Benefit Design Options

Milwaukee County Retirement Sustainability Taskforce

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The Pew Charitable Trusts

- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

Pew's Public Sector Retirement Systems Project

- Research since 2007 includes 50-state trends on public pensions and retiree benefits relating to funding, investments, governance, and employee preferences
- Technical assistance for states and cities since 2011

Presentation Overview

- **Introduction**
  - Core Concepts of Pension Plan Design

- **Common Retirement Plan Models**
  - Final Average Salary Defined Benefit
  - Defined Contribution
  - Side by Side Hybrid
  - Cash Balance

- **Assessing Tradeoffs of Plan Design Choices**

- **Options for Consideration**

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Introduction

Core Concepts in Plan Design

Principles for Fiscal Sustainability and Retirement Security

- No one-size-fits-all solution, but **key principles** can guide any reform process.

- **Fiscal sustainability principles**
  - Commit to fully funding and paying for pension promises.
  - Manage investment risk and cost uncertainty.
  - Follow sound investment governance and reporting practices.

- **Retirement security principles**
  - Target sufficient contributions and savings to help put employees on a path to a secure retirement.
  - Invest assets in professionally managed, pooled investments with low fees and appropriate asset allocations.
  - Provide access to appropriate distribution options, including lifetime income in the form of annuities.

Core Concepts for New Plan Design

- Any plan design should put workers on a path to a secure retirement while being affordable and sustainable.
- Trade-offs between cost, risk, and benefit levels.
- Plan design is more important that plan type.
- Changing benefits for new workers does not eliminate the existing unfunded liability or the need to address it.
- No one-size-fits all—different states and cities have found success with a variety of plan designs.

Common Retirement Plan Models

Four Plan Types Used Across States

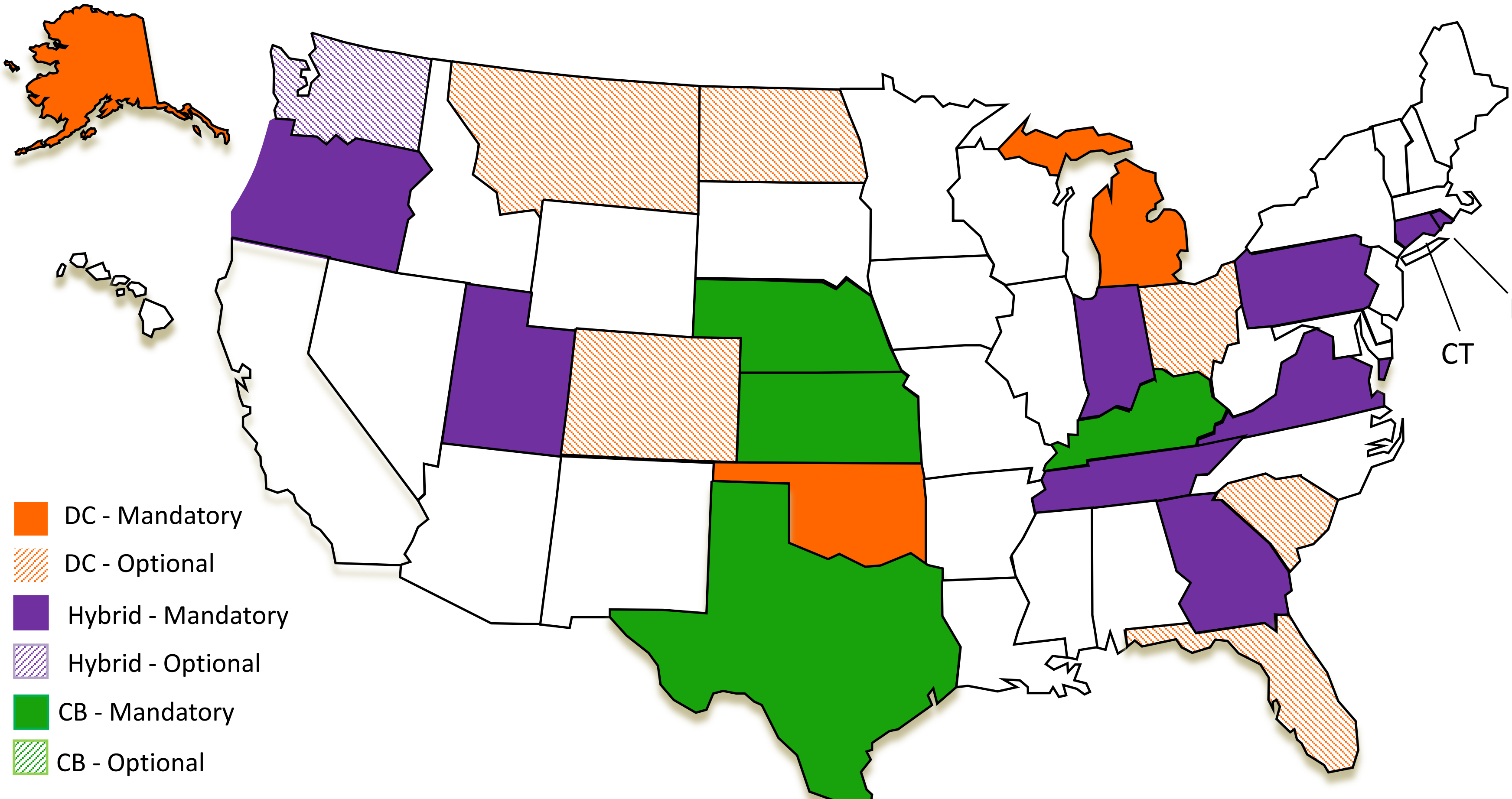
- State pension plans vary in design but fall into four basic categories of plan type.
- Final average salary defined benefit plans remain the most common approach.
- Twenty-three states have adopted an alternative plan design as a mandatory or optional benefit; in 16 states this is the default or mandatory benefit.
- Alternative plan types include defined contribution, side by side hybrid, and cash balance plans.
- Any of these plan types can, if well designed and fully funded, provide a secure retirement on an affordable and sustainable basis.

