Unlikely Rescuer

By Kerry Pechter *Sun, Nov 13, 2011*

At least three proposals have been floated to open state pensions to private sector workers who have no retirement plan. Given the troubles of many state plans, that's counterintuitive. Artwork by Zaza Khabuliani.

Concerned that only about half of all full-time workers in the U.S. are covered by an employer-sponsored retirement savings plan at any given time, a number of pension advocates, economists and public officials have hatched ideas for expanding coverage.

So far this fall, in separate initiatives, the National Conference on Public Employee Retirement Systems (NCPERS), economist and 401(k) critic Teresa Ghilarducci of The New School, and Massachusetts state representatives have proposed plans that would give more people access to state pension plans.

In a kind of pension version of the medical "public option," these proposals suggest that a state could leverage its existing pension infrastructure and expertise, and either administer a professionally-run defined contributions for private sector workers without plans, or else allow such workers to contribute to a separate sleeve of a state's public retirement fund.

This approach has been under discussion in state pension circles for some time. A similar idea was developed for Washington State in the mid-2000s, according to Boston University pension expert Zvi Bodie. But it was reportedly opposed by private plan providers and was dropped before it came to fruition.

In an interview, Professor Bodie was sympathetic but skeptical regarding the likelihood of expanding access to public pensions. "This is yet another proposal to do something that makes sense," he told RIJ about the NCPERS plan (described below.) "But why should it have any better chance of success than the others?"

Some might question whether state pension plans are the right vehicle for solving the country's retirement savings shortage. After all, many of which emerged from the 2008 financial crisis badly underfunded. But with gridlock at the national level, state governments are seen by some as better able than Congress to take action.

Like the push to broaden health insurance coverage by introducing a public insurance option or state insurance exchanges, any push to broaden retirement plan coverage by opening up state plans is likely to be controversial. Nonetheless, the need exist and the proposals are out there. Here are summaries of three of them.

The Massachusetts plan

Two weeks ago, the Massachusetts House of Representatives voted 143 to 7 to approve H. 3754, which authorized the state treasurer to "sponsor a qualified defined contribution retirement plan… that may be adopted by not-for-profit employers for their employees," in compliance with IRS rules and the Employee

Retirement Income Security Act, or ERISA.

Like most bills, it is short on operational specifics. Participants might invest in a privately run, state-supervised qualified trust or in the existing state employees plan. Under the proposal, the treasurer could contract, after a competitive bidding process, with plan advisors, administrators or investment managers in the private sector to create and manage a qualified trust for non-for-profit employers and employees.

Participants could be permitted to contribute to the "same investment products as provided through a deferred compensation plan for employees of the commonwealth administered by the treasurer." The assets in the new plan would be segregated from the state employee assets, however.

The bill, a revival of a proposal made in 2009, was approved without debate and sent to the Massachusetts Senate for consideration. Not-for-profits employ14% of the state's workers, and less than one in five workers in not-for-profits has access to an employer-sponsored retirement plan, according to an October 27 Boston newspaper report.

Massachusetts has a $5 billion deferred compensation plan for about 300,000 state employees. According to a 2011 report by the Pew Center on the States, Massachusetts' long-term pension liability for current and future retirees of $61.1 billion for fiscal 2009 was only 68% funded. The state made 66% of its actuarially recommended contribution (ARC) of $1.97 billion in fiscal 2009.

Ghilarducci's plan

Not long after the Massachusetts legislators acted, economist and 401(k) critic Teresa Ghilarducci of the Schwartz Center for Economic Policy Analysis at The New School in Manhattan recommended that similar plans be adopted throughout the U.S. and be offered to all workers, not just employees of not-for-profits.

In a recent article, "How Policymakers and State Pension Funds Can Help Prevent the Coming Retirement Crisis," Ghilarducci and co-authors Lauren Schmitz and Robert Hiltonsmith described the plan this way:

"The best policy would be an individual account that would be portable between employers in which workers and employers would contribute at least 5% of pay into an account with guaranteed to earn at least 3 percent above inflation. At retirement, workers would have option of converting their savings into an annuity, a guaranteed stream of income for life."

Ghilarducci, whom Rush Limbaugh once called "the most dangerous woman in America" for arguing that the 401(k) system fails most Americans, had previously advocated "Guaranteed Retirement Accounts," a national defined contribution plan with a 5% employer/employee contribution, a $600-a-year tax credit and a 3% guaranteed real return.

"In effect," the report continued, "the state pension funds could "open a window", much like a bank would for a new customer, for private sector workers who want their retirement savings managed by professionals and, at retirement, have the option of a stable annuity."

Gridlock in Washington prompted her to change her strategy. “Due to the current political climate, the federal government may not be able to act, so states should step up and help their own citizens save for retirement. State legislatures could create such accounts and then take advantage of the already existing public pension infrastructure to invest the funds,” the SCEPA report said.

Secure Choice Pension

Yet another proposal for opening up state employee pension plans came in September from the National Conference on Public Employee Retirement Systems, or NCPERS, which represents more than 500 public plans in the U.S. and Canada. Its plan is called the Secure Choice Pension, or SCP.

Each state could create a SCP, setting it up as a multi-employer plan. SCPs would be modeled on cash balance plans, where employers contribute to professionally managed funds on behalf of employees. In a SCP, every participant would have a virtual account that would grow by 6% of covered earnings each year, plus an annual credit of the 10-year Treasury rate plus 2%. A guaranteed minimum accumulation rate of 3% a year would take effect if an employer withdrew from the plan and a funding shortfall occurred.

“This plan would establish statewide pension plans for all the employees in the private sector of that state,” said Hank Kim, the director of NCPERS. “Under the ideal situation it would be funded by a joint contribution from employer and employee. An administrative board composed of plan sponsors, employer and employee representatives and a board of trustees would run it.”

As for investment management, “We envision a co-investing of assets [with state pension assets] as the new plans start up, but the money would be in two completely separate trusts. It could be contracted out to insurance companies or 401(k) providers,” Kim told RIJ.

“[NCPERS] would provide a model plan document, but each state can tweak it,” Kim added. “Under our concept it would lead to an annuity. We would strongly discourage if not prohibit lump sum distribution. This would not be a plan for those who already have a pension plan or other coverage. This is a pension for those who don’t have one. We don’t think it will compete with the mutual fund or the 401(k) business. The penetration of 401(k)s into the small market, which is the one we’re looking at, hardly exists.”

A person entering such a plan at age 25 and staying in it for 40 years would ultimately receive an annuity replacing about 29% of his or her pre-retirement income, which would supplement Social Security’s replacement rate of 30%, NCPERS estimates. Someone entering an SCP at 35 would be able to replace 21% of income after 30 years and someone entering at age 45 would replace 13%.

Kim said he envisioned 25% to 30% of SCP assets invested in risky investments and about 70% to be invested in Treasury Inflation-Protected Securities, or TIPS. The strategy for dealing with funding shortfalls would apparently be left up to each state that sponsors an SCP. The liability could fall on the employer, or on a reserve created by the state, or by a pool funded by contributions from employers.

Considering the criticism that states have received for contributing too little to their plans, using unrealistic discount rates to value their obligations, and allowing benefits to get too generous, why should state pension plans be used as a model or a framework for a new breed of retirement plan, Kim was asked.

“Data shows that the criticism is really unwarranted,” he told RIJ. “There have been a few high profile instances of plans with funding challenges, but that’s because some plan sponsors, the states, have essentially taken holidays from their fiduciary contributions. Public plans have been around for over 100 years. We think we are a model, and shame on us to hold back on what might be a possible solution just because we’ve been criticized.”