September 1, 2015

Mr. Luke E. Martel
Program Manager – Fiscal Affairs Program
National Conference of State Legislatures
7700 E. 1st Place
Denver, CO 80230

Dear Luke:

Thank you for the opportunity to present the National Institute on Retirement Security (NIRS) research findings from, *Still a Better Bang for the Buck: An Update on the Economic Efficiencies of Defined Benefit Pensions,* at the National Conference of State Legislatures (NCSL) Legislative Summit on August 5, 2015. We value NCSL's leadership in convening that important dialogue for policymakers who are trying to find the most cost-efficient means of providing retirement security to public workers while also ensuring they can recruit and retain a qualified workforce to deliver vital services to citizens. It was a well-attended session and I appreciated the engagement and participation of legislators and legislative staff.

I am writing to provide formal comments on the presentation delivered by my fellow panelist, Josh McGee with the Manhattan Institute. At that session, he presented research on retirement benefit costs.

I understand that Mr. McGee would not give you permission to share with all panel members an embargoed copy of his research paper that was referenced extensively in his NCSL presentation, which would have fostered a more substantive discussion. Shortly after the session, the Manhattan Institute released his research, *Defined-Contribution Pension Plan are Cost-Effective*. Based on a review of this report, along with input from pension policy experts and members of the NIRS Academic Advisory Board, I found there were key points in Mr. McGee's presentation that were not given proper reference or context and could have been easily misconstrued. Therefore, I hope NCSL will post this letter with our key concerns on your website to accompany the other panel presentations to provide better balance to the discussion and understanding of each paper.

Most notable was that the PowerPoint presentation Mr. McGee used did not disclose that the data he referenced was not public pension plan data. His brief mention of data from the U.S. Department of Labor could have left the live audience and viewers of the online slides to mistakenly conclude that his presentation was based on the investment return results of public defined benefit (DB) pensions and defined contribution (DC) plans. Relying on experience from only private sector plans, which have generally moved to dissimilar investment strategies due to pension plan freezes, corporate accounting and other non-comparable factors, poses serious questions about the relevance of the findings in the Manhattan Institute's paper to the important plan design issues being discussed in state houses. Additionally, his analysis misrepresented key points in *Still a Better Bang for the Buck* covering: annuities; investment patterns of public DB pensions; and DC plans and the economic data supporting the NIRS' model.

For you information I would summarize the concerns that NIRS would like to make clear as follows:

- *Define-Contribution Pension Plan are Cost-Effective* clearly discloses in every graphic that the data its author used in the research and calculations came from the U.S. Department of Labor's filings of private sector retirement plan annual reports on the Form 5500. As you may know, governmental retirement plans do not file Form 5500 reports[i]. Therefore, not a single public DB or DC plan was included in the research data set used to evaluate investment returns. This material omission in the slides is inconsistency with the published Manhattan Institute paper and should be corrected as the slides are posted on the NCSL website.

- NIRS detailed the significant changes occurred in the retirement benefit landscape[ii] since 2008. To reflect these, NIRS report authors William Fornia and Nari Rhee updated the NIRS' model to compare the efficiency of a best-practice DC plan using a target date fund (TDF) with a typical public DB pension to keep *Still a Better Bang for the Buck*'s findings on point. NIRS explained why reliance on earlier research from the private sector no longer informed discussions of public retirement investing.[iii] Manhattan Institute's reliance on only private plan data to evaluate the investment performance of public DB and DC plans is a fundamental flaw seriously limiting its paper's value in the discussions of the cost efficiencies of public DB pensions over DC retirement plans.

- *Still a Bang for the Buck* rests on the real world workings of DB pensions and best practices in DC plans. The NIRS paper considered the low usage of annuities by DC retirees and clearly identifies the cost increase (36 percent) over a DB pension required to purchase the same amount of retirement income from the best-priced annuity. A circular argument that a cost-efficient DC plan is one in which legislators require a public DB pension to offer the same annuity payouts to DC plan retirees, in effect, positions the state to take back the longevity risk and investment risk, which Mr. McGee advocates shedding for a DC plan design.

- Target Date Funds (TDF) represent an improved default investment option in DC plans. The design of TDF allocation "glide paths" delivers lower returns at the time DC accounts have their largest values. This structural difference awards a cost advantage to the DB pension, which maintains an optimal asset allocation. Furthermore, the behavioral finance research that brought TDFs into favor also supports the reasonable adjustment in the NIRS model to reflect individually directed DC retirement accounts. The empirical data published by leading economists on the behavior of individual investors is extensive and clearly cited by NIRS and summarized in the paper by Barber and Oden.[iv]

Still a Better Bang for the Buck is an accurate, fair and research-based model of the economic efficiencies of public DB pensions when compared to the typical DC plan and an ideal DC plan with a pooled investment approach using a target date fund. I hope that NCSL will work with NIRS and agree to post this letter on its web page. NIRS will also post a more detailed fact check on the NIRS website. If this is not possible, or if you like to discuss this issue further, please do not hesitate to contact me. We would also welcome a follow-up discussion with Mr. McGee convened by NCSL.

Again, thank you for your attention to retirement security issues and for convening an important panel.

Kind regards,

Diane Oakley

Diane Oakley
Executive Director

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[i] Only private retirement plans must file Form 5500 under the Employee Retirement Income Security Act (ERISA).
[ii] W. Fornia and N. Rhee, 2012, "Still a Better Bang for the Buck: An Update on the Economic Efficiencies of Defined Benefit Pensions," NIRS, Washington, DC.
[iii] ibid. pages 5-6.
[iv] B Barber and T. Odean, 2011 (Sep.), "The Behavior of Individual Investors," Working Paper, see list of research http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1872211.

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