State Pensions: The Special Case of Teachers' Pensions

Striving for Sound Policy

Not Sound Bites

Bill Raabe – National Education Association

Agenda

I. The Current Status
II. The Value of Defined Benefit Pension Plans
III. The Weaknesses and Strengths of Cash Balance Plans
IV. The Real World
V. What Can We Do
VI. The Issue of Teacher Quality
VII. Questions to Consider

The Current Status

- The recession has had a impact on state and local budgets and public pension funds
- A recovery of pension funds has begun – some states' plans more stressed than others
- Long term, not knee-jerk, solutions are necessary
- Employer pension contributions are only 2.5 % of state and local government spending over the last 10 years (U.S. Census Bureau and NASRA)
- The GAO has found that most public pension plans are financially secure and positioned to meet their long-term obligations
- Many states making changes to plans to meet the needs they face – including lengthening vesting period (Is this good or bad policy? How does it relate to the CB lump sum attribute that some propose?)
- Public employees make less in salary and in total compensation compared to similarly situated professionals (3 separate studies – Schmitt, 2010; Keefe, 2010; Bender and Heywood, 2010)

The Value of Defined Benefit Pensions

- Provide "retirement security" as part of 3 legged stool (2 legs in some cases for teachers) to retirees

- Allow retirees to maintain a middle class lifestyle – Average benefit in Texas for a teacher with 26-30 years of service = $31,200 annually (No SS for most Texas teachers) – Using a career average earnings structure via a Cash Balance (CB) plan would reduce that benefit

- Help strengthen national and local economies (For each employer dollar contributed to state and local pensions, $11.45 in economic activity is supported – NIRS, 2009)

- The most efficient way to provide retirement security (Half the cost of Defined Contribution (DC) plans for same benefit – CB plans?)– 68% of pension receipts paid to beneficiaries come from investment earnings (NIRS, 2011)

The Value of Defined Benefit Pensions

- Assist in lowering the rates of poverty for the elderly (Six times greater rate of poverty for those without a pension – NIRS, 2009)
- Reward and encourage experience
- An effective retention tool – (NIRS, 2009)
- When offered the choice, new teachers and employees choose and prefer DB plans (NEA and Towers-Watson, 2010)

Cash Balance Plan Weaknesses

- <u>Employers</u>
  - Cash balance plans reward turnover
  - Converting from a defined benefit plan to a cash balance plan will not save a jurisdiction money and does not eliminate employers' responsibility for liabilities already accrued
  - Need for further legal clarification on the issues of alleged age discrimination

Cash Balance Plans Weaknesses

- <u>Employees</u>
  - Cash balance plans are unlikely to replace a sufficient percentage of pre-retirement income. If the employer's goal is to offer employees income adequacy in retirement, it is much more difficult to achieve this goal through a CB plan than a DB (Pratt, December 2009)
  - The lump sum option creates opportunity for less retirement security. One study of younger workers between the ages of 25 and 34 found that only 39.2% rolled over the entire amount of their cash balance plan (Purcell, 2005)
  - Outlive your benefit?

Cash Balance Plans Strengths

- Employers
  - Cash balance plans can be part of a human resource strategy to attract short-service, highly mobile professionals, such as those in the information technology industry whose skills might quickly become outdated.

- Employees
  - Cash balance plans are attractive to highly mobile employees. That's because if they leave after vesting, they can take their entire notional/hypothetical account balance in a lump sum (What's the impact of this on the funding of the plan ? On the individual – "leakage" of retirement savings?)

  - Employers bear the investment risk of providing employee retirement security

The Real World

- Charts and graphs do not the real world describe
- Teachers examining their "pension wealth?" – Not the teachers I work with
- Can I afford to retire? What's my annual benefit? Do I enjoy my job? What's my salary next year? What's my family situation? Do I want a new career?
- An example
  - Teach 7+ years – 5 year vesting – DB plan – Look at new career – Withdraw individual contributions or not? Can I afford it? What's my family situation?
  - Joins new organization – 17 years – DB plan – Consider new opportunity – Is it a good opportunity? Can I afford it? What's my family situation?
  - Leaves for another organization – DB Plan – Eligible for retirement with no penalty in 3 years. Can I afford it? What's my family situation? Do I enjoy my current work? Never once looked or will look at "pension wealth."
- A substantial increase in salary reduces the probability of older teachers retiring, just as an early retirement incentive increases the decision to retire (Strauss, 2005)

The Real World

- High turnover rate already for teachers in their first five years – then declines significantly (Education Commission of the States)

- Turnover and retraining cost real money ($33,400 per teacher – Milanowksi and Odden, 2007)

- There "is little empirical evidence available to date on the proportion of teachers who may suffer financial penalties from moving across state lines or having shorter working lives because they step out for a while for family or other personal reasons." (Janet S. Hansen – Fall 2010)

- Not much of a case for upending the retirement security of public employees unless we want to encourage turnover

What Must We Do

- Advocate for on-time and adequate contributions
- Be above reproach – ethical standards and practices – sound fiscal policies
- Prevent unfair manipulation of pension calculations (“spiking”)
- Ensure that return-to-work plans (“double-dipping”) are financially, actuarially, and educationally sound
- Examine the level of benefits and whether or not they can be sustained over time
- Examine the real-world impacts of your pension design – design to meet the needs of the career – What is the ideal teaching career?
- Separate ideology and hysteria form facts

The Issue of Teacher Quality

- A factor of
  - A focus on the needs of students
  - High quality teacher preparation
  - High quality induction and mentoring systems
  - High quality teacher evaluation systems
  - High quality professional development
  - Fair and efficient dismissal procedures
  - Collaboration on the above between union and management
- Not driven by the pension system you have

Questions

- Why is it, that after the stock market crashed and it was realized that a Defined Contribution plan would have left many unable to retire, past DC advocates have switched their allegiance to CB plans and are attempting to use human resources management as the lever?
- Is it about teacher quality at all?
- What are the unintended costs of a generation of workers without retirement security or the ability to ever retire?
- What is the impact on students of encouraging turnover?