigate and get it through the state legislature."

The initial proposal for Tier 6 included a voluntary DC plan, but that proved to be a nonstarter with labor. Though it would only apply to future employees, Schwartz maintained that no labor union leader "wanted to be going down in their union's history books as the one that agreed to those kinds of changes." The unions also felt that this concession would set a precedent for further concessions.

Ultimately, Tier 6 included a prorated employee contribution rate that increased with employee earnings, an increased normal retirement age, a decreased benefit multiplier, final average salary based on five years instead of three years, a cap on the total amount of salary that can be included in the final average, a cap on overtime, and a voluntary DC plan for nonunion employees making $75,000 or more. Tier 6 was approved with an expected $82 billion in pension savings. “When you layer 5 and 6 together you’re looking at about $115 billion in pension savings…for local governments, state government, city government, and the school districts,” according to Schwartz.

Schwartz added that an unsolved issue is addressing the concerns of local governments who view pensions as an unfunded mandate imposed by the state. Local governments inherit whatever pension system the state implements with very little input. This was not a concern when financial markets were doing well and local governments needed to contribute very little into the system. But when markets crashed and local governments were suddenly expected to reallocate a large portion of their budgets, it quickly became a political issue. Property taxes would have to increase to cover the increased payments. The governor and the Division of the Budget in New York have been trying to develop ways beyond enacting Tier 6 to help local governments with pension and mandate relief.

When Liabilities are Huge

According to Lois Scott, Chicago’s property taxes would have to increase dramatically to meet the financial obligations for its four employee pension plans and the Chicago Teachers plan. Together, those five funds have an unfunded pension liability of roughly $24 billion. With a pension system that is only 38 percent funded, Scott explained that investment returns can never place the system back on track. Scott observed, “Every one of our funds is drawing down its assets and liquidating investments every month to make current payments.” But Chicago’s pension funding challenge is only part of the problem. Taxpayers face “layers and layers and layers of unfunded pensions in the State of Illinois and the City of Chicago. If you take the city’s unfunded, the Chicago Public Schools’ unfunded, the Chicago Park District’s unfunded, the Chicago share of Cook County pensions, the Metropolitan Water Reclamation District, the Illinois International Port District, and then our share of the State’s underfunded pension problem on top of it, we’re talking about a crisis situation.”

“So what do we do?” Scott noted that the State of Illinois has constitutional language stating that “a pension benefit once granted can never be impaired.” So changes must be made in the context of that provision. She explained that Mayor Emanuel has outlined a roadmap designed to protect taxpayers and citizens and provide the essential services needed to run the city, while honoring the commitments made to retirees and workers. The roadmap proposed by the mayor would pause COLAs to allow the city the chance to catch up with its funding obligations. Many nonunion workers throughout the city have not received a pay raise in eight years while retirees are receiving an “automatic annual adjustment” that ranges from 1.5 to 3 percent of their annuity, most of that on a compounding basis. In addition, the roadmap calls for increasing employee contributions and retirement ages, and it would introduce choice through a cash balance type plan for a portion of the city’s future and unvested employees.

Bankruptcy and Other Options

A wide range of questions was posed to the panel. Lois Scott was asked about options when a crisis like in Chicago isn’t solved by political institutions and traditional processes. She indicated that there is a lot of uncertainty regarding what happens when pension funding reaches a crisis stage and there’s simply not enough money to meet obligations. She explained that the insolvency of some of these funds is predictable based on how fast they are being liquidated to pay current year obligations. Clearly, states cannot declare bankruptcy and municipalities must have State authorization to declare Chapter 9. But it is unclear what it would mean if a pension fund became insolvent. The legislature and the courts will have to decide if they are going to “prioritize paying retirees at the same time we can’t pay teachers and cops.” Larry Schwartz added that another option for local governments could be the creation by the state legislature of financial control boards.

Larry Schwartz was asked whether the back-to-back pension reforms in New York signified a long-run political shift in the state regarding pension policies. Schwartz suggested that some things have changed, and some have not. He indicated that state constitutional restrictions prevented the state from negotiating with active employees and retirees to see if they would be willing to make some sacrifices. But reform efforts in New York had produced the "poison pill of pension sweeteners." "If they [the legislature] want to come back and provide pension sweeteners to Tier 6, they're going to have to appropriate in the budget the entire statewide cost." Schwartz also observed that pension reform isn't done in a political vacuum. "You have hundreds of other things going on and you got to figure out strategically how your pension problem" fits into your many priorities.

