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# **Options for New Plan Design- Transitioning to a Defined Contribution Plan**

**Milwaukee County Retirement Sustainability Taskforce**

**March 29, 2018**

**David Draine, Senior Officer  
Public Sector Retirement Systems Project**

# The Pew Charitable Trusts

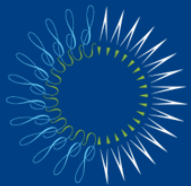
- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

## 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

- **Review of WRS Results**
- **Considerations for DC Plans and Options to Model**
- **Fiscal Metrics**
- **Retirement Security Metrics**
- **Issues to Consider**
- **Conclusion**



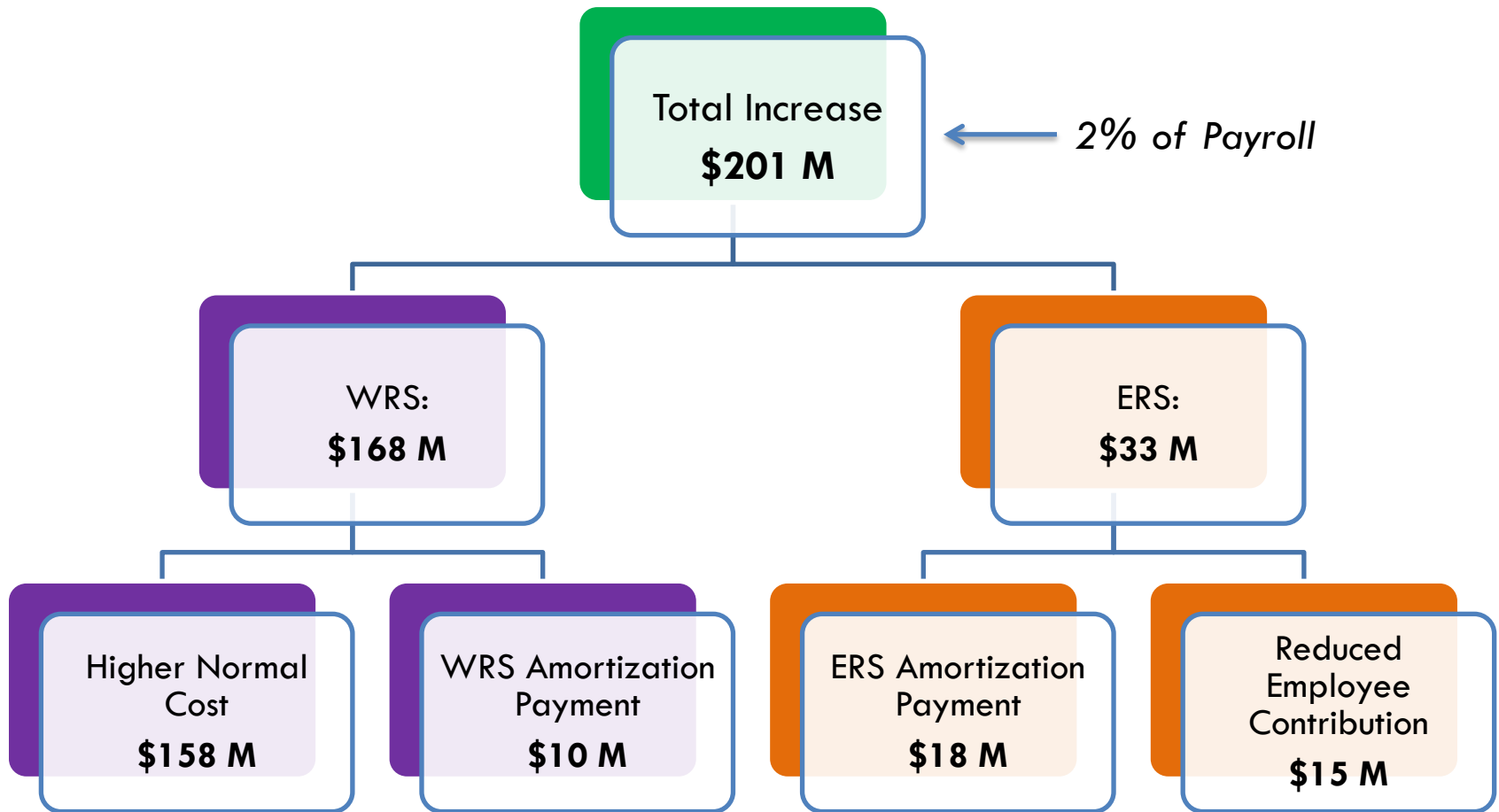
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## **Review of WRS Results**

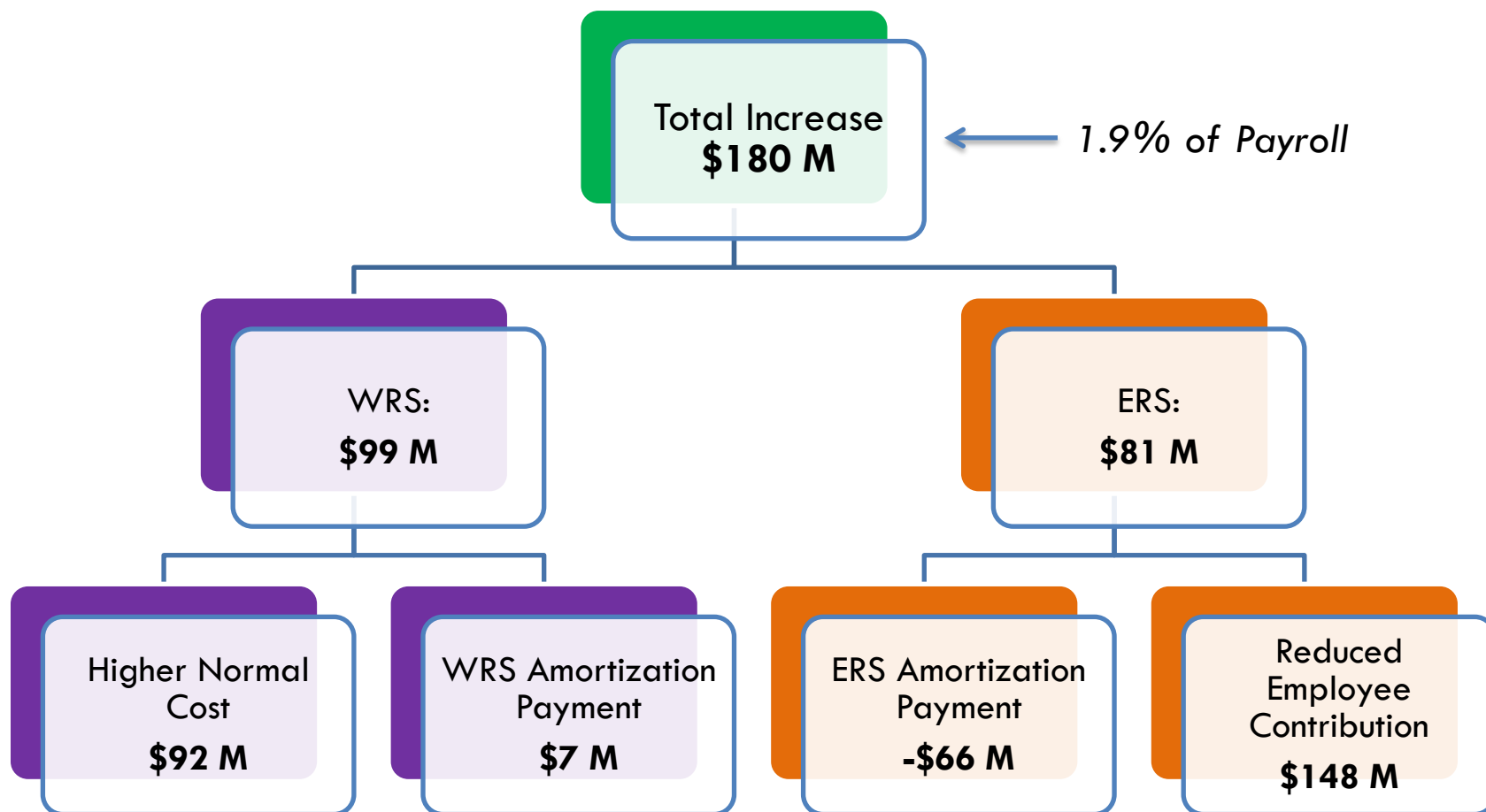
# Review of WRS Results

- Based on questions from last month's presentation, we wanted to more clearly lay out our findings
- The following charts break down the source of the cost increases associated with the soft and partial freeze transitions to WRS.
- As noted, the cost increases add up to 2% and 3.9% of payroll respectively. Total costs under current policy through 2046 are expected to be 18% of payroll