Types of Retirement Plans

- **Defined benefit (DB) plan:** A plan in which the employer promises a specific amount of monthly retirement income based on a formula that typically takes into account the employee's salary, years of service, and age.
- **Defined contribution (DC) plan:** A plan that provides employees with an individual retirement account that grows through investment of accumulated employer and employee contributions. Annual returns are generally based on investment performance and are not typically guaranteed.
- **Side by Side Hybrid Plan:** A plan that combines a defined benefit based on the employee's final average salary with a separate defined contribution savings account.
- **Risk Managed Hybrid (RMH):** A hybrid plan with a formal mechanism for distributing unexpected costs between employers and employees and a DC component with a focus on retirement security for employees.
- **Cash Balance:** Participants get an individual retirement account with the two key protections associated with a defined benefit—guaranteed benefits and lifetime retirement income.

Growing Number of States with Alternative Public Sector Retirement Plans

23 states have implemented an alternative plan for workers.



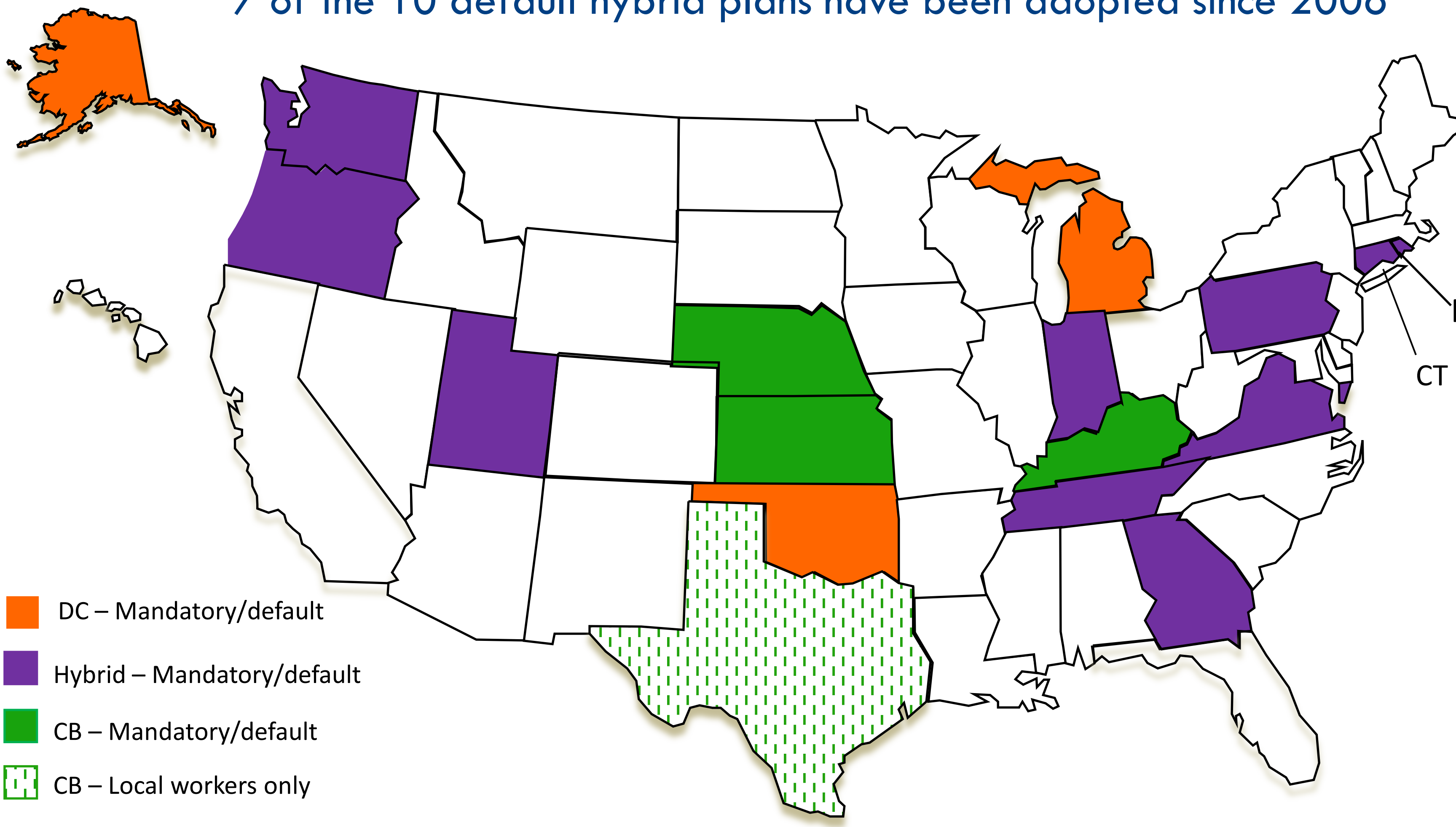
Notes

- 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. This includes Indiana where workers choose between a hybrid and DC plan, Michigan where state workers are in a DC plan and teachers have a choice between a DC and hybrid, and, Ohio where workers choose between a DB, hybrid or DC plan, and Utah where workers choose between a hybrid and DC plan.
- Texas's cash balance plan is only available to local workers.
- In addition, California provides an optional cash balance plan for part-time workers and adjunct educational employees.

Sources: NASRA, NCSL

Alternative Plans are the Default or Mandatory Option in 16 states

7 of the 10 default hybrid plans have been adopted since 2006



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. This includes Indiana where workers choose between a hybrid and DC plan, Michigan where state workers are in a DC plan and teachers choice between a DC or hybrid plan, and Utah where workers choose between a hybrid and DC plan. Twelve states total offer a default or optional hybrid plan.
- Texas provides a cash balance plan to over 400,000 local workers through the state's Texas Municipal Retirement System and Texas County and District Retirement System.

Sources: NASRA, NCSL

Final Average Salary Defined Benefit

- Benefit is calculated as a percentage of final average salary using a formula of years of services times a multiplier.

- The benefit formula is targeted towards career workers and late joiners. Young workers who leave after 10 to 15 years of service can end up with a low level of retirement benefit.

