



# The Secure Choice Pension:

## A Way Forward for Retirement Security in the Private Sector



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Representing more than 500 funds throughout the United States and Canada, NCPERS is a unique non-profit network of public trustees, administrators, public officials and investment professionals who collectively manage nearly \$3 trillion in pension assets. Founded in 1941, NCPERS works to promote and protect pensions by focusing on advocacy, research and education.

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# Executive Summary

**R**ETIREMENT READINESS IS WOEFULLY LACKING FOR MANY PRIVATE-SECTOR WORKERS. Private companies’ dramatic shift away from defined benefit pension plans has fundamentally changed the way workers save for retirement and has left workers with an unsure and likely insufficient nest egg. The traditional model of the three-legged stool of Social Security, personal savings that include 401(k)s, and a pension has dramatically declined for private-sector workers. All private-sector workers have Social Security and many have access to 401(k)s, but unfortunately the majority do not have access to a pension.

The effects of this shift have been accumulating for some time and are increasingly near the tipping point. Many workers are simply not prepared for retirement by any measure. Those who do have significant savings are faced with the uncertainties of outliving their savings and the vagaries of the markets.

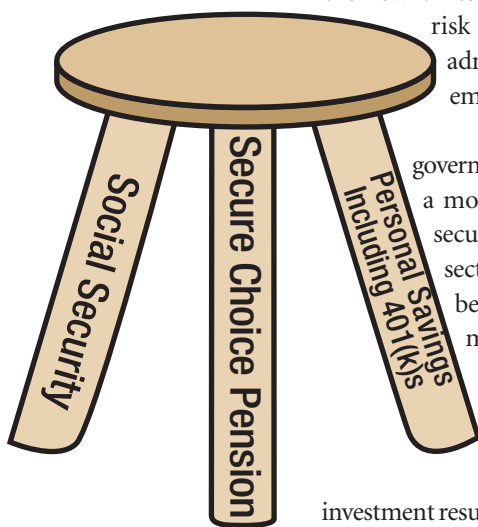
Several clear needs must be addressed. Most workers need the certainty and predictability of a lifetime annuity, but they also need choice and flexibility. They need to be able to take their pension with them when they change employers. And they need to have the benefits of professional plan management to achieve these goals.

These important protections involve cost and risk, however. Many private employers are unable or unwilling to assume all the risk on their own. Alternatives are needed for sharing risk with workers and leveraging administrative savings that larger employers can provide.

Public plans and their government sponsors can help provide a model to address the retirement security crisis that faces the private sector. Any new alternative should be influenced by the factors that make public plans a success, including the experience with defined guaranteed benefits and the economies of scale to deliver the necessary investment results in a cost-effective manner. A new choice that draws on these lessons is needed to provide retirement security in the private sector. The Secure Choice Pension would provide this new choice. It is designed to provide the following:

- The Secure Choice Pension is designed as a public-private enterprise for those who currently do not have a pension (particularly for small and mid-sized businesses).
- The Secure Choice Pension is not a replacement for existing pension plans in the public or private sectors, nor is it intended to replace 401(k)s.
- The Secure Choice Pension will be modeled after a “cash balance” type defined benefit plan, as described in more detail below.
- The Secure Choice Pension in conjunction with Social Security and personal savings, including 401(k)s, will help close the existing \$4-8 trillion retirement savings gap as estimated by several research groups.
- The Secure Choice Pension will decrease the burden on state and local governments by reducing the need for retirees to rely on public assistance.
- The Secure Choice Pension will manage downside funding risk through conservative assumptions as developed in a model plan design and/or determined by each state.
- The Secure Choice Pension will provide workers with a guaranteed pension but will permit some opportunity for increased benefits in good economic times.

In summary, the goal of the Secure Choice Pension is to provide private-sector workers who currently do not have access to a pension – particularly those who work for small to mid-sized companies – with a guaranteed, affordable, sustainable pension through a public-private structure that shares the risk between employers and employees and manages funding risk.



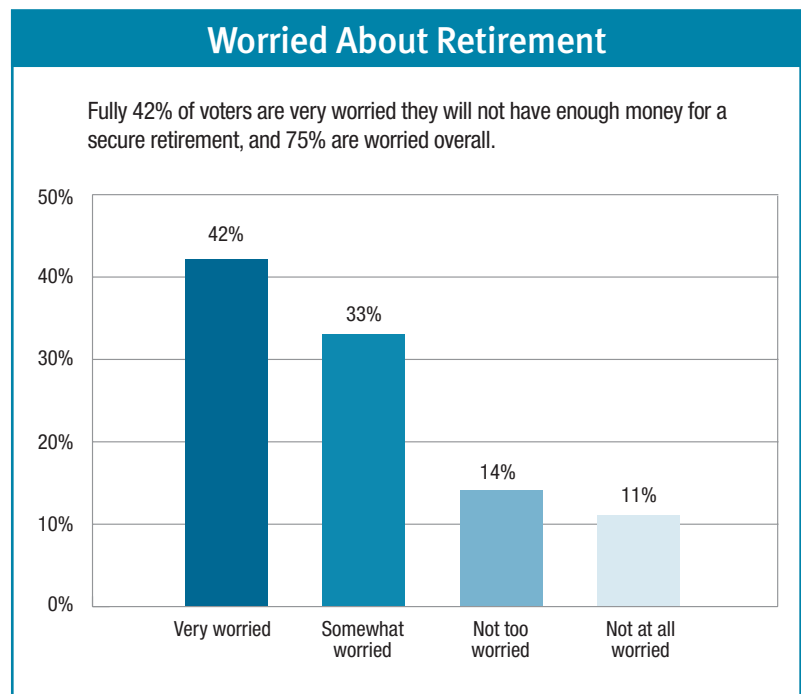
## Why We Need the Secure Choice Pension

**A** MERICAN PRIVATE-SECTOR WORKERS NEED A NEW CHOICE that provides a secure yet flexible retirement program.

Most individuals need to save more for retirement. Millions of people are not currently saving enough to allow for a secure retirement. These people may be forced to work longer before retirement, experience a less-than-reasonable quality of life during retirement, or become dependent on public safety-net programs.

The Employee Benefit Research Institute (EBRI) recently calculated an average American retirement savings deficit of approximately \$48,000 per person, with an aggregate national retirement savings shortfall of almost \$4.6 trillion.<sup>1</sup> This calculation does not include the costs of nursing home or home healthcare. Adding such costs would increase the shortfall by an average of \$25,317 per individual for married households, \$32,433 for single males, and \$46,425 for single females.<sup>2</sup> The analysis also found that if Social Security retirement benefits were eliminated, the aggregate national retirement income deficit would almost double to \$8.5 trillion, or an individual average of approximately \$89,000. These amounts represent the additional individual average amounts needed at age 65 to eliminate expected deficits in retirement.

In calculating the gap between what American households in their peak earning years (ages 32–64) currently have in retirement savings and what they will need to maintain their standard of living in retirement, the Center for Retirement Research at Boston College estimated a savings deficit of between \$5.2 trillion and \$7.9 trillion, depending on inflation-adjusted investment returns.<sup>3</sup> The calculation took into account all major sources of retirement income and assets, including Social



Security, traditional pension plans, 401(k) plans, and other forms of personal savings.

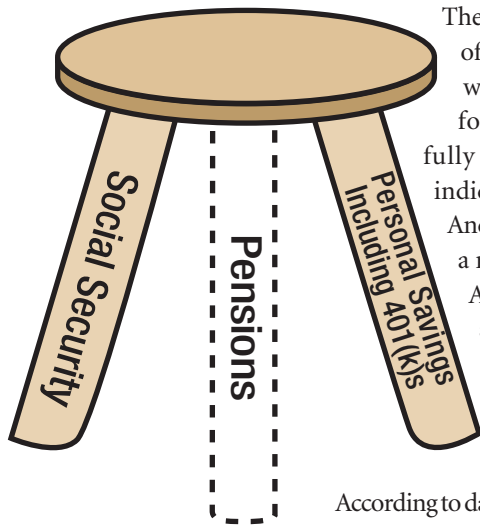
An April 2011 study designed by Lake Research Partners and sponsored by the National Conference on Public Employee Retirement Systems (NCPERS)<sup>4</sup> found that Americans consider retirement security a matter of major concern but more and more difficult to achieve.

