Public-Private Partnerships: A Way Forward in Improving Retirement Security

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The United States is facing a retirement security gap which, unless addressed quickly, will bring hardship to large numbers of the elderly, strain social safety nets, and stymie long-term economic growth. Millions of people are not currently saving enough to allow for a secure retirement. Many other workers, who are at least accumulating enough resources to avoid penury, will be forced to significantly curtail retirement spending, causing economic headwinds for generations.

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States can help by developing and providing a simple turnkey model plan that small private-sector employers can adopt to provide a decent retirement income to employees. This can be accomplished without cost to taxpayers. Additional efficiencies and economies of scale may be gained if states opt to leverage the existing states’ governmental retirement plans infrastructures. In a perfect world, certain inhibiting provisions in the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code) would be eliminated and states would be able to offer competing nationwide, multiple-employer, defined benefit plans to the private sector, similar to the present Section 529 college savings plans. However, even in our imperfect world, individual states should develop and offer immediately viable alternative retirement savings programs to small private-sector employers.

This article examines the dangerous US retirement savings shortfall and proposes an achievable start to a solution: the “Secure Choice Pension.” As discussed further below, the Secure Choice Pension is a tax-qualified defined benefit plan that would provide defined pension benefits for employees of small employers, and that could be adopted by individual states without changes to federal law.

A PERILOUS SHORTFALL

Recent studies examining the nationwide retirement savings gap across a wide variety of age groups and metrics have consistently shown retirement savings to be perilously low. Based on current and projected rates of savings, most people will need to save more to have a secure retirement. In fact, millions of people are not in any kind of retirement savings plan at all—the vast majority because there is no plan available to them. When the retirement savings gap is as large as it currently is, individuals, families, and the nation face tragic consequences.

A 2010 report from the Employee Benefit Research Institute (EBRI) examining individuals between the ages of 36 and 62 calculated an average US retirement savings deficit of approximately $48,000 per person, with an aggregate national retirement savings shortfall of almost $4.6 trillion. This calculation did not include the costs of nursing home or home health care. Adding such costs would increase the shortfall by an average of $25,317 per individual for married households, $32,433 for single males, and $46,425 for single females. The analysis also found that if Social Security retirement benefits were eliminated, the aggregate national retirement income deficit would almost double to $8.5 trillion, or an individual average of approximately $89,000. These amounts represent the additional individual
average amounts needed at age 65 to eliminate expected deficits in retirement.

In calculating the gap between what US households in their peak earning years (ages 32 to 64) currently have in retirement savings and what they will need to maintain their standard of living in retirement, the Center for Retirement Research at Boston College estimated a savings deficit of between $5.2 trillion and $7.9 trillion, depending on inflation-adjusted investment returns. The calculation took into account all major sources of retirement income and assets, including Social Security, traditional pension plans, 401(k) plans, and other forms of personal savings.

Analyzing a broader age-range (working households aged 25 to 64), a recent report from the National Institute on Retirement Security (NIRS) calculated a U.S. retirement savings deficit of between $6.8 trillion and $14.0 trillion. The report found that more than 38 million households did not have any retirement account assets. The great majority of households, even those with retirement accounts, fell short of meeting conservative retirement assets targets. In a recent update to its study on access to retirement plans, an Investment Company Institute (ICI) report found that 47 percent of workers aged 21 to 64 did not have access to an employer-sponsored retirement plan. In addition, younger workers, lower-earning workers, part-time workers, and part-year workers are less likely to work for firms that sponsor retirement plans.

An April 2011 study designed by Lake Research Partners and sponsored by my employer, the National Conference on Public Employee Retirement Systems (NCPERS), found that Americans consider retirement security a matter of major concern but more and more difficult to achieve. The study found that 75 percent of respondents worried that they will not have enough money for a secure retirement, with fully 42 percent of respondents indicating they are very worried. And they are right to be worried. Half of all households approaching retirement (ages 55 to 64) have $100,000 or less in retirement savings, if they have anything at all. That would be enough to replace a mere 10 percent of these households’ median income. Similarly, a 2011 report from the General Accountability Office (GAO) acknowledges that ensuring income in retirement may involve difficult choices, including lowered consumption and lifestyle expectations. According to data from the U.S. Census Bureau, in 2013 almost 10 percent of Americans age 65 and older lived in poverty. In 2013, the poverty threshold for a person aged 65 years or older living alone was a yearly income of $11,173. Today, as more people enter retirement with inadequate retirement savings, they may increasingly face living in poverty.

Without adequate retirement savings, many people who would otherwise retire will have to continue to work, perhaps well into their 70s.
retirement age, the ability of younger workers to enjoy upward mobility in the workplace is limited. Young adults in the millennial generation (those who “came of age” in the new millennium) began entering the workforce as the baby boomers began to retire. The economy has already had a stunting effect on millennials’ personal and professional development. Some 40 percent of all unemployed workers, 4.6 million people, are millennials. Forcing millennials to delay the start of their careers may degrade the overall earning potential of an entire generation.