The issue of COLA changes was raised. Lois Scott explained that the COLA often comprises 25-40 percent of a pension fund's total liability, so it's very important to take a hard look at the financial consequences of those COLAs. Dan Liljenquist noted that Utah did not touch COLAs; other states might not have that luxury. Chuck Reed said there was language in the San Jose ballot measure that allowed the COLA to be suspended for up to five years in the event of a fiscal emergency.

The panel was asked their thoughts about what was wrong systematically with pension plans. Lois Scott responded that Illinois laws set a funding formula that does not incorporate actuarial funding costs. The focus on short-term planning and "getting through the next election cycle" also has an impact. Chuck Reed added that many plans around the country are inherently unstable with a significant risk of underfunding.

Dan Liljenquist was asked if, looking back at his experience in 2010, he would have done anything differently in Utah's pension redesign. Liljenquist responded that the state legislature allowed for modifications, as it planned for a legislative session between the legislation's passage and before anyone became vested in the new system. During this session, language was added that essentially said, "if we ever come to a point where the hybrid arrangement is substantially unstable we can liquidate the whole thing." Liljenquist would have preferred a cash balance plan to minimize some of the long-term risks, but the votes weren't there.

Larry Schwartz was asked to elaborate on reform provisions that allow the governor or the mayor to grant pension enhancements. Schwartz said that some things were left open to future negotiation, but he noted that any additional costs would have to be paid. They wanted a system with some flexibility so that, in the event that the actuaries' predictions were wrong, they could raise the employee benefit, though in a fiscally sound way.

The issue of whether pension benefit reductions shifted costs to public income support and social service programs was also raised. Liljenquist agreed that a poorly designed pension plan could exasperate long-term problems, but he felt that the Utah pension plan on top of Social Security benefits was more generous than private sector plans. Scott said that when it comes to pensions, we need to determine if we are "talking about a social safety net, social justice issues, or are we talking about preservation of a lifestyle."

Finally, Liljenquist was asked about structuring retirement benefit payments under a DC plan so that an individual's account is not liquidated prematurely before death. Liljenquist admitted it was a challenge. In Utah, borrowing is restricted to lessen the chance of DC program failure. However, he views it as work still in progress.

The Keynote Address: A Federal Perspective

Earl Pomeroy, former U.S. Representative, North Dakota, shared a federal perspective on pension reform and retirement security issues. Pomeroy foresees a relatively large cut in entitlement spending along with some degree of tax increases as the ultimate outcome of the ongoing budget debate. He characterized the two basic strategies that he sees for addressing entitlements:

- Capping exposure and shifting risk.
- Preserving risk-bearing while stabilizing finances.

Pomeroy also applied this rubric to analyzing pension reform. He argued that the “cap and shift” strategy is effective at controlling government spending, but generally causes an unacceptable level of harm to individuals because of the degree of risk shifted. He questioned how much risk could be shifted to individuals in the process of reforming Social Security, Medicare, and Medicaid without driving significant numbers of seniors into poverty. The same question holds in his mind for pension reform. Pomeroy thus argued for a national strategy on retirement income security that would:

- preserve Social Security by addressing underfunding more aggressively with revenue increases than benefits cuts;
- preserve defined benefit plans where possible;
- improve the structure of the defined contribution plans; and
- increase incentives for personal savings outside workplace plans.

He noted several beneficial aspects of DB plans, which still cover over forty million workers and retirees in the private sector along with over twenty million in the public sector — universal participation, professionally managed investments, longevity risk sharing, and annuitized income. Pomeroy maintained the DB system would have been addressed differently if viewed in the context of a national retirement income security strategy. Instead, legislation to improve funding has made DB plans more complicated and expensive to administer, especially the Pension Protection Act, which also amplified the volatility of plan funding. Given the poor decisions that workers often make when covered by a 401(k) plan, Pomeroy views the 401(k) model as better suited to complement a DB plan than to serve as a primary retirement plan.

Focusing specifically on state and local pensions, Pomeroy argued that dramatic reform is generally not warranted given the system’s success to date in providing retirement income security for public sector retirees. He feels that current underfunding has been overstated into a crisis by some to justify switching to a DC model for reasons unrelated to retirement income security.