<sup>1</sup>Jack VanDerhei, "Retirement Savings Shortfalls for Today's Workers," *Notes*, 31, no. 10 (Oct. 2010): 2, [http://www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_10-Oct10.RetShrtfl-Cobra.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_10-Oct10.RetShrtfl-Cobra.pdf) (EBRI's estimates are present values, stated in 2010 dollars).

<sup>2</sup>*Ibid.*, p. 4.

<sup>3</sup>Retirement USA, "The Retirement Income Deficit," <http://www.retirement-usa.org/retirement-income-deficit-0> (using numbers calculated for Retirement USA by the Center for Retirement Research at Boston College).

<sup>4</sup>Lake Research Partners, National Conference on Public Employee Retirement Systems: National Research, Findings from Focus Groups among Voters and a Survey of 809 Likely 2012 General Election Voters, survey conducted April 18–21, 2011.



The study found that 75 percent of respondents worried that they will not have enough money for a secure retirement, with fully 42 percent of respondents indicating they are *very* worried. And they are right to be worried. As a recent report from the General Accountability Office (GAO) acknowledges, ensuring income in retirement may involve difficult choices, including lowered consumption and lifestyle expectations.<sup>5</sup>

According to data from the U.S. Census Bureau, approximately 10 percent of Americans age 65 and older live in poverty.<sup>6</sup> According to calculations for 2009, for a person aged 65 years or older living alone, the poverty threshold was a yearly income of approximately \$10,000.<sup>7</sup> Today, as more people enter retirement with inadequate retirement savings, they may increasingly face living in poverty.

A 2007 study by the GAO projected that a full 37 percent of workers born in 1990 may reach retirement age with *no* retirement savings

from defined contribution plans. Low-income workers fared the worst, with a full 63 percent of Americans in the lowest income quartile projected to have no retirement plan savings. Even those people in the highest income quartile had a projected replacement ratio of less than 34 percent of preretirement income from their defined contribution plan.<sup>8</sup>

An American making \$60,000 a year who is 35 years from retirement needs to set aside approximately 12 percent of his or her income each year to replace 80 percent of that income in retirement. This burden becomes even greater if a worker delays beginning to save. For example, a person with the same salary who is 20 years out and just beginning to save for retirement would have to set aside over 20 percent of his or her income to match that 80 percent income replacement level.<sup>9</sup>

Yet as of 2007, half of all households approaching retirement (ages 55–64) had less than \$98,000 in retirement savings, if they had anything at all. That would be enough to replace a mere 10 percent of these households' median income.<sup>10</sup> Given the recent economic recession, the outlook has only gotten worse. A report by

## Projected Average Annuity Equivalents and Replacement Rates from DC Plan Balances at Retirement, by Income, under Baseline Assumptions

Individual-level results	Overall	By income quartile			
		1	2	3	4
Annuity equivalent (per year, 2007 dollars)	18,784	1,850	6,554	16,635	50,098
Replacement rate (percent)	22.2	10.3	18.2	26.3	33.8
Percent of workers with no DC savings	36.8	63.0	39.8	27.9	16.4

Source: GAO projections using PENSIM model.

<sup>5</sup>U.S. Government Accountability Office, *Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices*, GAO-11-400 (June 2011): 50, <http://www.gao.gov/new.items/d11400.pdf>.

<sup>6</sup>U.S. Census Bureau, *Poverty Status in the Past 12 Months, 2005–2009 American Community Survey 5-Year Estimates*, [http://factfinder.census.gov/servlet/STTable?\\_bm=y&-geo\\_id=01000US&-qr\\_name=ACS\\_2009\\_5YR\\_G00\\_S1701&-ds\\_name=ACS\\_2009\\_5YR\\_G00\\_](http://factfinder.census.gov/servlet/STTable?_bm=y&-geo_id=01000US&-qr_name=ACS_2009_5YR_G00_S1701&-ds_name=ACS_2009_5YR_G00_).

<sup>7</sup>U.S. Census Bureau, *American Community Survey: 2009 Subject Definitions*, Appendix A: 135, [http://www.census.gov/acs/www/Downloads/data\\_documentation/SubjectDefinitions/2009\\_ACSSubjectDefinitions.pdf](http://www.census.gov/acs/www/Downloads/data_documentation/SubjectDefinitions/2009_ACSSubjectDefinitions.pdf).

<sup>8</sup>U.S. Government Accountability Office, *Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers*, GAO 08-8 (Nov. 2007): 22, <http://www.gao.gov/new.items/d088.pdf>.

<sup>9</sup>Calculated using the CNN Savings Calculator, available at <http://cgi.money.cnn.com/tools/saveyoung/index.html>. The Savings Calculator assumes a retirement age of 65, annual inflation of 2.5%, and factors in the impact of Social Security.

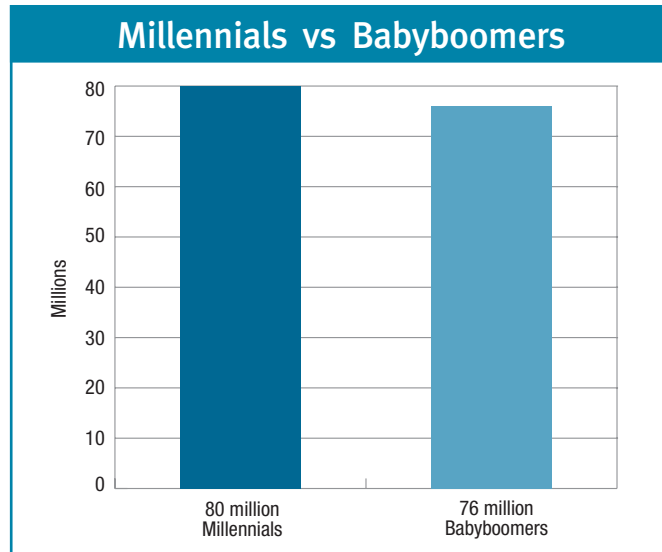
<sup>10</sup>Monique Morrissey, *Toward a Universal, Secure, and Adequate Retirement System*, Retirement USA Conference Report, Economic Policy Institute (Oct. 21, 2009): 18, [http://www.epi.org/page/-/pdf/20091021\\_retirement\\_usa.pdf?nocdn=1](http://www.epi.org/page/-/pdf/20091021_retirement_usa.pdf?nocdn=1).

EBRI concluded that between 4 percent and 14 percent of U.S. households that would have had adequate retirement income prior to the recession now may not.<sup>11</sup> Other analysts estimate that in 2009 a total of 51 percent of households were at risk of not having enough retirement savings, and younger generations are subject to an increased risk.<sup>12</sup> About \$4 trillion of equity assets in retirement plans were wiped out between October 2007 and October 2008.<sup>13</sup>

With their retirement savings greatly diminished, many people who would otherwise retire will have to continue to work, perhaps well into their 70s.<sup>14</sup> In a 2011 retirement confidence survey, 20 percent of workers said that the age at which they expect to retire has increased in the past year. The most frequently cited reason for postponing retirement, at 36 percent, was the poor economy. Only 23 percent of respondents indicated that they expect to retire before age 65.<sup>15</sup>

When people are forced to delay retirement past their desired retirement age, the ability of younger workers to enjoy upward mobility in the workplace is limited. Young adults in the millennial generation (those who “came of age” in the new millennium) are entering the workforce as the baby boomers are of an age to retire. The millennial generation includes a large number of individuals: depending on how they are counted, estimates range from 50 million<sup>16</sup> to more than 80 million.<sup>17</sup> The millennial generation thus may include even more people than the baby

boomer generation, which is numbered in the mid-70 millions.<sup>18</sup> The economy has already had a stunting effect on millennials’ personal and professional development. The generation has been termed the “boomerang” generation



because of their inability to find jobs, many have had to move back into their parents’ homes.<sup>19</sup> As of 2010, fully 37 percent of 18- to 29-year-olds were unemployed or out of the workforce.<sup>20</sup>

Further, in many cases, remaining in the workforce imposes potentially detrimental physical burdens on older workers. In 2009, more than 7 million workers age 58–69 (approximately 45 percent) held physically demanding or difficult

<sup>11</sup>EBRI, *Between 4–14% More U.S. Households “At Risk” of Running Short of Money in Retirement Due to 2008–2009 Recession*, (Jan. 20, 2011), <http://www.ebri.org/pdf/PR910.20Jan11.RetIncAd.pdf>.