The expenditures made by retirees not only support jobs and economic output in local economies throughout the United States but also provide much-needed patient capital to domestic equities markets. Expenditures made from benefit payments from plans that provide a guaranteed payment in the form of a periodic payment or annuity benefit are particularly important because retirees receive a regular, guaranteed benefit regardless of stock market fluctuations or economic downturns. Thus, such payments serve as predictable and important stimuli to the economy. In a 2014 study, using data from the U.S. Census Bureau for 2012, NIRS found that expenditures made from state and local pension benefits payments had a total economic impact of more than $451.7 billion. Examining both public and private pensions, expenditures linked to benefit payments from defined benefit pension plans nationwide generated more than $943 billion in total economic output, supporting 6.2 million U.S. jobs that paid $306.9 billion in total compensation to U.S. workers and $135.1 billion in tax revenue.

**STATE-BASED PUBLIC PRIVATE PLAN MODEL**

Decreasing the retirement savings shortfall means increasing access to and use of retirement savings plans, while taking into account the flexibility and portability needs of an increasingly mobile workforce. This must be done while managing and balancing risks among employers and participants. Neither the current paradigm of defined contribution plans such as 401(k) plans (when a private employer offers any retirement plan at all) nor the traditional defined benefit pension plans offer a complete answer. Defined contribution plans offer flexibility while protecting employers from risk; however, they place the risk and the burden of investment management on often-unprepared employees. As a whole, defined benefit plan investments outperform those of defined contribution plans, particularly in down markets. However, employers unwilling to assume all the risk and facing a difficult regulatory environment have frozen or eliminated many defined benefit plans, resulting in such plans becoming increasingly rare except in certain industries and unionized workforces in the private sector and the public sector. In developing an alternate
solution, it is important to start with a model proven to work. Public pension plans stand out as a potential model. Such plans have a successful track record of performance in delivering adequate benefits in a sustainable and efficient manner. Because public pension plan assets are pooled and managed by professionals, these systems can achieve higher returns at a lower cost than the typical defined contribution plan. A study by the consulting firm Towers Watson found that, using an asset-weighted measure of returns, professionally managed defined benefit plans outperformed defined contribution plans by an annual average of 76 basis points from 1995 to 2011.

In addition, public pension plans pool mortality and other risks, allowing these plans to provide benefits at lower costs for participants and plan sponsors. By pooling assets, public plans are able to reduce administrative costs and asset management and other fees. Asset management fees have been found to average approximately 25 basis points for public pension plans, while asset management fees for private 401(k) plans are 35 to 145 basis points higher, on average.

In addition to these economic efficiencies, public pension plans also decrease government spending by reducing the need for retirees to rely on public assistance. A 2012 report from NIRS calculated that pension income saved the government approximately $7.9 billion in public assistance expenditures in 2010 and kept 1.22 million Americans off public assistance.

A VIABLE SOLUTION: THE SECURE CHOICE PENSION

A new type of retirement program (the “Secure Choice Pension” for the purposes of this article) uses the public pension plan model for its inspiration and may be the start of a viable solution to the retirement savings shortfall.

The Secure Choice Pension would empower a private sector-state government partnership to create a simple, employer- and employee-friendly pension plan providing lifetime retirement income to workers who do not otherwise have access to a pension. The Secure Choice Pension would be a tax-qualified retirement plan in which private employers with fewer than 100 employees may choose to participate; it would be intended to operate in compliance with the requirements of ERISA and the Code. Thus, the Secure Choice Pension would be covered by the full panoply of ERISA and PBGC protections. The Secure Choice Pension would also be completely insulated from the state or state retirement systems’ creditors, and the state would have no liability for any underfunding.

A state could put in place the Secure Choice Pension by enacting legislation to provide for the establishment of a nondepository trust company with the powers allowed to such trust companies under
existing state banking law, governed by an independent board of three to five individuals with expertise in the investment, retirement, actuarial, and human resources fields. The enabling legislation would then direct the trust company to establish the Secure Choice Pension, having the following specified characteristics:

- The Secure Choice Pension would be intended to qualify as a single tax-qualified pension plan under the Code.

- The Secure Choice Pension would be an employee pension benefit plan subject to ERISA.

- Benefits under the Secure Choice Pension would be insured under the ERISA plan termination insurance program administered by the PBGC, and the trust company would be authorized to pay PBGC premiums from plan assets.

- Any private employer in the state with fewer than 100 employees would be permitted to elect to participate in the Secure Choice Pension by executing a participation agreement.

- The Secure Choice Pension would provide for defined pension benefits under a cash balance approach, based on amounts contributed by each employer and by participating employees, together with interest credited on the accumulated contributions. This crediting rate would be established annually, but the annual rate would not be less than 3 percent.