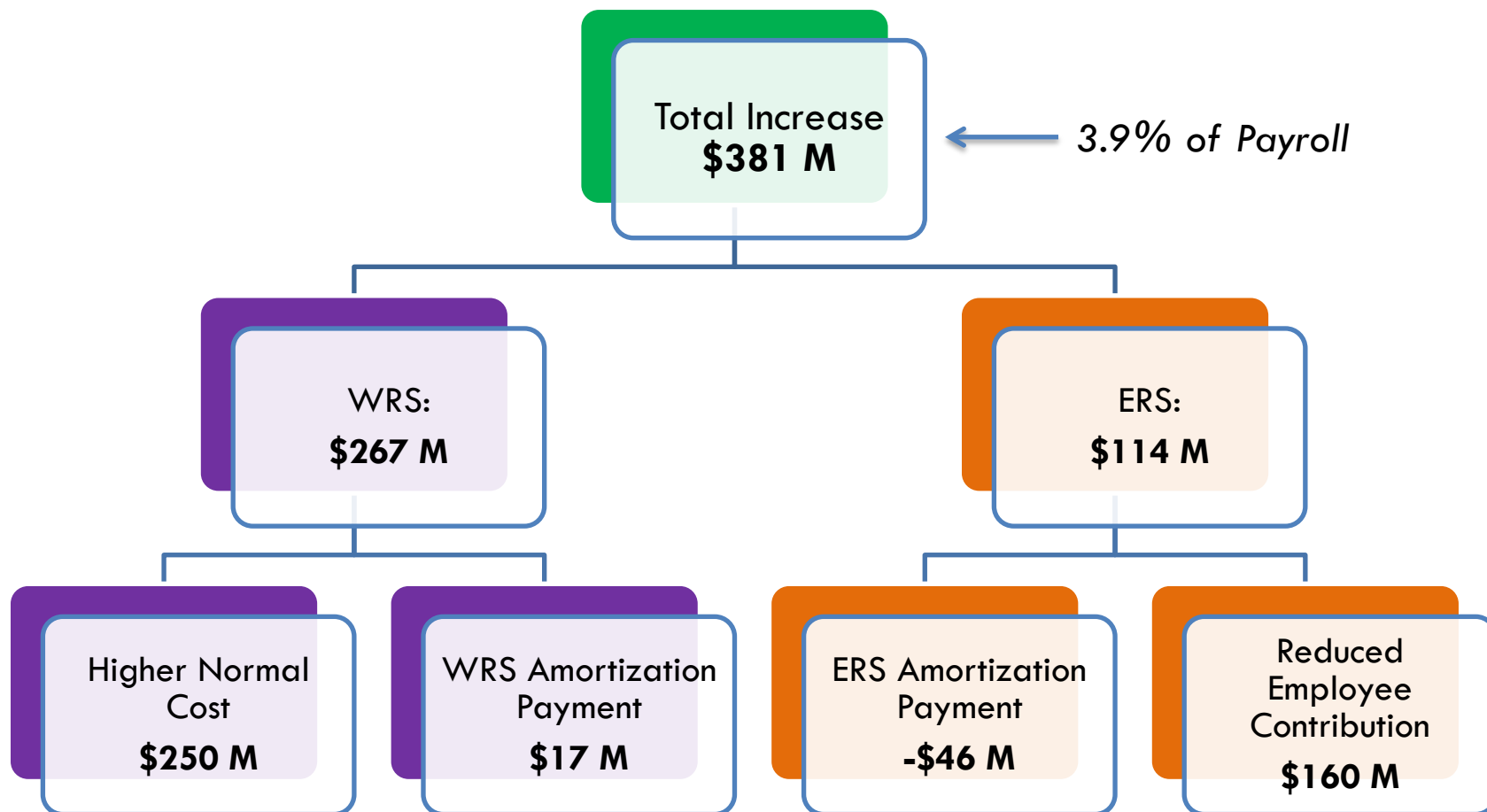
# Breaking Down the Increased Employer Costs: Baseline to Soft Freeze—WRS



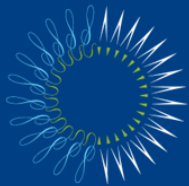
# Breaking Down the Increased Employer Costs: Soft Freeze to Partial Freeze—WRS



# Breaking Down the Increased Employer Costs: Baseline to Partial Freeze—WRS







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## **Considerations for Establishing a DC Plan**

# Considerations for DC Plan Design

- Policymakers need to achieve three things in designing and implementing a DC plan.
  - Sufficient employer and employee contributions
  - A limited number of low-fee, appropriate investment options
  - Appropriate distribution options
- States like Nebraska and West Virginia have moved away from DC designs when their plans failed to provide retirement security.
- There are proven models of good DC design in the public sector.

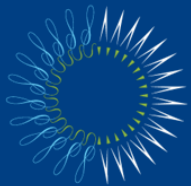
# Assumptions for DC Modeling

- Employee contribution rates fixed at 2019 levels.
- Four options are presented for employer contribution rate.
- Plan assets grow either at a long-term estimated return (7%) or at a lower rate (5%).
- To compare benefit levels, we assume workers annuitize using plan assumptions for longevity and a 4% return assumption.
- Vesting is kept at 5 years.
- Employer is assumed to continue to offer death and disability benefits; contribution rate for those is taken from the 2016 valuation.

# DC Plans to Model

Varied Employer Contributions to the DC, Employee Contributions are Fixed at 2019 Rate