<sup>12</sup>Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, Center for Retirement Research at Boston College, *The National Retirement Risk Index: After the Crash*, 4 (Oct. 2009): Fig. 4, [http://crr.bc.edu/images/stories/Briefs/IB\\_9-22.pdf](http://crr.bc.edu/images/stories/Briefs/IB_9-22.pdf).

<sup>13</sup>Alicia Munnell, Jean-Pierre Aubry, and Dan Muldoon, Center for Retirement Research at Boston College, *The Financial Crisis and State/Local Defined Benefit Plans*, 1 (Nov. 2008): 1, [http://crr.bc.edu/images/stories/Briefs/ib\\_8-19.pdf](http://crr.bc.edu/images/stories/Briefs/ib_8-19.pdf) (the decline was divided equally between defined benefit and defined contribution plans).

<sup>14</sup>EBRI, *Work Later in Retirement? For Many, It Won’t Be Enough*, Fast Facts #205 (July 19, 2011), <http://www.ebri.org/pdf/FFE.205.19July11.LateRet.pdf>. EBRI, *Older Workers: Who’s Working?* Fast Facts #208 (Aug. 2, 2011), <http://www.ebri.org/pdf/FFE.208.2Aug11.LbrPart-1.pdf>.

<sup>15</sup>EBRI, 2011 Retirement Confidence Survey–2011 Results, 2011 RCS FACT SHEET #5: Changing Expectations About Retirement (Mar. 2011): 1, [http://www.ebri.org/pdf/surveys/rcs/2011/FS5\\_RCS11\\_Expect\\_FINAL1.pdf](http://www.ebri.org/pdf/surveys/rcs/2011/FS5_RCS11_Expect_FINAL1.pdf).

<sup>16</sup>Pew Research Center, *Millennials: Confident. Connected. Open to Change*, (Feb. 24, 2010), <http://pewsocialtrends.org/2010/02/24/millennials-confident-connected-open-to-change/>.

<sup>17</sup>Amy Larrabee and Erica Robinson, *Ready or Not, Here They Come: Motivating and Retaining the Millennial Generation*, [http://www.belloaks.com/documents/Motivate,%20Retain%20Millennials\\_BellOaks.pdf](http://www.belloaks.com/documents/Motivate,%20Retain%20Millennials_BellOaks.pdf). Peter Leyden, Ruy Teixeira, and Eric Greenberg, *The Progressive Politics of the Millennial Generation* (June 20, 2007), [http://newpolitics.net/node/360?full\\_report=1](http://newpolitics.net/node/360?full_report=1).

<sup>18</sup>*Ibid.*

<sup>19</sup>Michelle Hirsch, “The Boomerang Generation: More Reasons to Move Back Home,” *The Fiscal Times* (June 12, 2010), <http://www.thefiscaltimes.com/Articles/2010/06/12/The-Boomerang-Generation-More-Reasons-to-Move-Back-Home.aspx#page1>.

<sup>20</sup>Pew Research Center, *supra* note 16.

jobs.<sup>21</sup> And when people who are not financially prepared for retirement are forced to leave the workforce, there is a further strain on workers and the national economy that is difficult to quantify but undoubtedly very significant.

The expenditures made by retirees not only support jobs and economic output in local economies throughout the United States but also provide much-needed patient capital to domestic equities markets.<sup>22</sup>

Expenditures made from benefit payments from plans that provide a guaranteed payment in the form of a periodic payment or annuity benefit are particularly important because retirees receive a regular, guaranteed benefit regardless of stock market fluctuations or economic downturns. Thus, such payments serve as predictable and important stimuli to the economy. In a 2009 study, using data from the U.S. Census Bureau for the fiscal year 2005–2006, the National Institute on Retirement Security (NIRS) found that expenditures from state and local pension benefits had a total economic impact of more than \$358 billion, supporting more than 2.5 million American jobs that paid more than \$92 billion in total compensation to American workers. NIRS found that, nationally, the largest economic impacts were seen in the manufacturing, healthcare and social assistance, finance and insurance, retail trade, and accommodation and food services sectors.<sup>23</sup>

Increased retirement savings is good not only for specific American workers but also for the broader economy. The assets currently in retirement savings are an important source of investment capital. Defined benefit plans and those plans with

longer investment time horizons are particularly important sources of capital because they infuse patient, or long-term, capital into businesses and the financial markets. At the end of 2010, total U.S. retirement assets were \$17.5 trillion.<sup>24</sup> By March 31, 2011, that number was \$18.1 trillion. Of that amount, approximately \$6 trillion was in either public or private defined benefit plans.<sup>25</sup> Retirement savings counted for 37 percent of all household financial assets in the United States at the end of the first quarter of 2011.<sup>26</sup> At the end of 2009, approximately 60 percent of 401(k) participants' assets were invested in equity securities (i.e., investments that provide capital to businesses) through equity funds, the equity portion of balanced funds, and company stock.<sup>27</sup> And as of the first quarter of 2011, public pension plans held approximately \$1.862 trillion in corporate equities and \$272 billion in mutual fund shares.<sup>28</sup> Retirement plan investments fuel America's economic engine.

Furthermore, the impact of retirement assets on capital formation cannot be underestimated. Investments generating the creation of capital have supported thousands of companies that would otherwise not exist, including FedEx, Staples, Outback Steakhouse, and Starbucks. As a witness before the Joint Economic Committee of Congress testified in 2008, defined benefit pension plans, including state and local pension plans, have historically been a "sizable and reliable pool of capital" for investment into the nation's emerging growth companies. Industry in the United States that is reliant on capital creation would be "much weaker without the strong investment participation from defined benefit plans."<sup>29</sup>



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<sup>21</sup>Older Women's Economic Security Taskforce, National Council of Women's Organizations, *Raising the Social Security Retirement Age Is Dangerous* (2010), [http://www.socialsecuritymatters.org/Home\\_files/OWESRetirementAgeBriefFINAL.pdf](http://www.socialsecuritymatters.org/Home_files/OWESRetirementAgeBriefFINAL.pdf).

<sup>22</sup>NIRS, *Why Do Pensions Matter?* (Jan. 2010): 1, [http://www.iaff.org/pensions/documents/why\\_do\\_pensions\\_matter.pdf](http://www.iaff.org/pensions/documents/why_do_pensions_matter.pdf).

<sup>23</sup>Ilana Boivie and Beth Almeida, NIRS, *Pensionomics: Measuring the Economic Impact of State and Local Pension Plans* (Feb. 2009): 1, <http://www.nirsonline.org/storage/nirs/documents/Pensionomics.pdf>.

<sup>24</sup>ICI, *2011 Investment Company Fact Book* (2011): 98, [http://www.ici.org/pdf/2011\\_factbook.pdf](http://www.ici.org/pdf/2011_factbook.pdf).

<sup>25</sup>*Ibid.*, p. 101.

<sup>26</sup>ICI, "Retirement Assets Total \$18.1 Trillion in First Quarter 2011" (June 30, 2011), [http://www.ici.org/research/retirement/retirement/ret\\_11\\_q1](http://www.ici.org/research/retirement/retirement/ret_11_q1).

