Cost-Sharing Features in State Retirement Systems

National Conference of State Legislatures
Legislative Summit
Nashville, Tennessee
August 5, 2019

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Strengthening Public Sector Retirement Systems
The Pew Charitable Trusts

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  o Improve public policy
  o Inform the public
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Pew’s Public Sector Retirement Systems Project

Ø Research since 2007 includes 50-state trends on public pensions and retiree benefits, funding, investments, governance, plan design, and retirement security.

Ø Technical assistance for states and cities since 2011.
Outline and Toplines

Outline
Ø Overview of cost sharing
Ø How states incorporate cost sharing features
Ø High performing state examples

Toplines
Ø There is no one-size-fits-all solution for plan design or cost sharing features
Ø Cost sharing features can help plans achieve sustainable costs and...
Cost Sharing in Traditional Defined Benefit Plans

26 DB plans in 17 states have formal cost-sharing policies.
Plan Design Definitions

**Defined Benefit Plan (DB):** Plan that provides a lifetime benefit based on a formula that accounts for the employee’s salary and years of service.

**Hybrid Plan:** Combines a DB with a separate Defined Contribution (DC) (401(k)-style) savings account.

**Cash Balance Plan (CB):** Pooled and professionally-managed employee savings account with a guaranteed minimum annual investment return and lifetime benefit.

**Cost Sharing Features:** Formal mechanisms that allocate risk and/or distribute unexpected costs to employers, employees, and retirees.

**Career Replacement Income:** Retirement income as a share of career-end take-home pay, indexed for inflation and including Social Security.

**Retirement Savings Rate:** The percentage of salary saved annually that is available to an employee who leaves public service before reaching retirement age eligibility.
Growing Number of States with Alternative Retirement Plans

23 states have implemented an alternative plan for workers:

- **DC - Defined Contribution**
- **DC - Cash Balance**
- **Hybrid**
- **CB - Money Purchase**
- **Hybrid**

Notes: In cases where a state has more than one alternative plan, the plan type with the greater number of participants is marked on the map. California provides an optional cash balance plan, but California’s cash balance plan is available only to local workers. In 2017, Illinois approved the adoption of an optional hybrid that has yet to be implemented. Vermont offers a defined contribution plan.
# Well-Funded Plans Have A Range of Designs and Cost Structures

**Plans with the Strongest Risk Management Provide Path to Retirement**

<table>
<thead>
<tr>
<th>Plan</th>
<th>Plan Type</th>
<th>2017 Funded Ratio</th>
<th>Risk Sharing/Predictable Costs*</th>
<th>Career Replacement Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wisconsin Retirement System</td>
<td>Defined Benefit w/ Money Purchase</td>
<td>103%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>South Dakota Retirement System</td>
<td>Defined Benefit w/ Money Purchase</td>
<td>100%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Tennessee – Public Employees Retirement Plan</td>
<td>DB/DC Hybrid</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Nebraska – State and County Employees Pension Plans</td>
<td>Cash Balance</td>
<td>100%+</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Utah Retirement System</td>
<td>DB/DC Hybrid with Optional DC</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

*Criteria is met if the potential increase of expected employer costs, expressed as a percent of payroll, in a lower than expected return scenario is less than two percent. The range in contributions rates between 2007 and 2017 is less than five percentage points.

**Criteria is met if the retirement benefit is at least 90 percent of take-home pay, on average (adjusted for inflation) in retirement, including Social Security.
The Top 3 States Have Maintained Well-funded Plans and Costs Stable

Costs for the bottom 3 have increased by 22 percentage points since 2007.

Employer Contributions/Payroll: Top 3/Bottom 3

Source: Comprehensive annual financial reports, actuarial reports and valuations, other public documents, or as provided by plans.

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Different Cost-sharing Features and Strategies

Ø **South Dakota**: fixed employer and employee costs and adjustable benefits, includes post retirement annuity adjustment based on investment performance.

Ø **Wisconsin**: employer and employee contributions rise and fall equally based on investment performance.

Ø **Tennessee**: combines a smaller DB with a DC plan, funding policy creates a reserve of automatic changes to benefits and contributions.

Ø **Nebraska**: cash balance plan with predictable employer costs.

Ø **Utah**: hybrid plan with an optional DC, hybrid plan has a fixed employer contribution rate are responsible for making up the different if costs exceed 10%.
Lessons Learned From Well-Funded States

Ø Pre-defined automatic rules

Ø Margin of safety in assumptions

Ø Transparency and communication

Ø Variable COLA

Ø Contributions
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