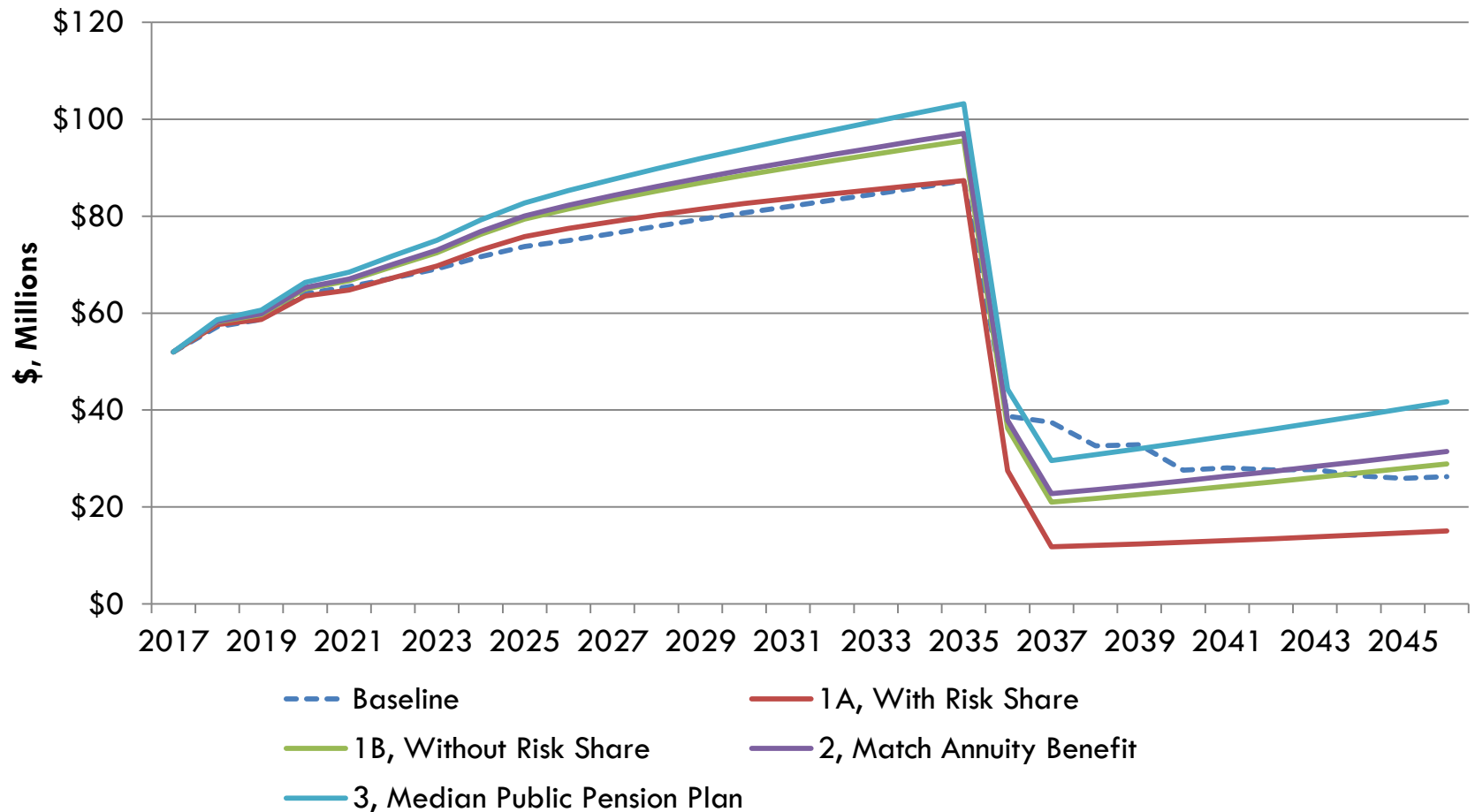
Option	Employer Contribution Rate	Employee Contribution Rate (General/Public Safety)	Description
1A	1.8%	7.2%/8.5%	Employer contribution calculated to match 2019 employer normal cost rate
1B	4.5%	7.2%/8.5%	Employer contribution calculated to match 2019 employer normal cost rate if there was no unfunded liability
2	5%	7.2%/8.5%	Employer contribution calculated as the amount expected to match the replacement income for a career worker.
3	7%	7.2%/8.5%	Employer contribution equal to the median employer contribution to public sector DC plans. Note that these are typically optional plans. Median employee contributions are 3%



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## **Fiscal Metrics**

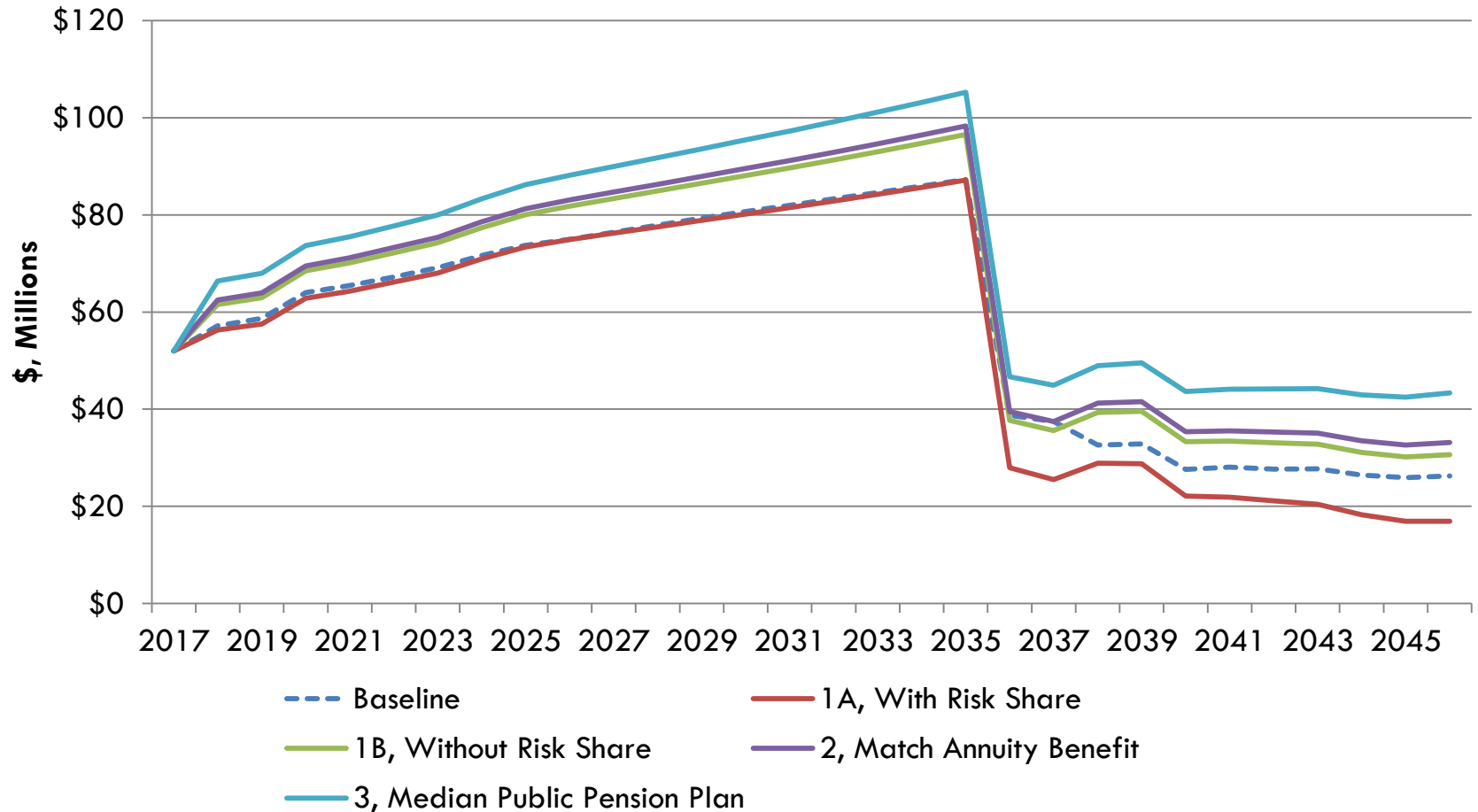
# Expected Employer Costs Under Soft Freeze to DC



## Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

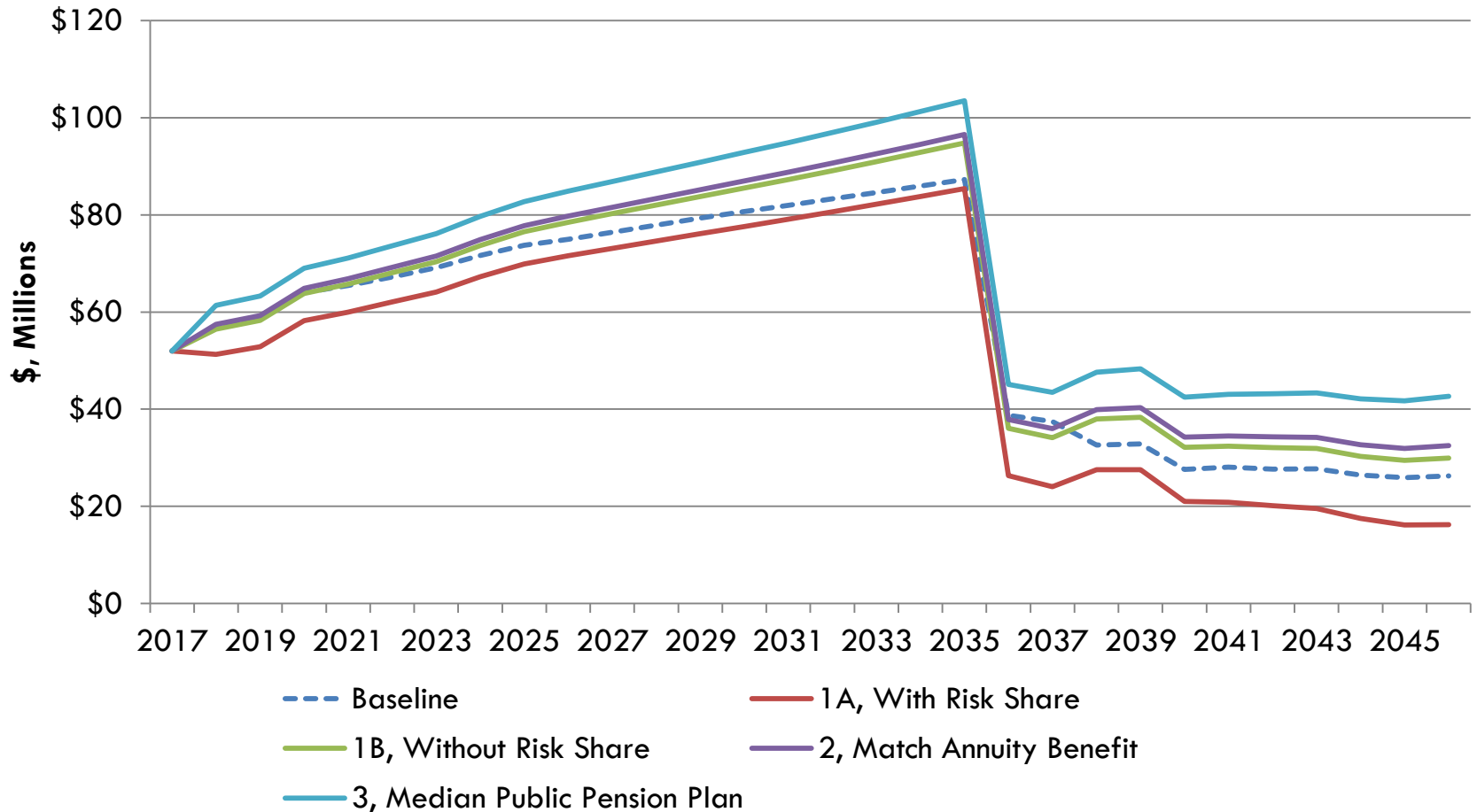
# Expected Employer Costs Under Partial Freeze with Salary Increase to DC



## Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

# Expected Employer Costs Under Partial Freeze without Salary Increase to DC



## Notes:

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.



# Total Employer Contribution for Each Option, 2017-2046

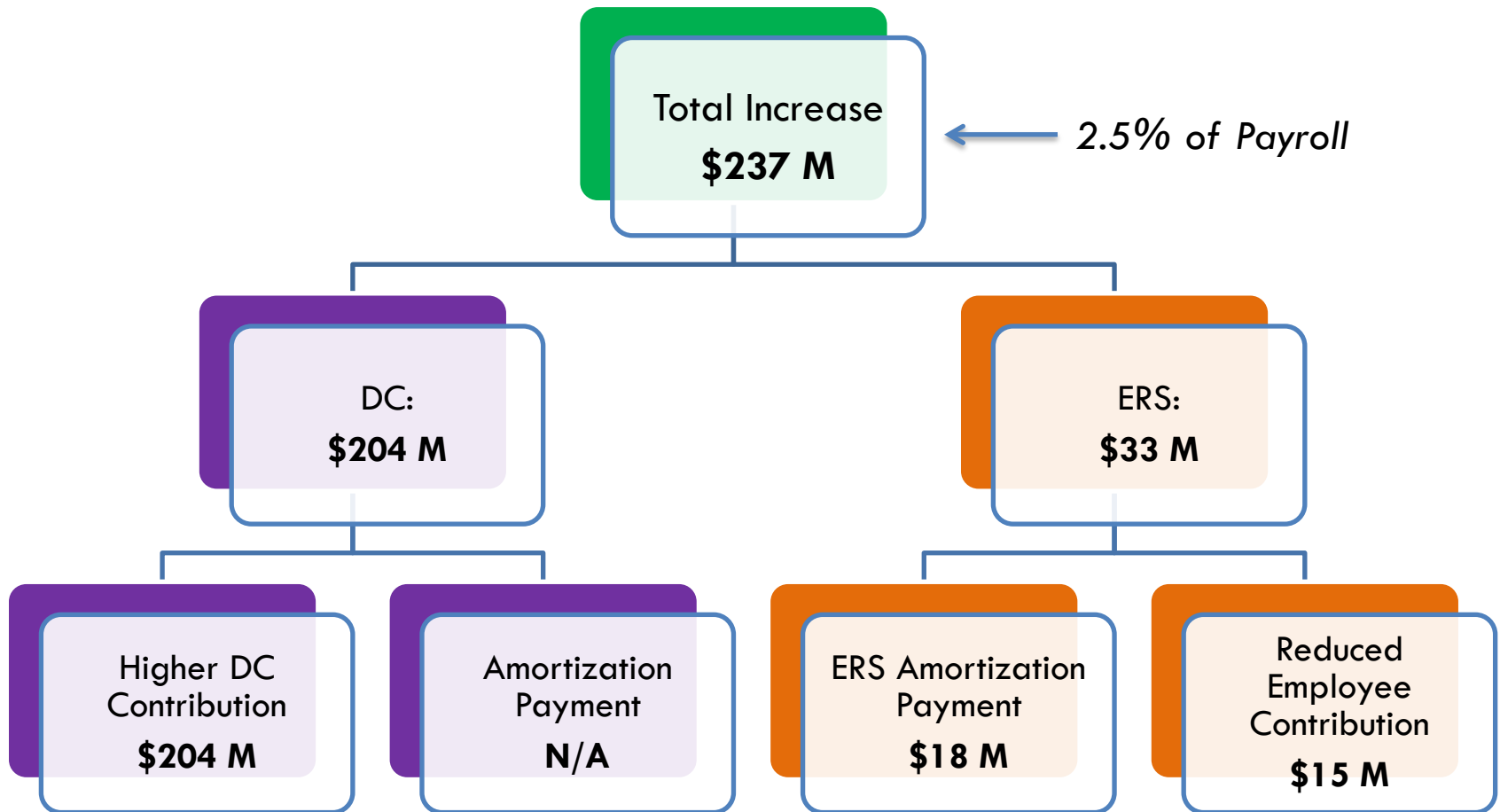
	Employer Costs	Baseline	1A, With Risk Share	1B, Without Risk Share	2, Match Annuity Benefit	3, Median Public Pension Plan
Soft Freeze	Total	\$1,723	\$1,571	\$1,773	\$1,810	\$1,960
	Defined Benefit Costs	\$1,723	\$1,399	\$1,399	\$1,399	\$1,399
	Defined Contribution Costs	\$0	\$172	\$373.6	\$411.0	\$560.4
Partial Freeze, Salary Increase†	Total	\$1,723	\$1,629	\$1,886	\$1,933	\$2,123
	Defined Benefit Costs	\$1,723	\$1,411	\$1,411	\$1,411	\$1,411
	Defined Contribution Costs	\$0	\$218	\$474	\$522	\$712
Partial Freeze, No Salary Increase	Total	\$1,723	\$1,559	\$1,815	\$1,862	\$2,052
	Defined Benefit Costs	\$1,723	\$1,340	\$1,340	\$1,340	\$1,340
	Defined Contribution Costs	\$0	\$218	\$474	\$522	\$712

## Notes

These figures assume an extra half percent in DC employer contributions to replace death and disability benefits.

† The partial freeze assumes that salary growth, retirement eligibility, vesting, and inflation growth would be carried over from the defined benefit system to the defined contribution system for purposes of determining the ultimate defined benefit at retirement.