- Employee contributions would be post-tax (but pension payments would be partially tax-free).

- The Secure Choice Pension would be prohibited from providing past service credit for benefit accrual purposes, early retirement benefits, or death benefits (other than to a participant’s spouse, domestic partner, or dependent children).

- The Secure Choice Pension would use conservative actuarial assumptions established in writing by the trust company on the advice of an independent actuary and designed to maintain the Secure Choice Pension on a fully funded basis and minimize the likelihood of any funding shortfall.

- The only benefits provided under the Secure Choice Pension would be lifetime annuities. The Secure Choice Pension would be prohibited from offering lump sum distributions, loans, or hardship distributions.
• The amount of the annuity would be based on the participant’s cash balance at retirement (no earlier than age 65), using conservative actuarial assumptions set by the board. If the Secure Choice Pension’s long-term investment performance was significantly higher or lower than anticipated, the board would have the authority to increase monthly benefits or require additional employer contributions or decrease benefits.

Under the enabling legislation, the trust company would be authorized to invest the Secure Choice Pension’s assets alongside the state’s retirement system. The trust company would determine the appropriate asset allocation and the assets and liabilities of the Secure Choice Pension and the state system would be completely separate. In this way, the Secure Choice Pension would be permitted to take advantage of the existing state retirement system infrastructure and allowed to participate in the efficiencies and economies of scale available to large public plans right from the start. Beyond the minimal cost to a state to set up the Secure Choice Pension, the program would be funded entirely through employee and employer contributions. There would, therefore, be no cost to taxpayers. In addition, as a cash balance plan, the possibility of underfunding in the Secure Choice Pension is greatly diminished.

The Secure Choice Pension Company also would be authorized to hire service providers (including actuaries) to assist in the administration of the Secure Choice Pension and to pay the fees and expenses of such service providers from the assets of the Secure Choice Pension.

The trust company would act as trustee and administrator of the Secure Choice Pension. As administrator, the trust company would make all required ERISA filings. These filings would include, to the extent applicable, filings on behalf of individual plans that are considered to be participants in the Secure Choice Pension for purposes of Title I of ERISA and for a Code ruling that the trust company and Secure Choice Pension documents satisfy Code requirements.

In a perfect world, federal legislation amending ERISA and the Code would allow employee contributions to be tax-deferred (like 401(k) plans), clarify that the plan was a single employer rather than a multiple employer, and insulate employers from ERISA fiduciary liability for management of a plan like the Secure Choice Pension. However, the state legislation enabling Secure Choice can be adopted right now without any federal law changes. Secure Choice would be an important start to providing access to an effective retirement plan to millions and, when working together with Social Security and other retirement savings, to reducing the perilous retirement savings shortfall.
NOTES


2. Id. at 4.


5. Id.


7. Id.


13. Id. at 43.


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07-03, last accessed Nov. 10, 2014, citing research by the Georgetown University Center on Education and the Workforce.


18. Id., at 24.


24. As defined by Investopedia, a basis point is a unit that is equal to 1/100th of one percent, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. www.investopedia.com, last accessed Nov. 10, 2014.


27. Id.


29. Limiting participation to employers with 100 or fewer employees would allow the Secure Choice Plan to take advantage of simplified annual reporting requirements.
30. To enact a plan similar to a Secure Choice Plan on a federal level with the additional features described would require amendments to: ERISA Section 401 (to limit the scope of coverage of ERISA's fiduciary responsibility provisions in connection with employers participating in a Secure Choice Plan); ERISA Section 502(a) (to limit the ability to bring private causes of action); ERISA Sections 302, 303, 304, and 305 (to (1) apply the multiemployer plan funding rules to a Secure Choice Plan, (2) provide for satisfaction of any underfunding attributable to a withdrawing employer by state funding (through a reserve accumulation or otherwise) or a reduction of benefits (subject to a guaranteed minimum)), and (3) permit employers to reduce participants' accrued benefits to reflect any unfunded liabilities; ERISA Section 513 (to allow states to allocate the risk of underfunding and provide options to protect against underfunding); ERISA Section 101 (to detail the disclosure and reporting obligations of a Secure Choice Plan as a single plan that is a multiple-employer plan); Code Sections 412, 430, and 431 (to (1) apply the multiemployer plan funding rules to a Secure Choice Plan, (2) provide for satisfaction of any underfunding attributable to a withdrawing employer by state funding (through a reserve accumulation or otherwise) or a reduction of benefits (subject to a guaranteed minimum), and (3) permit employers to reduce participants' accrued benefits to reflect any unfunded liabilities); Code Section 401(a)(11) (to provide that the default form of payment under a Secure Choice Plan would be an annuity supplemented by nonguaranteed periodic dividends funded by a dividend reserve); and Code Section 413 (to specify that a Secure Choice Plan is, except to the extent otherwise provided, permitted to be established, and treated, as a multiple employer plan).