He stressed the need for funding discipline, in contrast to a culture that consistently underfunds pension plans to enable spending on other budget items. He sees an integrated set of adjustments to contribution rates, retirement ages, and benefit accruals based on realistic market return assumptions as being sufficient to restore sound plan finances over a reasonable period of time.

If such adjustments do not restore an adequate funding level and consensus emerges that more fundamental change is needed, Pomeroy views a hybrid DB/DC model as more appropriate than a pure DC model. Such a redesign should balance plan cost, benefit adequacy, and degree of risk shifting. He sees an untenable shift of risk to workers as inherent with a pure DC redesign.

Session 2: Retirement Plan Design for the Future Public Workforce

Retirement plan design was examined from a strategic human resources perspective during the forum’s final session. Given the imperative for state and local governments to provide services effectively and efficiently, questions about whether and how the workforce and employment model in the public sector need to evolve were considered. The implications for retirement plan design were then explored.

The discussion was led by a panel representing a range of experience and expertise:

- Jeffrey R. Brown, William G. Karnes Professor of Finance, University of Illinois at Urbana-Champaign, TIAA-CREF Institute Fellow
- Robert L. Clark, Zelnak Professor, Poole College of Management, North Carolina State University; TIAA-CREF Institute Fellow
- Joshua M. Franzel, Vice President, Research, Center for State and Local Government Excellence
- David M. Morrell, University-Wide Benefits Administrator, The State University of New York

- Yvonne R. Walker, President, Local 1000, Service Employees International Union; Chair, Retirement Security Committee, SEIU Executive Board
- Randi Weingarten, President, American Federation of Teachers

Workforce Evolution

In discussing how the public sector workforce structure has evolved and is likely to evolve, Josh Franzel noted two key trends — the aging of the public sector workforce and the relatively high education level of public sector workers. He explained that the share of workers age fifty or older in the public sector increased from 25 percent in 1992 to 37 percent in 2012. In 2012, the median ages of state and local workers were forty-four and forty-five years, respectively, compared with forty and forty-one in 1992. He then noted that while state and local government employees have been always been relatively well educated, they have become even more so over the past twenty years. In 2012, 28 percent of public sector workers had a bachelor's degree and 29 percent had a masters, professional, or doctorate degree. By comparison, among private sector workers, 20 percent have a bachelor's degree and 9 percent have advanced degrees.

Much work in the public sector is knowledge-based and requires advanced education or training, both before and during employment. This drives the higher levels of education found in the sector. Franzel stressed the implications for recruitment of workers to the sector and subsequent retention of them. He noted that governments often have difficulty filling positions that are knowledge-based and require advanced training, such as engineers, epidemiologists, information technology professionals, physicians, nurses and skilled trade occupations. Governments face difficult choices in offering competitive compensation and benefit packages that will attract and retain personnel with key skill sets, while also ensuring that these packages are fiscally sustainable. This difficulty has persisted in the current postrecession economy despite an overall unemployment rate that remains well over 7 percent; the unemployment rate is less than half that for those with a bachelor's degree or higher.

Franzel argued that it will be some time until public sector employment levels return to their 2008 prerecession peak. Franzel explained that the approaches state and local governments have taken in response to the recession and relatively flat government revenues, such as regional and interlocal cooperation on service provision and public-private partnerships, will hold down employment levels. Over the past year, one-half of public sector human resource executives reported pay freezes, 42 percent had imposed hiring freezes, and 29 percent reported layoffs; but such figures have improved since the recession's end. He also noted an uptick in the number of retirements among retirement-eligible employees; this is noteworthy given the age demographics of the workforce.

The SUNY Experience

The State University of New York (SUNY) employs 88,000 individuals across sixty-four geographically dispersed campuses; 54,000 of these employees are in nonfaculty positions. Dave Morrell noted two fundamental changes in the composition of SUNY's workforce. First, SUNY's workforce is becoming younger as the university hires to replace baby boom workers as that cohort moves into retirement. Second, the nature of the position hires has changed as the nature of the work required to support faculty, students, and the public evolves, for example, with the use of online activity and mobile media. This evolution necessitates a growing number of professionals and paraprofessionals with the requisite skills and expertise that have not previously existed in the university's workforce.

Morrell explained that these developments have led to fundamental shifts in the university's employment model. Until relatively recently, a career employment model was the norm — an early-career worker was hired and then remained with the university for decades until retirement. Now the university is experiencing increased worker mobility and shorter employment tenures. It is increasingly common for individuals, particularly in certain positions and units, to be employed with the university for relatively short periods before moving onto a new job with a different employer. This employment pattern matches the expectations of both the worker and the university — hires will leverage their SUNY employment experience into their next career move. This development has been accompanied by an analogous increase in the hiring of midcareer workers with needed expertise and experience.