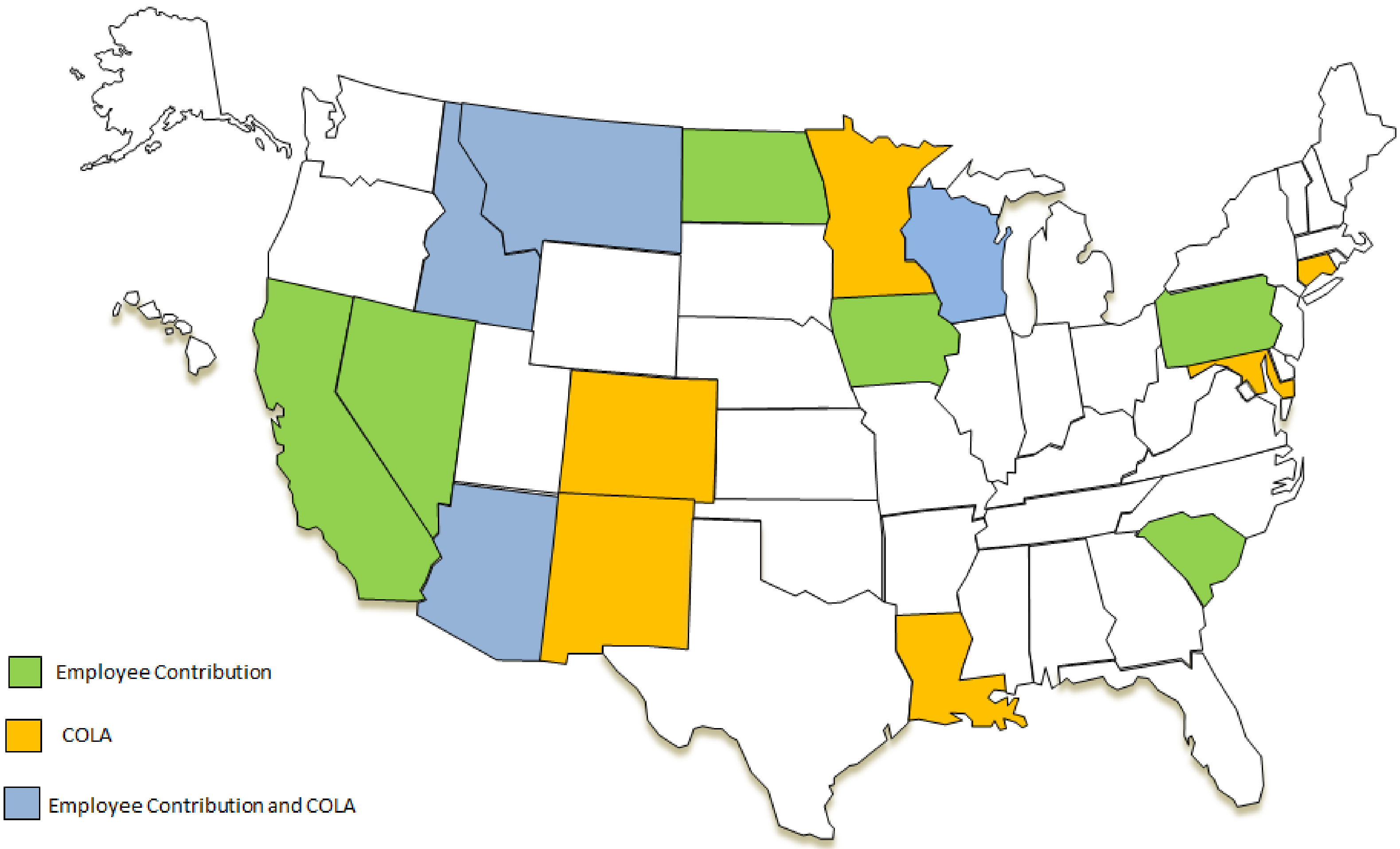
- Most common approach.

- Plan design can expose states to high levels of investment risk. However, DB plans can include risk mitigation mechanisms to make employer costs more predictable.

- Provides a clear and certain benefit for plan participants.