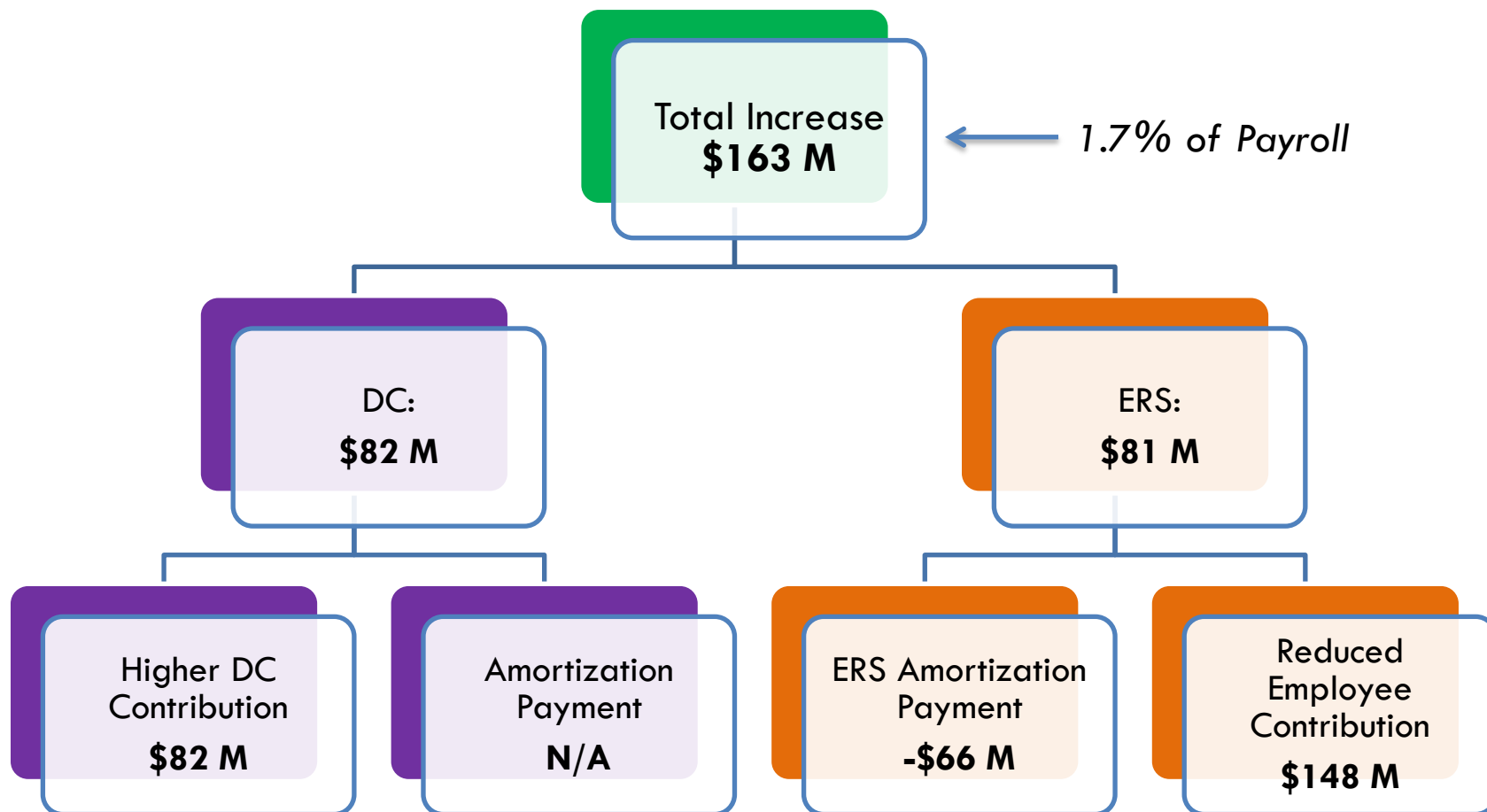
# Breaking Down the Increased Employer Costs: Baseline to Soft Freeze—DC Plan, Option 3



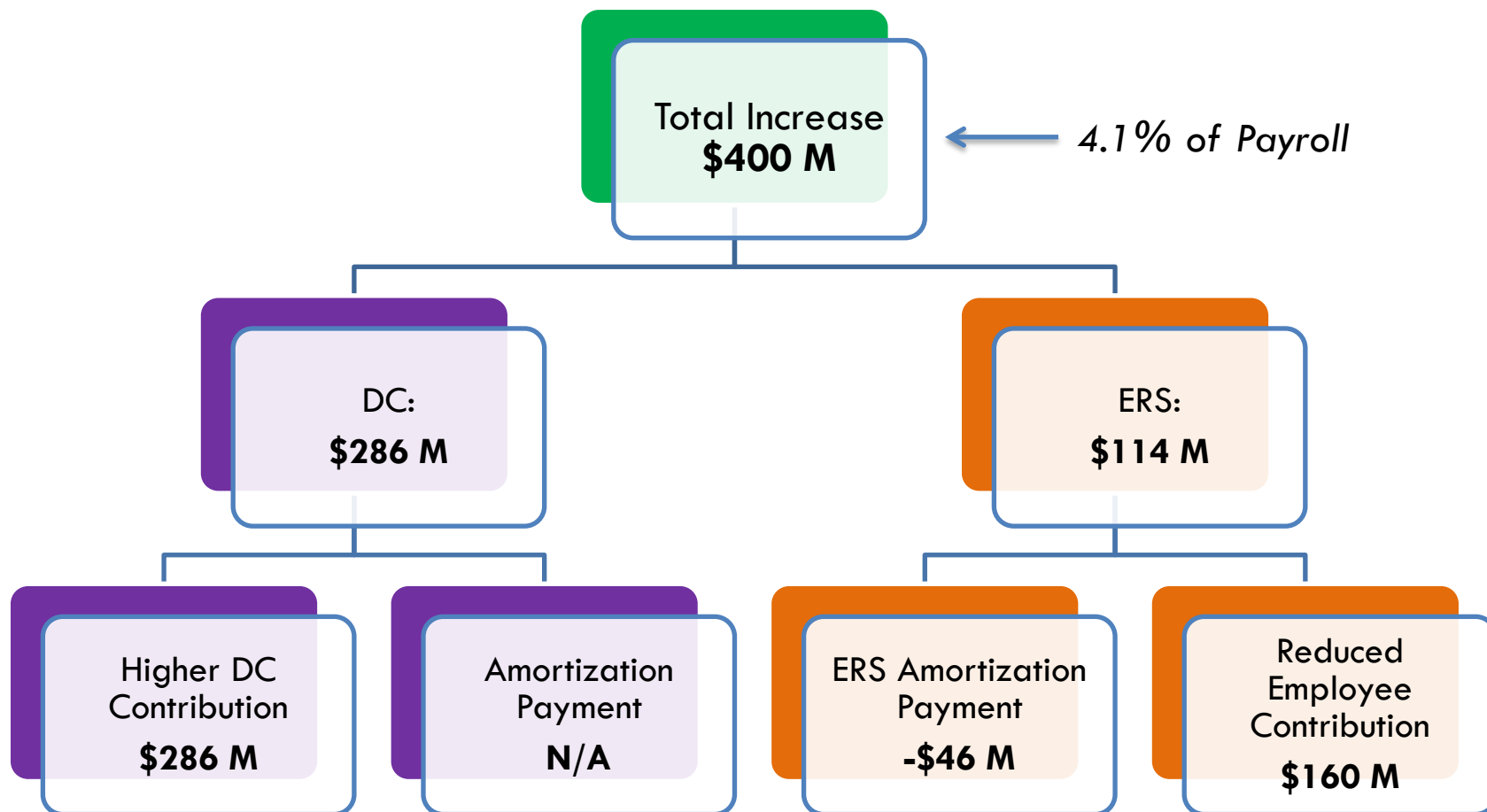
Note: Totals may not add due to rounding.