Alternative Experiences

Yvonne Walker noted a somewhat different experience with California state workers represented by SEIU and referenced studies finding decreased worker turnover during the past several years. She observed that younger workers want a variety of job and career experience, but they prefer that to occur within their current state employment. She maintained that state government is well positioned to provide such an employment experience. Job mobility across departments within state government can provide a variety of job experience. California employees may also be able to benefit from state reciprocity with county and city governments.

Walker noted that women tend to stay in the California workforce longer than men. Given family responsibilities — single mothers, caretakers for aging parents, etc. — the stability and security of public sector employment are particularly attractive to women. She also noted lower mobility among minorities in the state's workforce.

The K-12 Teacher Experience

Randi Weingarten explained that anywhere from one-third to one-half of teachers leave the profession within the first five years for reasons such as the unexpected rigor of the job, lack of support, and relatively low salaries. Those that remain at the five-year point tend to stay for a relatively long period of time. She also noted a transformation in the age composition of the teacher workforce resulting from retirements among the large wave of teachers who entered the profession in the 1980s and 1990s.

She explained that simultaneously the profession is becoming an increasingly high-skilled profession. Teachers cannot simply be "one page ahead of their students," as in the past, particularly at the elementary school level. Understanding, not memorization, is required of students, so they must be taught higher-order skills — critical thinking, innovative thinking, applying knowledge, and teamwork. Individuals must now enter the teaching profession with both subject matter knowledge and pedagogical knowledge if they are to be effective. Such skills are then refined and further developed with experience.

Competitive salaries are increasingly imperative to attract the necessary talent level and skill set, along with a professional environment in terms of how teachers are managed. Retaining the right talent requires a professionally rewarding career trajectory composed of various potential paths and it requires financial rewards for experience and the higher-level performance that comes with experience. This makes deferred compensation in the form of a DB plan vitally important to reward and retain teachers with experience.

Implications for Retirement Plan Design/Redesign

Jeff Brown stressed that any discussion regarding redesign of an existing pension system should proceed from a focus on retirement income security as opposed to wealth maximization. More fundamentally, he maintained that reform discussions typically fall into a DB versus DC distinction when there is a much richer set of solutions available. Brown stressed the importance of thinking in terms of plan elements. A DB and a DC are simply alternate ways of packaging a set of plan attributes and there is significant middle ground between the two.

He argued for applying a risk management perspective that considers the range of uncertainties for employers and employees in providing for retirement income security — longevity risk, inflation risk, asset market risk, liquidity risk, and employment risk (voluntary job change and involuntary termination). Such a perspective leads to consideration of hybrid combinations of traditional DB and DC elements in terms of participation, contributions and funding, and benefit payments. He argued that the stereotypical private sector 401(k) plan is not the appropriate model from a risk management perspective. But the traditional DB plan is not a realistic model either, given the lack of a compelling funding discipline in many public systems and the lack of asset-liability matching. He noted recent plan innovations, such as automatic enrollment, automatic portfolio allocation, lifecycle funds, and in-plan annuitization (much more common among 403(b) plans than 401(k) plans) and argued that such features should be included in a plan being designed from a clean slate.

But given that pension reform does not happen from a clean slate, but involves redesign of existing plans, an initial consideration should be whether workers in a given state or locality are covered by Social Security. Social Security is essentially a DB plan providing lifetime income with replacement rates that vary across the income distribution. In states where workers are not covered by Social Security, Brown argued there is a case for incorporating an income floor, which can be done through a traditional DB design or an income-oriented DC design that incorporates annuities. Such an income floor should be designed to address concerns about workers falling into poverty or near-poverty status in retirement. Beyond such a minimum, redesign should consider essential expenses that ought to be covered in an inflation-protected, longevity-insured manner. Again, this can be done in either a DB or a DC context. Brown maintained that the guaranteed income component should be in the 70 to 80 percent range of working income.

Weingarten cautioned that there is a funding adequacy issue for DC plans as well as DB plans; specifically, there must be an adequate level of contributions in order to provide adequate retirement income. Current private sector norms in terms of typical employer 401(k) matching contributions are inadequate even with the equivalent worker contribution.