Cost Sharing is Used in Traditional DB Plans

29 DB plans in 17 states have formal cost sharing plans.



Defined Contribution

- Employer and employee contribute to an individual retirement account.
- Benefit is based on the accumulated savings in the account at retirement from employer contributions, employee contributions, and investment returns.
- Employer faces predictable costs; employee benefits depend on investment performance.
- To be effective vehicles for retirement security, a defined contribution plan must have:
    - Adequate combined employer and employee contributions
    - A limited number of low-fee, appropriate investments
    - Easy access to distribution options such as annuities

Examples of State Defined Contribution Plans

	Plan name	Employee default contribution (percent of salary)	Employer Contribution (percent of salary)	Total Contribution (percent of salary)	Annuity Option?	Number of investment options
Michigan	Defined Contribution Retirement Plan	3.0%	7.0%	10.0%	Yes	29 (11 target date)
Montana	Public Employees' Retirement System - Defined Contribution Retirement Plan	7.9%	8.03%	15.93%	Yes	29 (12 target date)
Oklahoma	Oklahoma Public Employees Retirement System DC plan	4.5%	6.0%	10.5%	Yes	21 (4 target date)
South Carolina	State Optional Retirement Program	9.0%	5.0%	14.0%	Yes	Available through four investment providers: TIAA-CREF, Valic, MassMutual, and MetLife Resources
Utah	Tier 2 Defined Contribution Plan (Public Employees)	0%	10.0%	10.0%	Yes	20 (12 target date)

Notes: Under Oklahoma PERS, the employee default is not sufficient to take advantage of the full employer match. The employee needs to contribute an additional 2.5% (7% total) to receive an additional employer match of 1%, resulting in a total contribution of 14%. Utah provides an additional employer match for voluntary employee contributions under a supplemental DC plan. Employers will match up to $1,352 annually to the supplemental plans. Pew estimates that the additional contributions represent 2 percent from the employee and an additional employer match of 2 percent, bringing the total contribution rate for many DC plan members in Utah to about 14 percent.

Side by Side Hybrid

- The benefit is a combination of a final average salary defined benefit (typically with a 1% multiplier) and a defined contribution plan.
- Most common alternative plan design.
- Reduced defined benefit lowers employer risk while maintaining some level of guaranteed benefit.
- Defined contribution account ensures that short- and medium-term workers can accrue retirement savings.
- Recent trend towards risk-managed hybrid plan: Side by side hybrid with risk sharing features included in the DB portion of the benefit.

Examples of State Side by Side Hybrid Plans

	Multiplier	COLA	DB Risk Managed	Employer Contribution to DC	Default Employee Contribution to DC	Total Default Contribution to DC	Employee Contribution to DB
Georgia Employee's Retirement System	1%	No	No	3% matching (0% mandatory)	5%	8%	1.25%
Tennessee Consolidated Retirement System	1%	Yes	Yes	5%	2%	7%	5%
Rhode Island Employee Retirement System	1%	Ad hoc	No	1%	5%	6%	3.75%
Virginia Retirement System	1%	Yes	No	3.5% matching (1% mandatory)	1%	2%	4%
Pennsylvania State and School Employees	1.25%	No	Yes	2.25%	2.75% - 3.25%	5% - 5.5%	5% -5.5%
Michigan Public Schools Retirement System	1.50%	No	Yes	1%	3%	4%	50% of total cost (6.2%)
Connecticut State Retirement System	1.30%	Yes	Yes	1%	1%	2%	5%-7%
Federal Government Retirement System	1%	Yes	No	5% matching (1% mandatory)	3%	7%	0.80%

Notes: Other data points on hybrid plans, including investment and distribution options, and retirement age are available in the Pew Charitable Trusts' brief "Hybrid Public Pension Plans," available at http://www.pewtrusts.org/~/media/assets/2015/04/hybrid-public-pension-plans_brief.pdf.
For Pennsylvania State Employees and School Employees, the table only includes the default hybrid plan. The Michigan Public Schools hybrid plan is not the default option, new employees are defaulted in a DC plan but can choose the hybrid plan instead.