<sup>27</sup>Jack VanDerhei, Sarah Holden, and Luis Alonso, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009*, EBRI Issue Brief no. 350 (Nov. 2010): 1, [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_011-2010\\_No350\\_401k\\_Update-092.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_011-2010_No350_401k_Update-092.pdf).

<sup>28</sup>Federal Reserve, *Flow of Funds Accounts of the United States: Flows and Outstandings First Quarter 2011* (June 9, 2011): 92, <http://www.federalreserve.gov/releases/z1/Current/z1.pdf>.

<sup>29</sup>Sherrill Neff, "Testimony of Sherrill Neff, Quaker BioVentures for the Joint Economic Committee of Congress," *Your Money, Your Future: Public Pension Plans and the Need to Strengthen Retirement Security and Economic Growth* (July 10, 2008), [http://jec.senate.gov/public/?a=Files.Serve&File\\_id=37a4b193-6355-4c78-a30d-109f47fe841d](http://jec.senate.gov/public/?a=Files.Serve&File_id=37a4b193-6355-4c78-a30d-109f47fe841d).



# The Guiding Principles of the Secure Choice Pension

**T**O MEET THE NEEDS DESCRIBED ABOVE, any new type of retirement program for the private sector needs to take into account the following key principles:

- enhanced lifetime retirement security for all participants;
- flexibility and portability given the increasingly mobile workforce;
- managed and shared risk with protections for employers, employees, taxpayers, and the plan.

## **Lifetime Retirement Security for All**

The majority of workers approaching retirement have only small retirement savings – if they have any at all.<sup>30</sup> An alarming number of people have no access to any employer-sponsored retirement plan; as of 2006, only 43.2 percent of private-sector workers had an employer-sponsored retirement plan.<sup>31</sup> In the past, many retirees could rely on defined benefit pension plans to help provide a secure retirement income. However, defined benefit pension plans have become increasingly rare.<sup>32</sup> A new retirement solution should broaden accessibility to well-run plans with high-quality investment management and administrative services, removing the administrative burden and risks of self-management<sup>33</sup> from the participant.

In addition, longevity risk – the risk that a person will outlive his or her retirement savings – is increasing as life expectancy increases. A person

cannot plan solely based on average life expectancy, because half of all people will live beyond that average. Because people do not know their ultimate lifespan, it is difficult to be completely confident that they will not outlive their savings. Therefore, to provide complete retirement security, an ideal retirement solution needs to also provide a guaranteed benefit to continue throughout a person's retirement, however long that may be.

## **Flexibility, Portability, and Preservation**

A retirement system solution also requires flexibility and portability. It is much more common now than it used to be for people to work for many different employers throughout their lifetime.<sup>34</sup> Ideally, when participants change jobs, their pension account would go with them with immediate distribution of the account prohibited until retirement.

<sup>30</sup>GAO, *supra* note 5, pp. 49-50.

<sup>31</sup>Christian E. Weller, Testimony before the Joint Economic Committee of Congress, *Your Money, Your Future: Public Pension Plans and the Need to Strengthen Retirement Security and Economic Growth* (July 10, 2008), [http://jec.senate.gov/public/?a=Files.Serve&File\\_id=03739571-fb35-4dba-8c28-994192726169](http://jec.senate.gov/public/?a=Files.Serve&File_id=03739571-fb35-4dba-8c28-994192726169).

<sup>32</sup>GAO, *supra* note 5, p. 7. EBRI, "Employee Benefits in the United States: An Introduction," *EBRI Databook on Employee Benefits*, chapter 1 (updated Mar. 2011), <http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2001.pdf>.

<sup>33</sup>Jason S. Seligman and Jeffrey B. Wenger, *Asynchronous Risk: Unemployment, Equity Markets, and Retirement Savings*, Upjohn Institute Working Paper no. 05-114 (2005), [http://research.upjohn.org/up\\_workingpapers/114/](http://research.upjohn.org/up_workingpapers/114/) (discusses how, without proper management, defined contribution program participants are exposed to increased longevity risk, portfolio risk, market timing risk, and inflation risk).

<sup>34</sup>Carol Kinsey Goman, "Forces of Change: Condensed from This Isn't the Company I Joined: How to Lead in a Business Turned Upside Down," *Information Outlook* (May 2004), [http://findarticles.com/p/articles/mi\\_m0FWE/is\\_5\\_8/ai\\_n6077810/](http://findarticles.com/p/articles/mi_m0FWE/is_5_8/ai_n6077810/). Statement of the ICI, "The Retirement Challenge—Making Savings Last a Lifetime," *Hearing of the U.S. Senate Special Committee on Aging* (June 16, 2010): § VI, [http://www.ici.org/govaffairs/testimony/10\\_sen\\_aging\\_tmny](http://www.ici.org/govaffairs/testimony/10_sen_aging_tmny).

### ***Shared Risk***

A pension solution needs to strike a balance to manage and share risk among employers and participants. As discussed above, most private employers currently sponsor only a defined contribution plan such as a typical 401(k) or may not sponsor any retirement plan at all.<sup>35</sup> In either situation, the worker bears all of the risk in savings for his or her retirement. And even for workers who diligently save, an unexpected

economic downturn, such as we experienced in 2008, can significantly diminish retirement savings.

Yet, traditional pensions alone do not seem to be the answer either. Private-sector companies, including small employers, do not want to bear all of the risk that a traditional pension entails. Furthermore, traditional pensions do not always have the flexibility and portability that an increasingly mobile workforce needs.<sup>36</sup>

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<sup>35</sup>Weller, *supra* note 31.

<sup>36</sup>EBRI, *supra* note 32.

# The Power of Public Pension Plans is a Key Part of the Solution

**P**PRIVATE-SECTOR EMPLOYERS NEED A THIRD OPTION. Public pension plans stand out as a potential model. Such plans have a successful track record of performance in delivering adequate benefits in a sustainable and efficient manner.<sup>37</sup>

Because of their group nature, public pension plans create significant economies of scale and other economic efficiencies for taxpayers and employees, which allow them to offer retirement benefits in a proficient and cost-effective manner. As a witness testified before a Joint Economic Committee hearing entitled, “Your Money, Your Future: Public Pension Plans and the Need to Strengthen Retirement Security and Economic Growth,” because public pension plan assets are pooled and managed by professionals, these systems can achieve higher returns at a lower cost than the typical defined contribution plan. In addition, public pension plans pool mortality and other risks, allowing these plans to provide benefits at lower costs for participants and plan sponsors.<sup>38</sup> On average, plan fees can range between 0.8 percent and 1.5 percent of assets; larger institutional plans can reduce such fees to between 0.6 percent and 0.2 percent of assets.<sup>39</sup> By pooling assets, public plans are able to reduce administrative costs and asset management and other fees. Asset management fees have been found to average approximately 25 basis points for public pension plans, while asset management fees for private 401(k) plans are 35 to 145 basis points higher, on average.<sup>40</sup>

A 2008 study of 130 plan sponsors by Deloitte and the Investment Company Institute

(ICI) also found that plan size made a significant difference in fees and other costs. Specifically, the study found that plans with a greater number of participants and larger average account balances tend to have lower overall fees than plans with fewer participants and smaller average account balances. The study theorized that the observed effect was likely caused, in part, from fixed costs required to start and run the plan, many of which are directly connected to legal and regulatory requirements. Larger plans can take advantage of economies of scale because costs are spread over a larger base.<sup>41</sup> The consulting firm Watson Wyatt found that plan size made a particular difference in connection with defined benefit plans, theorizing that this effect could result from the inability of smaller defined benefit plans to afford as much expertise as bigger plans.<sup>42</sup> Larger defined benefit plans outperformed smaller plans by roughly 2 percent.<sup>43</sup>

Moreover, professionally managed defined benefit plans have consistently outperformed defined contribution plans. In its latest update comparing investment rates of return in defined benefit and defined contribution plans, Watson Wyatt found that through the end of 2008, median returns for defined benefit plans were approximately 1 percent higher than those obtained in defined contribution plans.<sup>44</sup>

<sup>37</sup>Weller, *supra* note 31.