It was noted that contribution rates in primary DC plans in the public sector generally exceed the norm in private sector 401(k) plans, typically exceeding 10 percent of earnings. Furthermore, the employer contribution is not a match in these cases; it is fixed at a nondiscretionary level as is the worker contribution. With supplemental plans in the public sector, this is not the case.

The North Carolina Experience

The Future of Retirement Study Commission was created by the joint boards of the North Carolina public employees retirement systems and charged with recommending the retirement benefits that should be provided to future hires of state and local government in North Carolina. The commission's charter stated that recommendations should, among other things, "encourage employee behavior that best meets the workforce needs of the state and local governments." Robert Clark, chair of the commission, explained how the commission thus sought to define the characteristics of a plan design that would best help the state attract, retain, motivate, and ultimately retire employees.

Clark explained that the commission was not working in a crisis mode. North Carolina's two retirement systems — one for teachers and state employees and the other for local government employees — have historically been among the best funded in the U.S. The question posed by the state treasurer was whether the current plan design was appropriate for the next fifty years?

The system was originally designed for a career employment workforce. But the commission found that career employment was not the norm among state and local employees in North Carolina. Approximately three-quarters of workers who leave the system in any given year are nonvested since they've been employed less than five years. So the commission considered how the current plan treated both groups of workers — the mobile majority and the significant minority who are, or intend to be, career employees — and whether changes targeting either were warranted.

Clark presented the commission's view that the plan would be a more effective recruitment tool if it treated short-term workers better. For example, high skill individuals might be more willing to enter teaching if they knew that the plan would still provide a meaningful payout even if the profession turned out to be a poor fit and they left after several years.

The commission also considered whether state and local government should provide a significant financial incentive for retirement at age fifty or fifty-five, as is the case with many public sector DB plans. It could be argued that this makes sense for certain occupations — police and firefighters, and potentially teachers — but there are other public sector jobs where workers would remain productive into their sixties. So why should government incentivize them to retire earlier?

The commission did not recommend dramatic changes to the existing defined benefit plan, which was well-funded and functioning as intended. It did recommend the creation of a statewide 403(b) plan for teachers to provide a more efficient retirement system over and above the DB plan. Previously, this was left to the local school districts. Such a plan was subsequently approved by the state legislature in 2011 and implemented in 2012.

Related Comments

Morrell reiterated the view that pension reform initiatives should account for evolution in the employment model and career experience. He noted that SUNY employees are eligible for two pension systems — a DB plan and a DC plan, both annuity-based. He shared that 73 percent of SUNY professional staff (and faculty) choose the DC option as their primary retirement plan type. He noted that this figure is rising and attributes that increase not simply to benefit reductions in the DB plan, but to considerations inherent with the evolving composition of SUNY's workforce discussed above — a desire for benefit portability given career goals and aspirations, anticipated and realized employment longevity, and lifestyle developments such as later retirement and employment (by choice, not necessity) after "retirement." Workers will typically have a need for a lifetime income stream that they can take from either a DB plan or from an annuity-based hybrid type model like SUNY's. At the same time, he observed, many workers want a lump sum in retirement to start a second career. He feels that the flexibility of SUNY's annuity-based DC plan addresses both desires, which in turn make it attractive in terms of recruitment and retention of professionals in today's job market.

Curtis Lloyd, vice chancellor, human resources, at the State University of New York, expressed the view that the Generation X and Generation Y workforce appears to be a cohort that in general will not want to spend a career with the same employer. He also shared his experience that many workers currently remained in their jobs solely because they have yet to reach the eligibility requirements for retirement with full benefits under their DB plan. While this may be a positive or negative depending on the specific situation, it argues that the DB model in general may be a poor fit for Generations X and Y.

Diane Oakley, executive director of the National Institute on Retirement Security, discussed worker preferences and understanding across plan types. She noted that among states where at least some employees (aside from higher education) have the option to choose their primary plan type — DB or DC — the vast majority of eligible employees have chosen or defaulted into the DB. She also argued that many DB terminations in the private sector occurred in the absence of worker input on the matter. She views the loss of midcareer employees who have accumulated significant human capital for their occupation through experience, e.g., teachers, as an unintended consequence of changing their primary plan type from DB to DC.

