Policy Option 7

EXPLORING MONTHLY EMPLOYER CONTRIBUTIONS

The Wisconsin Retirement System (WRS) is known to be one of the best-funded systems in the country. One of the characteristics of WRS is that employer contributions are part of payroll, just as employee contributions are. This has at least two advantages. First, it takes employer contributions out of the political realm where lump sum payments may be made in full or in part through an appropriation process. Second, the money is available to pension funds for investment sooner and on a regular basis along with employee contributions.

We do not have state-by-state data showing in which states employer contributions are made through payroll. Conversations with the former executive director of Nevada System indicated that employer contributions for the regular and public safety plan in Nevada are made on a monthly basis in sync with payroll deductions of employee contributions. But for some plans, for example, North Carolina's, Indiana's, California's, and Pennsylvania's, employers make contributions on a quarterly basis.

The main benefit of making employer contributions more frequently is that doing so tends to increase investment returns. This is because earnings are accruing against the funds over a longer period – and as we all learn in Economics 101 or personal finance classes, the power of compound interest multiplies money at an accelerated rate. For this reason, the New Jersey legislature unanimously passed legislation mandating that employer contributions be made on a quarterly basis. An analysis of the impact of this change shows that New Jersey's system would have earned $145 million more if quarterly payments had been in effect a year earlier.[20]

Table 2 shows the additional amounts state and local pensions would have earned if all employer contributions in the United States were made on a monthly basis. To estimate the impact of monthly employer contributions on returns, we have used 2018 US Census Bureau data (the latest data available). These data show that in 2018 state and local governments contributed $162.3 billion. Some states made these contributions on a monthly or quarterly basis and others on

20 reason.org/commentary/new-jersey-shifting-to-quarterly-pe/.

an annual basis or some other basis. If everyone made the contributions on a monthly basis, it would amount to about $13.5 billion per month ($162.3 / 12 = $13.5), as shown in column 2 of Table 2. During the same year, investment of $4.3 trillion of pension fund assets yielded $436.2 billion in returns. This return is approximately 10.05 percent ($436.2 billion / $4.3 trillion = 10.05). For our analysis, we have changed the 10.05 percent rate into a monthly rate of 0.8375 percent (10.05 / 12 = 0.8375).

The results in Table 2 show that if all plan sponsors made monthly contributions, state and local pension funds would have $9.96 billion more than what they had received under the prevailing employer contribution practices. This would be a relatively small yet significant contribution toward improving pension funding. Every dollar counts.

Table 2

If all state and local pension funds got employer contributions on a monthly basis in 2018, they would have earned $9.96 billion more ($1,000).

Month	Monthly Investments ($)	Monthly Interest ($)	Monthly Balance ($)
1	13,527,056	113,289	13,640,345
2	27,167,401	227,527	27,394,928
3	40,921,984	342,722	41,264,706
4	54,791,762	458,881	55,250,643
5	68,777,699	576,013	69,353,712
6	82,880,768	694,126	83,574,894
7	97,101,950	813,229	97,915,179
8	111,442,235	933,329	112,375,564
9	125,902,620	1,054,434	126,957,054
10	140,484,110	1,176,554	141,660,665
11	155,187,721	1,299,697	156,487,418
12	170,014,474	1,423,871	171,438,345
Estimated total annual contributions			171,438,345
Actual annual contributions			162,324,674
Additional money to invest in portfolio			9,113,671
Impact on return of total portfolio			847,363
Total impact of monthly contributions			**9,961,034**