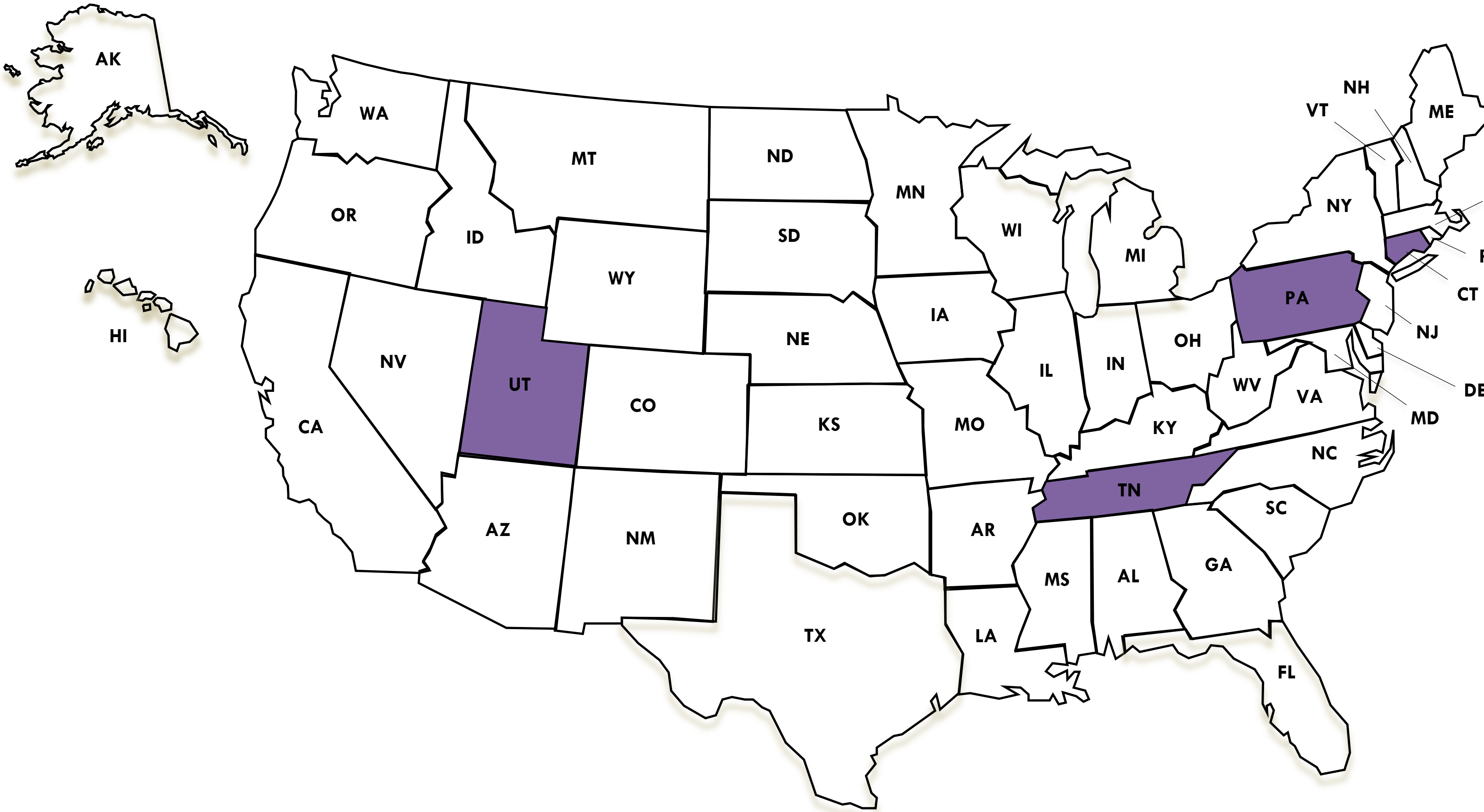
Emerging Trends on Risk Managed Hybrids

- Since the Great Recession, there has been growing trend towards hybrid plans. In the last ten years, seven states have adopted a hybrid plan for at least some new workers.

- Most recently, states have begun adopting plans that further reduce risk for the state while strengthening retirement security. Under these plans, known as Risk Managed Hybrids (RMH), unexpected costs are shared between employers and employees and the DC component has a focus on retirement security for employees.