In response, it was suggested that plan design in the public sector varies to a greater degree across occupations. Primary and supplemental plan designs would depend upon the labor market dynamics of occupation groups. The logic is analogous to the reason why many public higher education systems offer faculty the option of a primary DC plan in place of the DB, i.e., the need to compete for quality faculty. With benefits frozen at the point of job change until retirement age, a DB is not attractive to a potential faculty hire who thinks there is a relatively high likelihood that he or she will eventually leave for a position at a different institution.

Franzel noted an increasing need for supplemental DC plans in the public sector as the benefit level of DB plans is scaled back in response to fiscal challenges. He noted this also matches well with a desire to provide meaningful benefits to short-service employees.

It was argued that any cuts in retirement benefits will necessitate eventual increases in other forms of compensation to enable the public sector to compete for workers. The sector cannot recruit with the promise of job security to the same degree as in the past, so that advantage has been diminished.

Jared Llorens, assistant professor, Public Administration Institute, Louisiana State University, conjectured whether cuts in retirement benefits not offset by increases in other forms of compensation put state and local governments at risk of becoming second rate employers at some point in the next five to ten years.

Financial Literacy

Morrell argued the inherent importance of financial education, advice, and planning in addition to plan design considerations per se. Financial planning, in particular, retirement planning, needs to account for expected career patterns as well as lifestyle plans for retirement. This calls for an early career approach to retirement planning. Such thinking creates engagement in terms of saving an adequate amount and determining how best to manage that savings for income during retirement.

Steve Toole, director of retirement, State of North Carolina, highlighted the importance of financial literacy and the lack of it among today's population. He argued that financial education should be mandatory in high school. Individuals need to understand the importance of retirement savings because they need to save irrespective of the type of plan they have and more so for the large percentage of private sector workers with no retirement plan coverage.

The question was raised whether it is realistic and fair to expect K-12 teachers to teach personal finance when their level of financial literacy is likely no better than that of the general population. Weingarten explained that implementation of the Common Core might enable this to be done better since it seeks to align the baseline curriculum in literacy and mathematics with the knowledge and skills students need to be career ready and college ready.

Public Sector Pensions in a National Context

Yvonne Walker maintained that discussions focused strictly on public sector retirement systems ignore the national context of inadequate retirement readiness in general across the U.S. workforce. She stressed the need to recognize retirement income security challenges in the private sector, particularly with regards to workers not covered by an employer-sponsored plan. She noted that inadequate retirement income among private sector retirees translates into increased demand on public sector budgets for various forms of income assistance.

In this context she discussed the passage in California of Senate Bill 1234 creating the Secure Choice Retirement Plan, which is designed to provide private sector workers not covered by an employer-sponsored retirement plan with a tax-deferred retirement savings option through work. She encouraged future discussions to have a global versus sector-specific focus, and consider options such as universal Social Security coverage.

Weingarten echoed a call for a national retirement income policy and offered several governing principles for its development:

- Universal Social Security coverage with a guaranteed minimum payment for all workers.
- Shared responsibility of costs between employers and employees, with government assistance for low-wage earners.
- Portable pension accruals with no preretirement distributions.
- Required annual contributions and adequate reserve funding requirements.
- Social investing of some share of pension assets.

Morrell encouraged a holistic evaluation of the retirement income security system that considers integrating a universal DC system with a universal Social Security "DB" benefit. Funding levels of the DC could be at the discretion of individual employers and employees. Participant accounts would be portable across employers and sectors. He also argued that the funding of retiree health care should be part of a comprehensive discussion.

Bob Clark noted that while such a national discussion is important, existing underfunding in public sector plans still needs to be addressed. Those obligations are state-specific issues that need to be addressed on a state-by-state basis, which necessitates that the conversation also occur on a more micro level.

Clark also noted that Social Security reform is inevitable and will involve some combination of benefit cuts (possibly in terms of eligibility age increases) and in payroll tax increases. The same is true with Medicare. Clark argued that any increase in taxes paid by employers would inevitably impact the compensation package provided to employees. Ultimately, this translates into greater individual responsibility for retirement income. Clark thus stressed the importance of making financial planning and decision-making as easy as possible for individuals through plan design, financial education, and savings incentives.