<sup>38</sup>*Ibid.*

<sup>39</sup>*Ibid.*

<sup>40</sup>*Ibid.*

<sup>41</sup>Deloitte and ICI, *Defined Contribution / 401(k) Fee Study: Inside the Structure of Defined Contribution / 401(k) Plan Fees: A Study Assessing the Mechanics of What Drives the “All-In” Fee* (Spring 2009, updated June 2009): 7, [www.ici.org/pdf/rpt\\_09\\_dc\\_401k\\_fee\\_study.pdf](http://www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf).

<sup>42</sup>Watson Wyatt, “Defined Benefit vs. 401(k) Investment Returns: The 2006–2008 Update” (Dec. 2009), <http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=22909>.

<sup>43</sup>*Ibid.*

<sup>44</sup>*Ibid.*

In addition to these economic efficiencies, public pension plans also decrease government spending by reducing the need for retirees to rely on public assistance. A 2009 report by NIRS calculated that pension income saved the government approximately \$7.3 billion in public assistance expenditures in 2006 and kept 1.4 million Americans off public assistance.<sup>45</sup>

**The solution we propose below is not a replacement for existing pension plans in the public or private sector. It should be understood to be a basic plan for the private-sector workforce that currently does not have the benefit of a pension plan.** Public pension plans are designed

to meet different service delivery needs and the longevity of public plan sponsors. Rather, this model takes into consideration the retirement-age patterns of private-sector workers and the ability of private employers to offer reasonable, sustainable pension benefits.

The bottom line is that the benefits of these plans to states and the national government is that future retirees living in their jurisdictions will be contributors to the economy rather than dependent on welfare programs and services, which range from housing to income supplements to medical care.

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<sup>45</sup>Frank Porell and Beth Almeida, *The Pension Factor: Assessing the Role of Defined Benefit Plans in Reducing Elder Hardships* (July 2009): 17, [http://www.ncpers.org/Files/NIRS\\_pension\\_factor.pdf](http://www.ncpers.org/Files/NIRS_pension_factor.pdf).

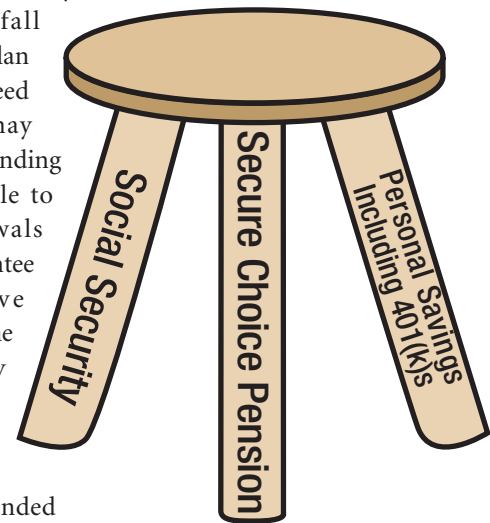
## The Secure Choice Pension Plan Design

**T**HE SECURE CHOICE PENSION (SCP) WOULD BE PART OF AN OVERALL RETIREMENT SAVINGS PLATFORM and would enhance existing employer-sponsored defined contribution arrangements to close the income replacement gap that now exists for most workers who are entering retirement. **The SCP is not designed for workers who already have access to a pension.** To establish an SCP, the Employee Retirement Income Security Act of 1974 (ERISA) and other applicable federal laws would be amended to permit any state to establish a plan by enacting appropriate enabling legislation. This legislation would be required to provide that each SCP would be administered by a board of trustees composed of public and private representatives.

Each SCP would be a multiple-employer defined benefit plan, based on the cash balance model. Each participant's benefit would be expressed as a virtual account balance, reflecting annual contributions made on his or her behalf and earnings credited under the SCP annually. Participants would be fully vested in their accrued benefits immediately, and the amounts contributed plus earnings credited to the participant's account would be guaranteed under the plan. SCPs would remain subject to the substantive benefit requirements of ERISA, including spousal protections, minimum funding requirements (with some modification to limit employer liability), and distribution rights.

As a type of cash balance plan, an SCP can be funded with a high degree of certainty because of specific design elements. Six important aspects are as follows:

1. SCPs would be multiple-employer plans in which the actuarial risks of plan funding would be spread across a broad universe of participants.
2. States would be permitted to use a number of different devices to allocate the risk of underfunding. As noted above, SCPs would be subject to the ERISA minimum funding requirements, and it is anticipated that they would be designed and administered to remain fully funded.
3. SCPs would utilize ERISA funding rules that currently apply to private-sector multi-employer plans.
4. The design would be nimble enough to adjust for changing economic conditions, anticipating both bull and bear markets and adjusting the benefit accrual accordingly. Furthermore, the allocation and interest crediting rates can be adjusted prospectively to better reflect benefit and financial needs of the employers.
5. The design would provide options to serve as a backstop for underfunding. A state may permit employers that leave an SCP to allocate any unfunded liability attributable to its employees either by funding any shortfall itself or by reducing plan benefits to a guaranteed minimum. States may choose to make up funding shortfalls attributable to employer withdrawals and finance the guarantee through a reserve accumulation under the SCP. Also, a state may provide for protection for underfunding liabilities through risk pooling programs funded by payments made by employers.
6. Finally, SCPs would be permitted to allow participants to enjoy a guaranteed minimum retirement income with an opportunity for additional earnings. An SCP would be required to provide for a life annuity benefit, which would be the "default" form of benefit. Unlike a traditional annuity, however, this benefit would not necessarily remain fixed throughout retirement. At the



time of retirement, a participant would be credited with a set number of “retirement units,” each of which would represent a specified amount of monthly retirement income. The SCP assets attributable to the participant’s accrued benefit at retirement would be transferred to a separate investment fund under the SCP, and it is anticipated that this fund would be managed more conservatively than the general accumulation fund, with a view to preserving capital. The SCP trustees, however, would be permitted to declare periodic “dividends” on retirement units when the SCP’s actuary has certified that such dividends would not materially impair the full funding of the retirement fund. When such dividends are declared, the nominal value of each retirement unit would increase. Although it is anticipated that participants would ordinarily be guaranteed this additional unit value, in the unlikely event that the retirement fund becomes underfunded, the SCP trustees may reduce the retirement unit value prospectively to an amount not less than the unit value as of the participant’s retirement.

Although the SCP would be a separate trust and have a separate administrative board, the assets of each SCP generally would be invested in tandem with the assets of one or more designated state retirement systems identified in the enabling legislation, particularly at the onset of the SCP. This partnership will allow the SCP and its participants to participate in the efficiencies and economies of scale available to large public plans right from the start. As the SCP itself becomes larger and more mature, it may eventually separate its investments.

As noted above, as cash balance plans, SCPs can be funded with a reasonable degree of certainty, so the possibility of underfunding is greatly diminished. In addition, employers participating in the SCP would not necessarily be required to make contributions greater than those specified in the SCP. The enabling legislation could permit employers to limit or avoid liability

for underfunding by providing for the reduction of participant account balances.

The SCP’s board of trustees will be subject to the general fiduciary standards of care but not to fiduciary-based lawsuits. However, investment managers hired to manage SCP assets and other vendors performing fiduciary functions for an SCP would be subject to all of the ERISA fiduciary responsibility requirements.

In conclusion, we want to spur discussion on how to achieve a reasonable long-term retirement benefit for all workers. The SCP looks at how the public pension plan model can be adapted to form the basis of a secure and flexible retirement plan in the private sector. It is intended to provide insight into achieving this goal, while accepting that there are aspects yet to be defined and details to be worked out. The need, however, is palpable.