[pewtrusts.org](http://pewtrusts.org)

# Breaking Down the Increased Employer Costs: Soft Freeze to Partial Freeze—DC Plan Option 3

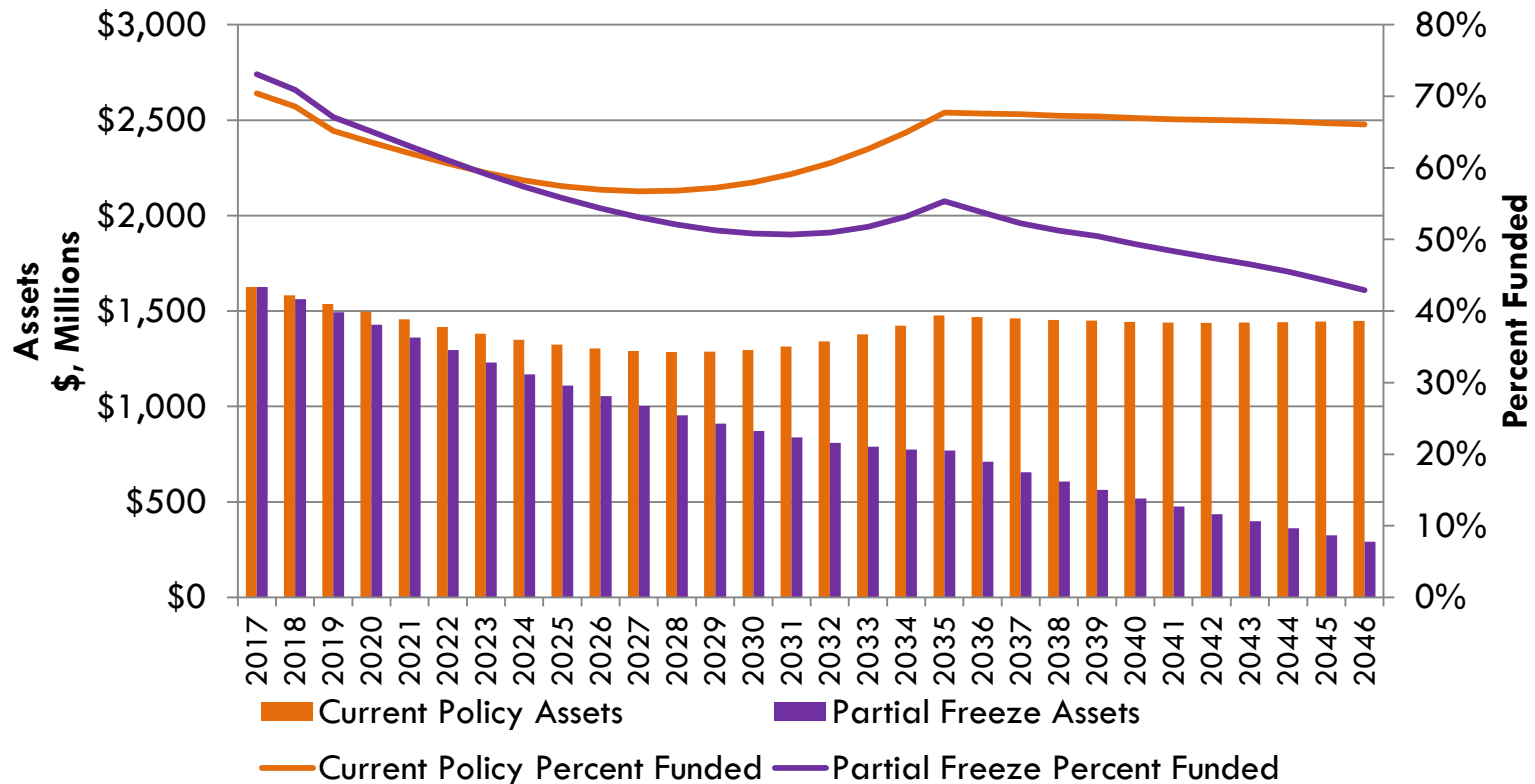


# Breaking Down the Increased Employer Costs: Baseline to Partial Freeze—DC Plan Option 3



# Assets and Funding Levels in a 5% Return Scenario for a Partial Freeze with Salary Indexed—ERS Only

Assets and Percent Funded in a 5% Return Scenario

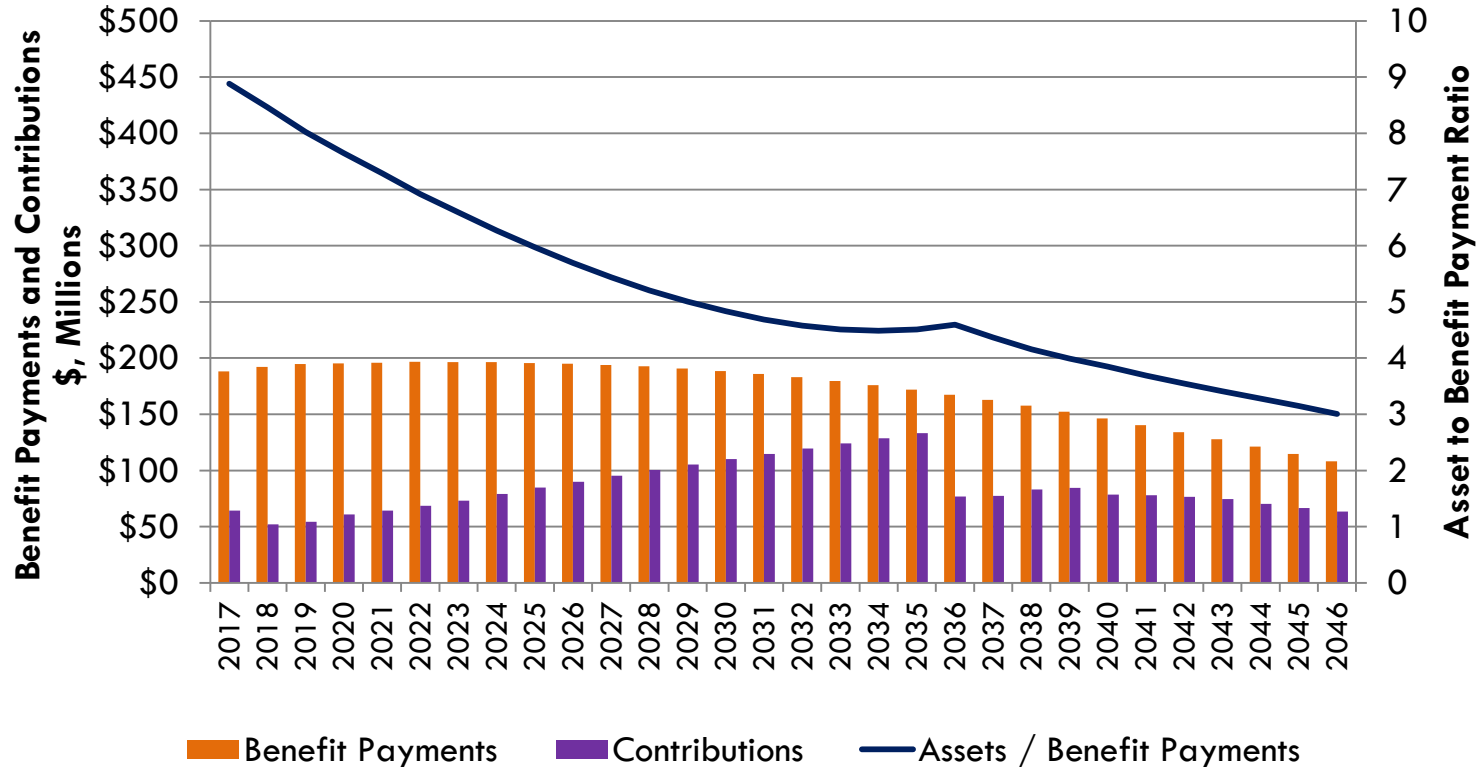


**Notes:**

Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

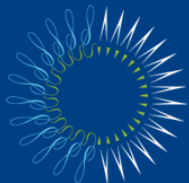
# Assets and Funding Levels in a 5% Return Scenario for a Partial Freeze with Salary Indexed—ERS Only