Conclusion

Retirement plan coverage remains near-universal among full-time employees in the state and local government workforce. The primary plan type in the sector is almost always a defined benefit plan, which is often supplemented by a voluntary defined contribution plan. Such a regime positions long-tenure employees very well for a financially secure retirement. That said, given the effects of the recent economic downturn, underlying state and local government fiscal challenges, and evolution in the structure of the public sector workforce, there has been and will continue to be much change in the provision and generosity of public sector retirement benefits. This increasingly involves more fundamental reform incorporating DC design in the primary plan offer. Addressing the dynamics of public sector pension reform was the subject of the forum sponsored by the TIAA-CREF Institute and SUNY's Rockefeller Institute of Government, *Public Sector Pension Reform: Addressing Pressing Fiscal Realities from a Long-Term Perspective.* The forum examined the experience of a range of states and localities in addressing their pension funding challenges through different reform strategies. Beyond that, it considered future evolution in the sector's workforce and employment model and how this will and should interact with retirement plan design. This report summarizes and synthesizes the experiences and thinking shared at that forum to provide a resource for others in addressing the same issues.

Endnotes

1 Source: *National Compensation Survey, March 2011* (Washington, D.C.: Bureau of Labor Statistics, U.S. Department of Labor, March 2011), http://www.bls.gov/ncs/ebs/benefits/2011/ownership/govt/table02a.pdf.

2 The annual required contribution (ARC) is the plan sponsor's required contribution to a defined benefit plan. The ARC is the sum of two parts: (1) the normal cost, which is the cost for benefits attributable to the current year of service, and (2) the amortization payment, which is a catch-up payment for past service costs to fund the unfunded actuarial accrued liability over the next thirty years. Under Governmental Accounting Standard Board (GASB) Statement 45, it is not required that sponsors pay the ARC each year, but it does need to be calculated and disclosed in a public employer's annual financial statements.

3 Among DB plans sponsored by state and local governments, the ratio of assets to liabilities was estimated to be 75 percent in 2011. The annual required contribution (ARC) was estimated to be 15.7 percent of payrolls in 2011 and the estimated percent of ARC paid was 79 percent. (See Alicia H. Munnell et al., *The Funding of State and Local Pensions: 2011–2015* (Boston, MA: The Center for Retirement Research, May 2012), http://crr.bc.edu/wp-content/uploads/2012/05/slp_24.pdf.

4 Ron Snell, *State Pension Reform, 2009-2011* (Washington, D.C.: National Conference of State Legislatures, March 2012), http://www.ncsl.org/documents/employ/StatePensionReform2009-2011.pdf.

5 See the Center for State & Local Government Excellence pension reform map, http://slge.org/research/retirement.

6 State and local employees comprised 14.3 percent of the total nonfarm workforce in January 2013. Data obtained from the U.S. Bureau of Labor Statistics on May 2, 2013.

About the Authors

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The Nelson A. Rockefeller Institute of Government is a national, independent organization that researches and publishes on public policy issues, with a particular focus on the fifty states and the local governments within them. A public policy "think tank" that seeks to educate rather than advocate, the Institute focuses on: state fiscal issues, education, federalism, intergovernmental relations, urban issues, health care reform, and social welfare policies. The primary goal of the Institute is to develop findings that state and local governments can use to become more effective.

About The State University of New York

The State University of New York (SUNY) was officially established in 1948 with the consolidation of twenty-nine unaffiliated institutions. Today, SUNY's sixty-four campuses comprise the nation's largest comprehensive system of public higher education. SUNY's mission is to provide to the people of New York educational services of the highest quality, with the broadest possible access, fully representative of all segments of the population in a complete range of academic, professional, and vocational postsecondary programs including such additional activities in pursuit of these objectives as are necessary or customary. SUNY provides access to almost every field of academic or professional study via over 7,000 degree and certificate programs.

About the TIAA-CREF Institute

The TIAA-CREF Institute is a thought leader and model for knowledge building and public engagement on lifetime financial security, retirement planning, and organizational success in higher education and the charitable and public sectors. A respected source of knowledge and expertise, the TIAA-CREF Institute sponsors and conducts objective, relevant research, allies with nationally recognized thought leaders and scholars, hosts and sponsors senior-level convenings, and administers highly regarded awards programs. A trusted partner, the TIAA-CREF Institute enables those we serve to anticipate trends, develop future strategies and solutions, and maximize opportunities for success.

About TIAA-CREF

TIAA-CREF is a national financial services organization with $520 billion in assets under management (as of March 31, 2013) and is the leading provider of retirement services in the academic, research, medical, and cultural fields. TIAA-CREF is dedicated to serving the retirement needs of those in the academic, medical, government, cultural, and research fields. With our strong nonprofit heritage, we subscribe to guiding principles directly influenced by the people we serve.