1. **The SCP is a basic plan for the private-sector workforce that currently does not have access to a pension plan. It is not a replacement for existing pension plans in the public or private sector.** Our model provides the private employer the ability to offer reasonable, sustainable, and secure pension benefits.
2. SCPs can reduce government spending by reducing the need for retirees to rely on public assistance. As discussed above, current pension income saves the government billions in public assistance expenditures. SCPs can further enhance that savings.
3. The SCP will close the “retirement savings gap” for private-sector workers when added to Social Security and personal savings, including 401(k)s.

The SCP is a much-needed approach to provide retirement security to private-sector workers who do not have access to a pension plan. It is a prototype to address the retirement security crisis through a guaranteed, affordable, sustainable pension that draws on the lessons learned from successful public pension plans, while managing and sharing risk among employers and employees. The time for the SCP is now.

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## EXHIBIT I

### Summary of Basic Plan Provisions

This exhibit summarizes the major provisions of the Plan included in the valuation. It is not intended to be, nor should it be interpreted as, a complete statement of all plan provisions.

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#### Pension:

<i>Age Requirement</i>	65.
<i>Amount</i>	A single life annuity actuarially equivalent to the participant's accrued virtual account balance.
<i>Virtual Account Balance</i>	A participant's virtual account balance accumulates at a rate of 6% of covered earnings plus credited annual interest at a rate determined by the yield on 10 year Treasury bills as of January 1 plus 2%.
<i>Minimum Credited Interest</i>	3% per year over the participant's working career; the minimum may be applied if the participant's employer withdraws from the Plan and assets are not sufficient to fully fund the virtual benefit.

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#### Disability:

<i>Age Requirement</i>	None.
<i>Amount</i>	A single life annuity actuarially equivalent to the participant's accrued virtual account balance.

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#### Vesting:

<i>Requirement</i>	Immediate vesting.
<i>Retirement Age</i>	65.
<i>Amount</i>	A single life annuity actuarially equivalent to the participant's accrued virtual account balance with credited annual interest to age 65.

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#### Pre-Retirement Death Benefit:

<i>Requirement</i>	None.
<i>Amount</i>	A single life annuity payable to the participant's spouse, determined to be actuarially equivalent to the participant's accrued virtual account balance.

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#### Optional Forms of Payment:

Single life.  
 Joint and 50% survivor pension.  
 Joint and 75% survivor pension.  
 Joint and 100% survivor pension.

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#### Actuarial Equivalence:

All plan benefits are paid in a form that is actuarially equivalent to the participant's virtual account balance with credited interest. Actuarial equivalence is determined using 5% interest and the RP-2000 Combined Mortality Table with rates blended for 50% males and 50% females.



## EXHIBIT II

## Statement of Contribution and Retiree Dividend Policy

The Secure Choice Pension's Effective Contribution Rate for participating employers is developed from the following calculations:

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**Standard Funding Contribution Calculation:**

<i>Objective of Calculation</i>	This calculation determines funding requirements necessary to exceed requirements based on ERISA multiemployer defined benefit plan funding requirements.
<i>Assumptions</i>	The Standard Funding Assumptions are determined by the Plan's actuary in consultation with the Trustees. Model assumptions are detailed in Exhibit III.
<i>Actuarial Value of Assets</i>	The Standard Funding Actuarial Value of Assets is determined using a smoothing method proscribed by the Plan's actuary in consultation with the Trustees, subject to IRS approval requirements for multiemployer defined benefit plan funding. The asset method is required to make provision for any Retiree Dividend Reserve which exists. The current method is described in Revenue Procedure 2000-40, Section 15 with 5 year smoothing. A detailed description of this method is provided in Exhibit III.
<i>Amortization Method</i>	Actuarial gains and losses are amortized by establishing a 15-year gain or loss base each year in accordance with ERISA multiemployer funding rules. However, in excess of ERISA requirements, if the net amortization payment is negative, this negative payment is not recognized as an offset to the normal cost of benefit accruals for active participants.

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**Conservative Funding Contribution Calculation:**

<i>Objective of Calculation</i>	This calculation determines the funding which will be required if life expectancy improvements are much greater than expected and the Plan's assets do not perform well enough to provide a margin over the expected interest crediting rate for participants. The funding will amortize losses over a longer period of time and use overfunding to offset normal cost of benefit accruals. The funded status with respect to Conservative assumptions is also used to determine what, if any, amount will be used to establish a Retiree Dividend Reserve.
<i>Assumptions</i>	The Conservative Funding Assumptions are the same as those used for the Standard calculation except the investment return is assumed to be exactly equal to the interest crediting rate and mortality is projected using an additional 20 years of life-expectancy improvement. These assumptions are detailed in Exhibit III.
<i>Actuarial Value of Assets</i>	Market Value of Assets with no recognition of the Retiree Dividend Reserve.
<i>Amortization Method</i>	20 year level dollar open amortization of the unfunded liability.

## EXHIBIT II (cont.) Statement of Contribution and Retiree Dividend Policy

The Secure Choice Pension’s Effective Contribution Rate for participating employers is developed from the following calculations:

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### Effective Contribution Calculation:

<i>Objective of Calculation</i>	This calculation determines the contribution as a percentage of payroll, which will be required for participating employers. Its purpose is to achieve relatively level plan costs. This is done by blending two separate contribution calculations which recognizes the expected margin incorporated into the design and a contribution calculation that uses a longer funding period but which does not recognize this margin until certain funding levels are attained.
<i>Calculation</i>	The contribution is determined by taking the sum of 70% of the greater of the Standard Funding Contribution and the Conservative Funding Contribution, plus 35% of the lesser of the Standard Funding Contribution and the Conservative Funding Contribution. This amount is adjusted to be not less than the Standard Funding normal cost. The final Effective Contribution is divided by projected payroll to determine a contribution rate to be paid on covered earnings by participating employers.

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### Retiree Dividend Reserve:

<i>Total Amount of Reserve</i>	The amount of the Reserve is the lesser of : (1) the prior year’s Reserve minus the prior year’s Retiree Dividend payments, or (2) 70% of the excess, if any, of the assets over 110% of the Conservative Funding accrued liability.
<i>Total Dividends for Plan Year</i>	The total amount of dividends paid from the Reserve for the upcoming Plan Year is determined by dividing the Reserve by the average expected lifetime of participant in pay status. Subsequent investment returns that are not sufficient to fully fund plan liabilities may result in a rollback of future Dividend payments.

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### Amendment Procedure:

The procedures used to determine the Effective Contribution, the Retiree Dividend Reserve, and the allocation of the Retiree Dividend Reserve may be amended by Trustees, subject to the approval of the entity guaranteeing the Plan. At all times, the Plan is required to meet funding requirements that are based on ERISA multiemployer defined benefit plan funding requirements.