**Benefit Payments and Contributions in a Partial Freeze, 5% Return Scenario**



**Notes:**

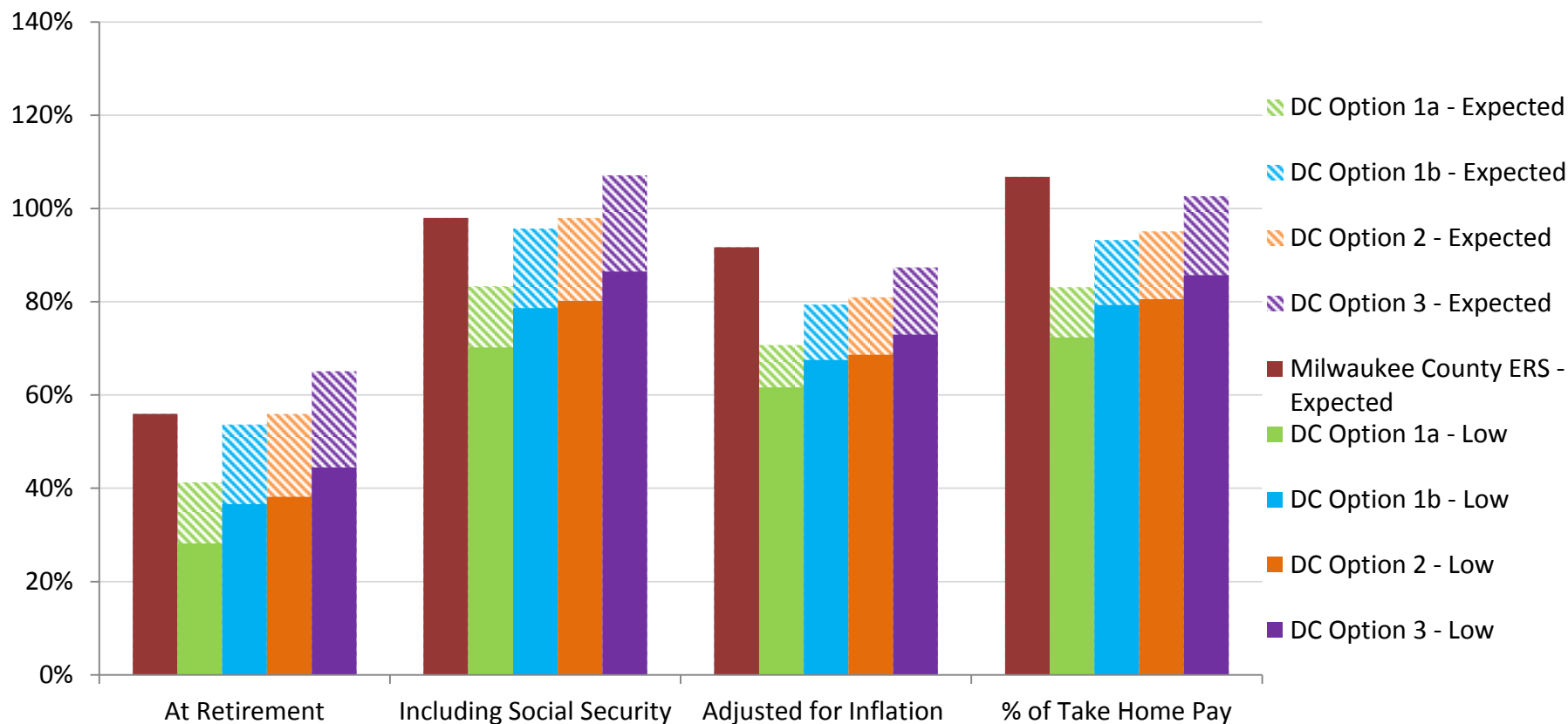
Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.



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# **Retirement Security Metrics**

# Replacement Income—Career Worker

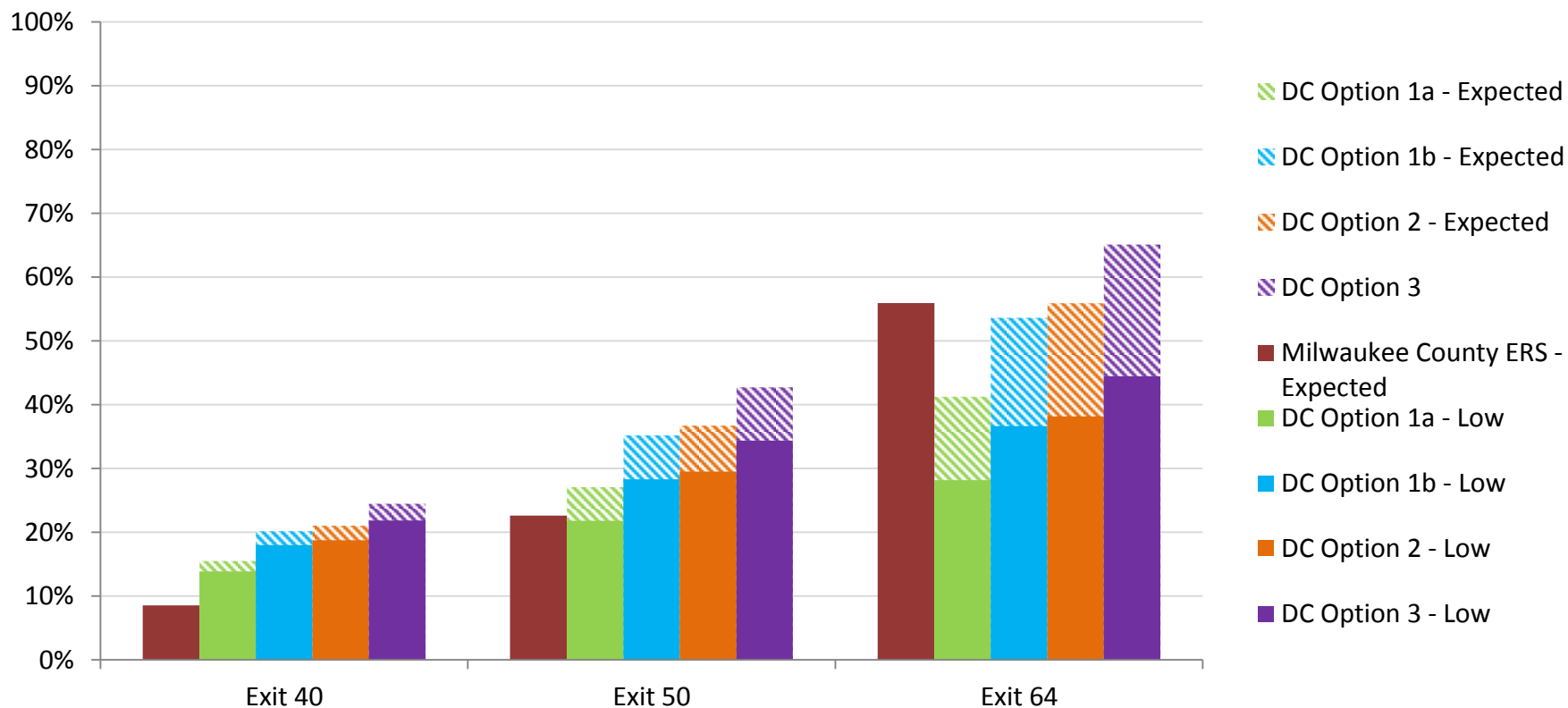


## Notes:

Pew analysis using ERS actuarial assumptions for salary growth and inflation. Expected return for DC plans is 7%; low return scenario is 5%. Annuitization is calculated using plan mortality assumptions and a 4% return assumption; DC annuities do not include a COLA.