Hybrid Feature	Standard	Risk-Managed
Smaller DB multiplier that reduces risk & increases employer cost predictability.	✓	✓
Separate DC component that improves the savings rate for shorter term workers.	✓	✓
Formal DB cost sharing to distribute unexpected cost increases between employee and employer.		✓
DC component designed to minimize risk for employees through adequate default savings rate, low fee investment options, and appropriate distribution options.		✓

States With Risk Managed Hybrids as the Default Option



Note: Michigan also recently adopted a risk managed hybrid plan for teachers. However, the risk managed hybrid plan is not the default. New teachers are defaulted into a defined contribution plan with the option to select the hybrid plan.

Cash Balance Plans

- Plan design that is similar to a defined contribution with some of the key features of a defined benefit plan.

- Individuals accrue retirement savings from employer pay credits, employee contributions, and investment returns.

- Benefit at retirement is based on accrued retirement savings, similar to a defined contribution account.

- Cash balance plans provide key defined benefit features:
  - Pooled, professionally managed investments
  - Guaranteed benefit
  - Annuity provided through the plan

Examples of State Cash Balance Plans

	Employee Contribution	Employer Pay Credit	Guaranteed Return	Gain Sharing
Kansas Tier 3 Cash Balance Plan	6%	• 3% to 6% based on tenure	4%	• 75% of returns above 6%, based on 5 year average
Kentucky Retirement System	• 5% for general employees • 8% for public safety	• 4% for general employees • 7.5% for public safety	4%	• 75% of returns above 4%, based on 5 year average
Nebraska State Employees Pension Plan and County Employees Pension Plan	• 4.5% for county members • 4.8% for state members	• 6.8% for county members • 7.5% for state members	• Greater of 5% or Federal Midterm Rate Plus 1.5%	• Granted depending on plan funding level and board approval
Texas County and District Retirement System	• 4% to 7% based on employer election	• Between 100% to 250% of the employee contribution	7%	None
Texas Municipal Retirement System	• 5% to 7% based on employer election	• Between 100% to 200% of the employee contribution	• Member contributions earn 5% • Employer pay credits get plan actual return	• Granted on board approval

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Assessing Tradeoffs in Plan Design

Cost, Risk, Retirement Security

Assessing Cost and Risk in Plan Design

- Plan type does not determine plan cost.
- Different plan types will expose taxpayers to different levels of risk.
- Policymakers need to decide how much risk should be taken and how it should be shared between taxpayers, workers, and retirees.
- Plan costs should be calculated both at the expected rate of return and at alternative return scenarios.

Measuring Retirement Security: Three Important Metrics

- **Potential replacement income.** What percentage of career-end take-home pay is replaced by retirement income?

- **Value of lifetime benefits.** How much will employees receive over their lifetime from their state-sponsored retirement benefit?

- **Retirement savings rate.** What percentage of salary is available to a worker as retirement savings who leaves public service before vesting or otherwise accruing a meaningful defined benefit?

Options for Consideration

Possible Plan Design Choices for Milwaukee County

Milwaukee County Policy Options

Policy Option	Comment
Maintain current DB plan.	• Look for ways to strengthen the existing system. • Consider further reductions to assumed rate of return, adopting stress test reporting.
Join WRS	• The Wisconsin Retirement System is one of the best funded DB plans across states and has robust risk-sharing in place to keep employer costs relatively stable. • Money-purchase benefit puts short- and medium-term workers on a path to retirement security.
Establish a Risk Managed Hybrid (RMH)	• Milwaukee County would continue to operate an independent retirement plan but would have more predictable employer costs. • Current benefit has employee contribution risk-sharing already built in. • TN, PA, CT, and UT have adopted a RMH as their default, primary benefit for new state employees.
Switch new hires to a defined contribution or cash balance plan	• Defined contribution option would insulate taxpayers from risk for benefits provided to new hires. • Closing the current plan will require adequate funding to maintain cash flow. • Cash balance designs would have many of the benefits of a defined contribution plan while keeping key protections for workers and continuing to use the existing plan infrastructure to provide benefits.

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Conclusion

Considerations Going Forward

Conclusion

- Goal is to identify an affordable and sustainable way to provide a secure retirement to public workers.
- Multiple viable options for Milwaukee County.
- Policy decision should balance cost, risk, and worker needs.
- New plan design will not eliminate the need to have a credible plan to pay for existing promises.

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