## EXHIBIT III

## Statement of Actuarial Assumptions and Methods

<b>Standard Mortality Rates:</b>	Healthy: RP-2000 Combined, projected generationally using Scale AA, blended for 50% males and 50% females. Disabled: RP-2000 Disabled Retiree, projected generationally using Scale AA, blended 50% males and 50% females.								
<b>Conservative Mortality Rates:</b>	Healthy: RP-2000 Combined, projected generationally with an additional 20 years of improvement using Scale AA, blended for 50% males and 50% females. Disabled: RP-2000 Disabled Retiree, projected generationally with an additional 20 years of improvement using Scale AA, blended 50% males and 50% females.								
<b>Withdrawal Rates:</b>	No withdrawal prior to retirement was assumed.								
<b>Disability Rates:</b>	No disability was assumed.								
<b>Retirement Rates:</b>	100% of participants are assumed to retire at age 65.								
<b>Benefit Election:</b>	Single life annuity.								
<b>Salary Scale:</b>	<table> <thead> <tr> <th><u>Age</u></th> <th><u>Rate</u></th> </tr> </thead> <tbody> <tr> <td>18-39</td> <td>5.00%</td> </tr> <tr> <td>40-49</td> <td>3.50%</td> </tr> <tr> <td>50+</td> <td>3.00%</td> </tr> </tbody> </table>	<u>Age</u>	<u>Rate</u>	18-39	5.00%	40-49	3.50%	50+	3.00%
<u>Age</u>	<u>Rate</u>								
18-39	5.00%								
40-49	3.50%								
50+	3.00%								
<b>Standard Investment Return:</b>	7.00%								
<b>Conservative Investment Return:</b>	5.00%								
<b>Inflation:</b>	3.00%								
<b>Standard Actuarial Value of Assets:</b>	Method as described in Revenue Procedure 2000-40, Section 15. Actuarial value is equal to the market value of assets less unrecognized returns in each of the last 5 years. Unrecognized return is the expected asset gain or loss on a market value basis, and is recognized over the 5-year period. An adjustment (if necessary) is made so that the actuarial value of assets is within a 20% corridor of market value. Finally, the actuarial value of assets is reduced by the amount of the Retiree Dividend Reserve.								
<b>Conservative Actuarial Value of Assets:</b>	Market value of assets without adjustment for the Retiree Dividend Reserve.								
<b>Actuarial Cost Method:</b>	Entry Age Normal Actuarial Cost Method. Entry Age is the age at the time the participant commenced employment. Normal Cost and Actuarial Accrued Liability are calculated on an individual basis and are allocated by salary, with Normal Cost determined as if the current benefit accrual rate had always been in effect.								
<b>Population Data:</b>	The distribution of ages and salaries for active participants in funding projections was generated by starting with an initial population uniformly distributed over ages 18-64 with salaries consistent with the assumed salary scale. This population was projected for 50 durations using the assumptions above with any participants leaving the active population being replaced by new entrants from the initial distribution.								

## EXHIBIT IV

## Sample Replacement Ratios

The tables below show the expected replacement ratios for a participant entering the plan at a given age. These ratios are the percentage of a participant's pre-retirement income which would be provided as a guaranteed life annuity if the participant worked from the age given until age 65 and then retired. Recent studies indicate that the average worker needs to replace 80% of pre-retirement income to maintain their standard of living.

## Estimated Replacement Ratios with a 5% annual crediting rate

Entry Age	Expected Social Security Replacement Ratio*	Expected Personal Savings Including 401(k) Replacement Ratio**	Total Replacement Ratio with Social Security and Personal Savings Only	Expected SCP Replacement Ratio***	Total Replacement Ratio with SCP
25	30%	25%	55%	29%	84%
35	26%	18%	44%	21%	65%
45	17%	11%	28%	13%	41%

\* Calculated using 2011 bend points and assuming career earnings consistent with national average. For ages 35 and 45, the replacement ratio is prorated to reflect the fraction of a participant's 35 years of covered earnings used in Social Security Primary Insurance Amount calculation which would be earned under their tenure with their current employer if they worked until age 65.

\*\* Calculated using assumed salary increases as shown in Exhibit III, an average return of 5% per year, a contribution rate of 6% per year, and annuity conversion based on PBGC annuity valuation assumptions.

\*\*\* Calculated using assumed salary increases as shown in Exhibit III and an expected credited interest rate of 5% per year.

## Estimated Replacement Ratios with the minimum 3% annual crediting rate

Entry Age	Expected Social Security Replacement Ratio*	Expected Personal Savings Including 401(k) Replacement Ratio**	Total Replacement Ratio with Social Security and Personal Savings Only	Expected SCP Replacement Ratio***	Total Replacement Ratio with SCP
25	30%	17%	47%	19%	66%
35	26%	14%	40%	15%	55%
45	17%	9%	26%	10%	36%

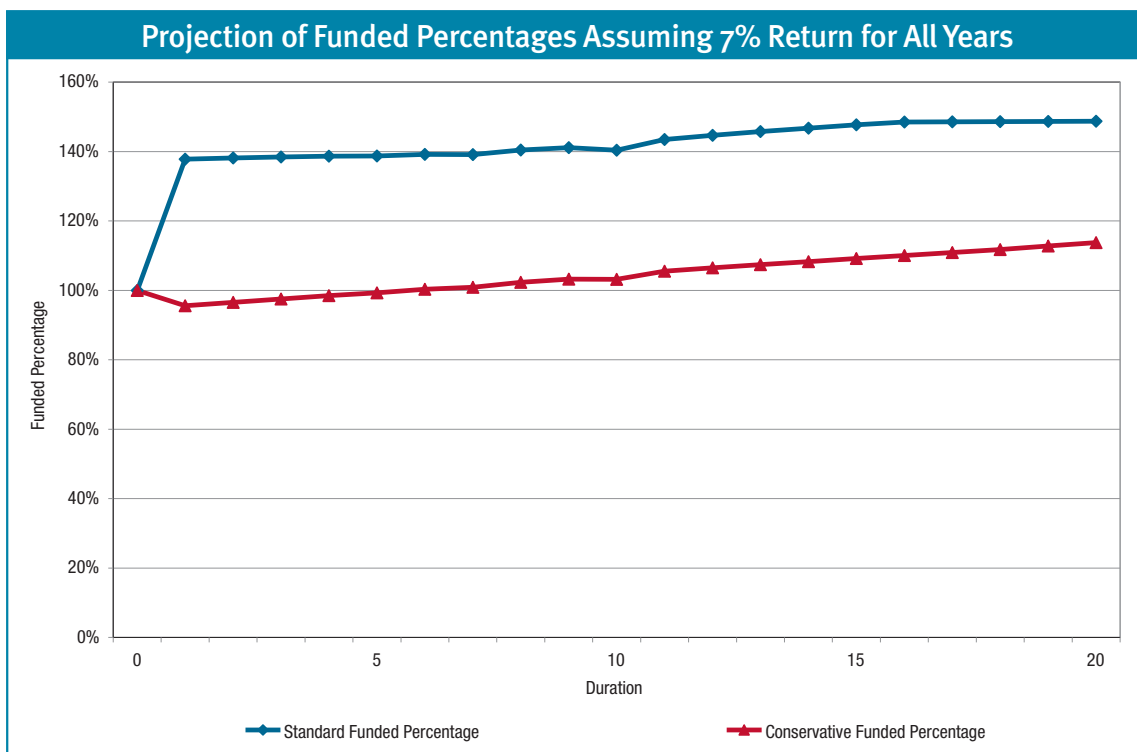
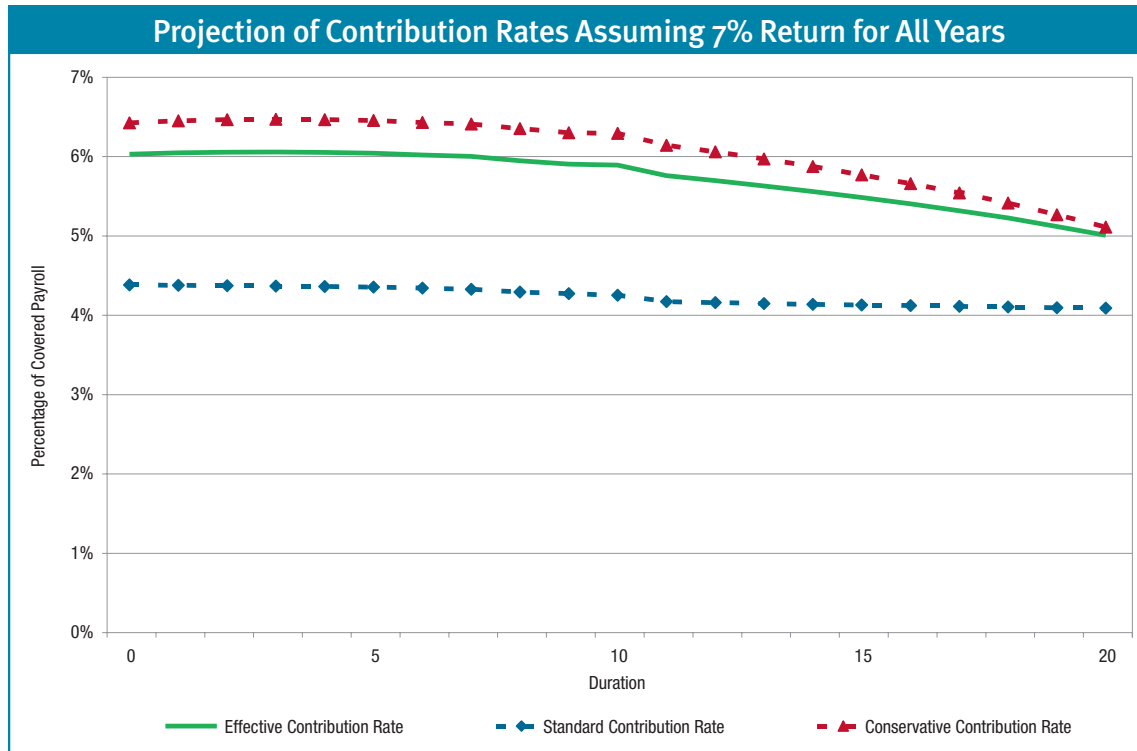
\* Calculated using 2011 bend points and assuming career earnings consistent with national average. For ages 35 and 45, the replacement ratio is prorated to reflect the fraction of a participant's 35 years of covered earnings used in Social Security Primary Insurance Amount calculation which would be earned under their tenure with their current employer if they worked until age 65.

