About NIRS

• Nonprofit, nonpartisan research organization founded in 2007.

• Contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole.

• National research and education programs.
Public Pension Basics

What is a pension?

– A pension (or DB plan) is a group retirement plan that offers a predictable monthly benefit.
– Pension Benefit is based on a formula that takes into account years of service, final average salaries and a benefit multiplier.
– Provides a steady, predictable income stream in retirement that cannot be outlived.
How Are Pensions Funded?

• Pensions are “prefunded” systems.

• Receipts come from:
  – Employer (state or local government)
  – Employee, out of his/her own paycheck
  – Investment earnings
Pension Funding is a Shared Responsibility

Employer and Employee Contributions as a Percentage of Payroll, by Sector

Source: Center for Retirement Research at Boston College, *The Financial Crisis and State/Local Defined Benefit Plans, 2008*
Investment Earnings Do Much of the Work Over Time

- Pension fund receipts over the past 15 years have been composed of:

- Employers (taxpayers) contribute 21 cents on the dollar of total pension receipts.

Source: U.S. Census Bureau, *State and Local Government-Employee Retirement Systems, 2010*
How Are Contributions Determined?

• The Annual Required Contribution (ARC) is determined by actuarial analysis.
• The ARC consists of….
What are Funding Gaps? Where do they Come From?

**Budget Risk** – Contributions into the plan are not adequate to cover promised benefits

**Investment Risk** – Sharp downturns in financial markets employer has to make up for investment loss
Professional Investment Managers Achieve Higher Returns

- Pensions achieve better investment returns than 401(k) type plans.
- These additional returns really add up over time.

How $10,000 Invested Grows over 30 Years

Retirement Savings Plans
401ks (or DC plans)

- Employer-Sponsored Savings Plans provide tax incentives to save money for retirement through payroll deduction.
- Employees make contributions from paychecks which employers match, typically with a contribution of $.50 for every $1 the employee saved.
- About 30 percent of employees choose not to participate in employer sponsored plans.
401ks (or DC plans)
Portability and Leakage.

• **Portability**  --  New employees find attractive the fact that if they leave their employer after 401(k) benefits vest they can take their full account to a new employer’s plan.

• **Leakage**  -  401(k) plans often provide for plan loans and employees can make withdrawals before retirement which can reduce their retirement income benefits.
Retirement Savings Plans
401ks (or DC plans)

• DC plans have an easily predictable cost
  – if plan offers a 50% match of employee contributions up to 6% of pay then the maximum cost would be 3 percent of payroll.

• Employees bear the investment risk in a DC or 401(k) plan. If investment losses cannot be recouped by retirement age, they may delay plans or retire with much less income.

• Employees bear risk that inflation will erode income.
DC or 401(k) plans

Investing Assets

• Employee chooses how much to contribute to the DC or 401(k) plan and also decides how to invest the amounts contributed among the different funds offered in the plan.
• Individual account grows with contributions and compounding investment returns each year.
• Over time, earning generally represent a greater percentage of assets in accounts, especially as retirement nears. So, investment returns are more important then.
Drawing Down Assets in DC or 401(k) plans

• Plans are not required to offer a guaranteed lifetime income option, and typically pay out benefits as a one-time lump sum.
• Income from DC plans depends on investment earnings both before and after retirement.
• No Spousal Protection of retirement income
• Financial advisors recommend moving to more conservative investments with age.
Drawing Down Assets in DC or 401(k) plans

Without lifetime income guarantees, the retiree must determine how much to take out of the account each year, if money is to last for as long as he and his spouse will live.

- Individuals underestimate life expectancy.
- Drawing income out over life expectancy still leaves retiree with a 50-50 chance of exhausting money in the DC account.
- Can purchase annuity to get income guarantees but only a few do.
## Selected Differences Between DB and DC Plans

<table>
<thead>
<tr>
<th></th>
<th>DB Plan</th>
<th>DC Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contributions</strong></td>
<td>In the public and private sectors, contributions are made by the employer. In the public sector, many pensions are employee contributory.</td>
<td>Employees make their own contributions to their savings account at whatever rate they choose. Employers will often make a match, but they are not required to contribute.</td>
</tr>
<tr>
<td><strong>Investments</strong></td>
<td>Contributions for all employees are pooled, and invested by professional asset managers in a diversified portfolio.</td>
<td>Investment portfolios consist of individual accounts. Employees make all investment decisions themselves, and can choose from a range of investment options offered.</td>
</tr>
<tr>
<td><strong>Amount of Money in Retirement</strong></td>
<td>The monthly benefit is determined by a set calculation, usually based on years of service and pay at the end of one’s career.</td>
<td>The money available in retirement is the amount that one has accumulated through contributions and investment earnings.</td>
</tr>
<tr>
<td><strong>Lifetime Income Guarantee</strong></td>
<td>Payouts are provided as a monthly income stream that is guaranteed for the remainder of the retiree’s life.</td>
<td>Plans are not required to offer a lifetime income option, and typically pay out benefits as a one-time lump sum.</td>
</tr>
<tr>
<td><strong>Supplemental Benefits</strong></td>
<td>Spousal benefits, disability benefits, and cost of living adjustments are common.</td>
<td>Supplemental benefits are not applicable, and generally not available.</td>
</tr>
</tbody>
</table>
Private Sector - Workers Participating in Retirement Plan by Plan Type, 1979-2008