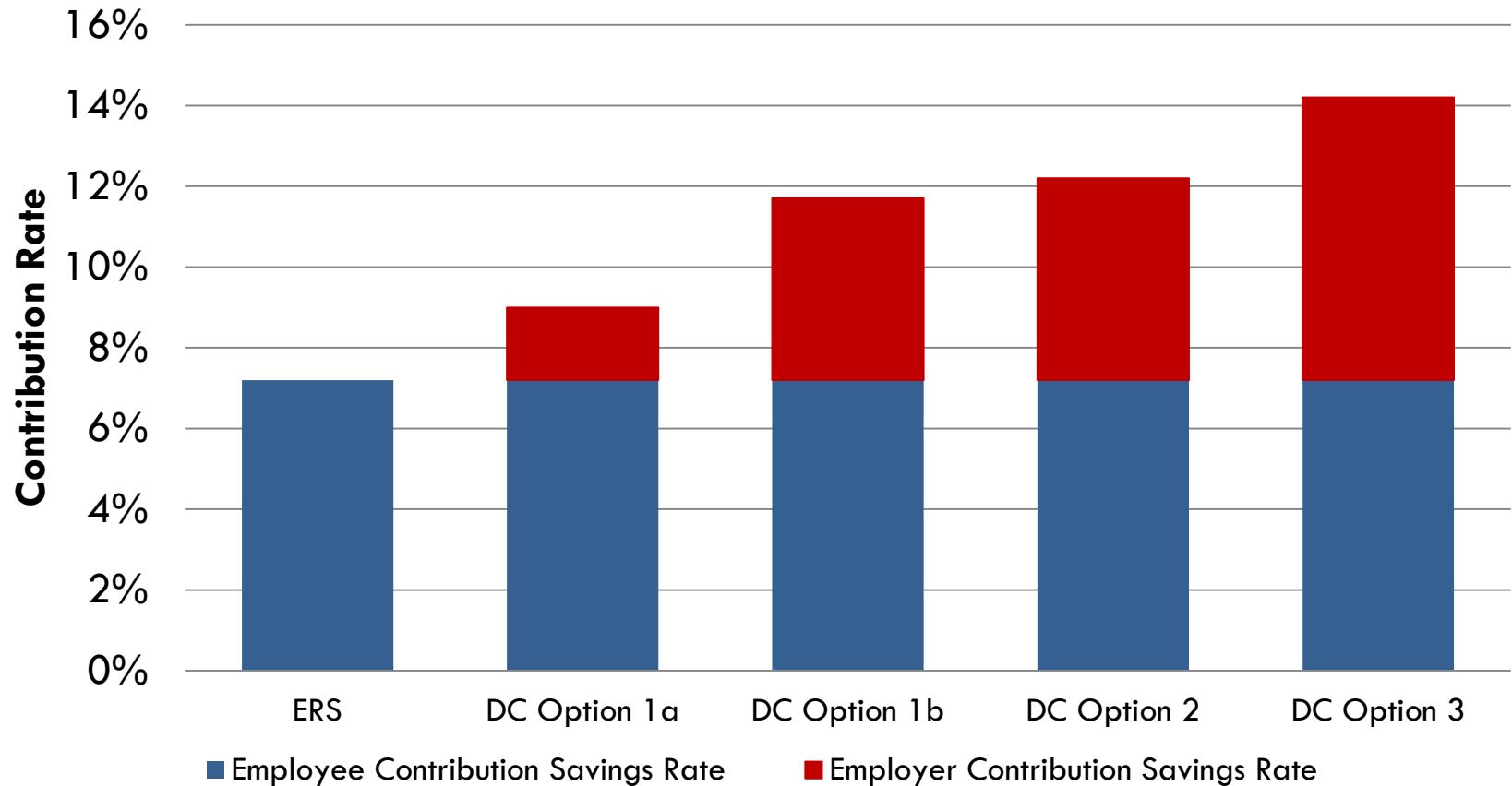
# Replacement Income—Mid-Career Worker



## Notes:

Pew analysis using ERS actuarial assumptions for salary growth and inflation. Expected return for DC plans is 7%; low return scenario is 5%. Annuitization is calculated using plan mortality assumptions and a 4% return assumption; DC annuities do not include a COLA.

# Retirement Savings Rate



**Notes:**

Based on 2019 employee contribution rates. Employee contribution rates for ERS vary based on actuarial projections..

# Replacement Income—Career Worker

		ERS	DC Option 1a	DC Option 1b	DC Option 2	DC Option 3
At Retirement	Expected Returns	56%	41%	54%	56%	65%
	Low Returns	56%	28%	37%	38%	45%
Including Social Security	Expected Returns	98%	83%	96%	98%	107%
	Low Returns	98%	70%	79%	80%	87%
Adjusted for Inflation	Expected Returns	92%	71%	79%	81%	87%
	Low Returns	92%	62%	68%	69%	73%
% Take Home Pay	Expected Returns	107%	83%	93%	95%	103%
	Low Returns	107%	72%	80%	81%	86%

## Notes:

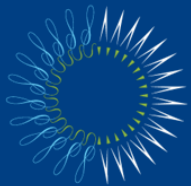
Pew analysis using ERS actuarial assumptions for salary growth and inflation.

# Replacement Income—Mid-Career Worker

		ERS	DC Option 1a	DC Option 1b	DC Option 2	DC Option 3
Exit 40	Expected Returns	9%	16%	20%	21%	25%
	Low Returns	9%	14%	18%	19%	22%
Exit 50	Expected Returns	23%	27%	35%	37%	43%
	Low Returns	23%	22%	28%	30%	34%
Exit 64	Expected Returns	56%	41%	54%	56%	65%
	Low Returns	56%	28%	37%	38%	45%

## Notes:

Pew analysis using ERS actuarial assumptions for salary growth and inflation.



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## Issues to Consider

# DC Design Issues

## ➤ What Should Contributions Be?

- Keep employee contributions at current levels or lower them?
- What employer contribution would be affordable for Milwaukee County and provide a sufficient benefit to employees?
- Combined DC contribution rates over 10-12% typical minimum benchmark, assuming Social Security participation.

## ➤ What Investment Options Should Be Made Available?

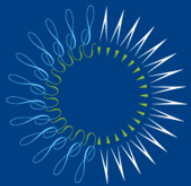
- Limited set of low fee investments that include life cycle or target data funds.
- Strong public sector examples include the Thrift Savings Plan.

## ➤ What Distribution Options Should be Made Available?

- Providing easy access to annuities can provide participants with lifetime income that doesn't run out.
- Alternatively, systematic withdrawal options allow for orderly income from DC accounts.

# Assumptions for Partial Freeze Analysis

- **How to manage reciprocity between plans?** We assume that vesting and retirement eligibility have full reciprocity for modeling purposes and examine different approaches of indexing salary at transition in calculating ERS benefits.
- **How to manage employee contributions in a partial freeze?** We assume that no employee contributions go towards ERS after transition.
- **Both assumptions can potentially be changed if that is the policy direction Milwaukee County is interested in.**



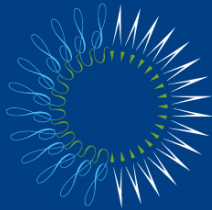
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# Conclusion



# Conclusion

- The total cost of transitioning to a DC plan will depend on the employer contribution rate set for the new plan design.
- Setting the employer contribution rate to match current replacement rates or at the median public plan rate leads to higher costs while matching the current employer normal cost (based on the current employee contribution rates) will lead to expected savings.
- The employer contribution rate will determine the expected level of replacement income. In many cases career employees will receive a reduced benefit while short- and medium-term employees might see higher replacement income.
- In all cases employee benefits will be less certain and will depend on investment performance. Employer costs for DC participants will be fixed.
- The partial freeze continues to offer limited or no savings compared to a soft freeze.
- New plan design will not eliminate the need to have a credible plan to pay for existing promises.



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David Draine  
ddraine@pewtrusts.org  
202-552-2012  
[pewtrusts.org/publicpensions](http://pewtrusts.org/publicpensions)

[pewtrusts.org](http://pewtrusts.org)