\*\* Calculated using assumed salary increases as shown in Exhibit III, an average return of 3% per year, a contribution rate of 6% per year, and annuity conversion based on PBGC annuity valuation assumptions.

\*\*\* Calculated using assumed salary increases as shown in Exhibit III and a minimum credited interest rate of 3% per year.

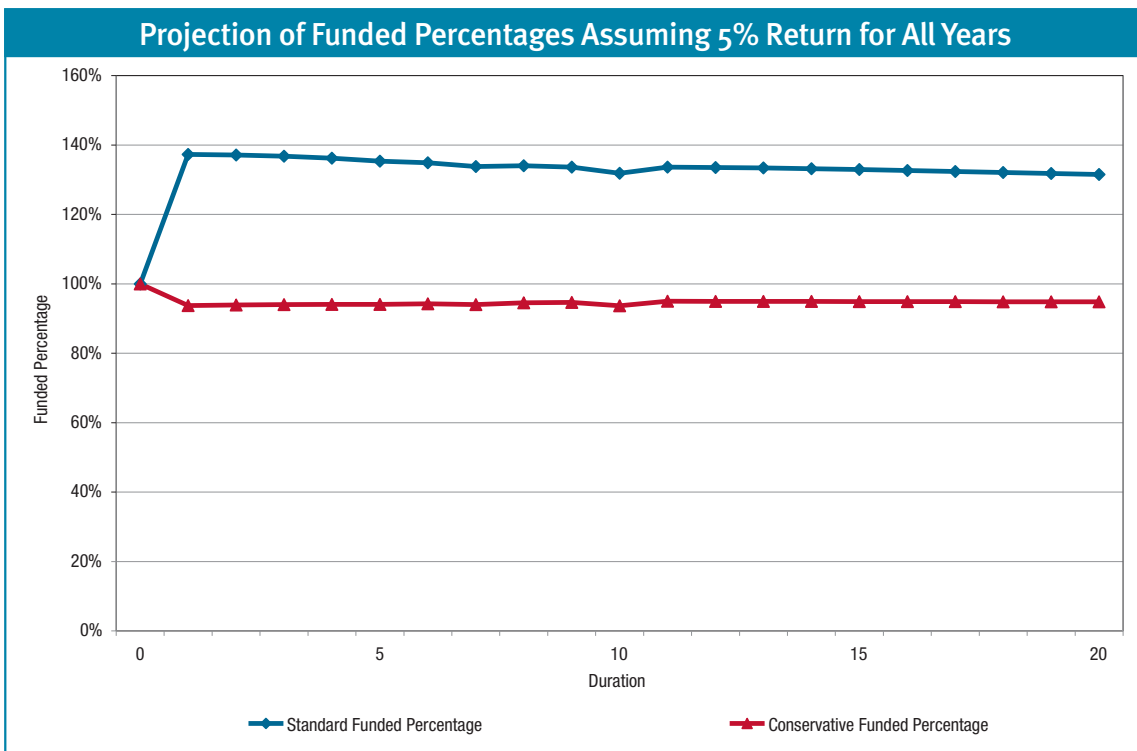
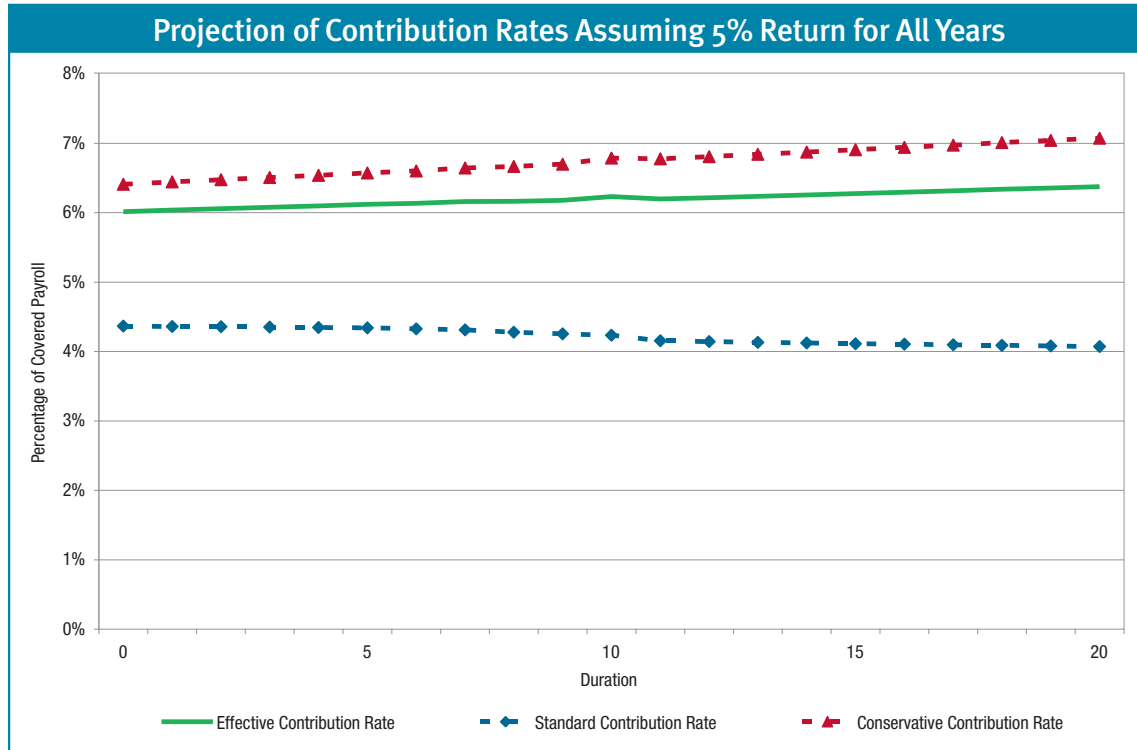
# EXHIBIT V

## Illustrative Plan Funding Requirements



# EXHIBIT V

## Illustrative Plan Funding Requirements





## THE NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS (NCPERS)

is the largest trade association for public sector pension funds, representing more than 500 funds throughout the United States and Canada. It is a unique non-profit network of trustees, administrators, public officials and investment professionals who collectively manage nearly \$3 trillion in pension assets held in trust for approximately 21 million public employees and retirees — including firefighters, law enforcement officers, teachers, and other public servants.

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