Source: EBRI
Savings in Retirement Accounts Near-Retiree Households (age 55 - 64)

Retirement Account Ability to Replace Earnings

- 57.3% of households have retirement accounts that can replace 0 - 100% of earnings
- 31.7% of households have retirement accounts that can replace 101 - 400% of earnings
- 10.9% of households have retirement accounts that can replace over 400% of earnings

Source: Towers Watson
DC Plan Individual Accounts
Investment Returns Matter in Last Years

Saving for Retirement, the Homestretch Matters
How the market performs during the last years of 401(k) savings can have a considerable impact on the final retirement nest egg. These charts assume a starting salary of $40,000 that grows by 3 percent a year and a savings rate of 8 percent.

IF INVESTMENT RETURNS ARE STEADY...

$1,000,000
750,000
500,000
250,000
0

Year number | RETURN: 7%
---|---
1 | contributions
10 | return on investment
20 | Savings pass the half-million mark by year 32
30 | Almost half the wealth accrues during the last decade.
40 |

IF INVESTMENT RETURNS SLOW...

A market downturn during the final decade cuts the total wealth by $363,000 or 36%.

return on investment
contributions

Public Pensions Typically Are Shared Funding Responsibility

Employee and Employer Pension Contributions, 1982 to 2009

Source: U.S. Census Bureau
Change from prior year in corporate and public pension contributions, 1989-2009

Corporate
Public

*Estimate

US Dept of Labor,
US Census Bureau,
Milliman
Average Public Pension Benefits
30% of Workers Not Eligible for Social Security

Source: U.S. Census Bureau
Lessons Learned Study

1. Employer pension contributions that pay the full ARC, and that at least equal the normal cost;
2. Employee contributions to help share the plan cost;
3. Benefit improvements that are actuarially valued before adoption and properly funded upon adoption;
4. COLAs granted responsibly;
5. Anti-spiking measures that ensure actuarial integrity, transparency;
6. Economic actuarial assumptions that can reasonably be expected to be achieved long term.
NIRS Public Opinion Research

• Americans highly anxious about retirement.
• Americans have low retirement expectations.
• Pensions relieve anxiety, are reliable.
Opinion Research Methodology

• The survey was conducted as a nationwide telephone interview of 800 Americans age 25 and older.

• Matthew Greenwald & Associates balanced the data to reflect the demographics of the United States for age, gender and income.

• The margin of error is plus or minus 3.5%
84% of Americans concerned about ability to achieve a secure retirement.

Source: NIRS
Open Ended Question

How would you personally define what a financially secure retirement means to you?
Covering Basics, Not Luxuries

- Surviving, living comfortably (34%).
- Paying the bills (17%).
- Maintaining pre-retirement lifestyle (11%).
80% Agree Leaders Need to Give Retirement Higher Priority

80% Agree with the Statement:
Leaders in Washington need to give a higher priority to ensuring more Americans can have a secure retirement.

79% Agree with the Statement:
Leaders in Washington do not understand how hard it is to prepare for retirement in this economy.
84% Agree Americans With Pensions More Likely to Have Retirement Security

84% Agree with the Statement:
Americans with traditional pensions are more likely than those without pensions to have a secure retirement.

- 45% Strongly Agree
- 39% Somewhat Agree
- 10% Somewhat Disagree
- 5% Strongly Disagree
81% Say All Americans Need Pension For Independence, Self-Reliance

81% Agree with the Statement: I believe that all workers should have access to a pension plan so they can be independent and self-reliant in retirement.
Knowledge of Employee Contributions Increases Support for Public Pensions

Public employees deserve benefits because they help finance cost from every paycheck. 71% Agree (‘11), 70% Agree (‘09)
68% Say Teachers Deserve Pensions To Compensate for Lower Pay

- Strongly Agree: 41%
- Somewhat Agree: 16%
- Somewhat Disagree: 14%
- Strongly Disagree: 2%
- Don't Know: 27%
83% Say Police/Firefighters Deserve Pensions Because of Job Risks

- Strongly Agree: 50%
- Somewhat Agree: 33%
- Somewhat Disagree: 6%
- Strongly Disagree: 1%
- Don't Know: 9%
73% Say States Should Sponsor Retirement Plans Small Employers/Individuals Can Join
Questions?