Pension Primer

Rhode Island General Assembly
Tuesday, September 6, 2011
Providence, Rhode Island

Diane Oakley
Executive Director

NATIONAL INSTITUTE ON
Retirement Security

About NIRS

- Nonprofit, nonpartisan research organization founded in 2007.
- Contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole.
- National research and education programs.

NATIONAL INSTITUTE ON
Retirement Security

Public Pension Basics

What is a pension?

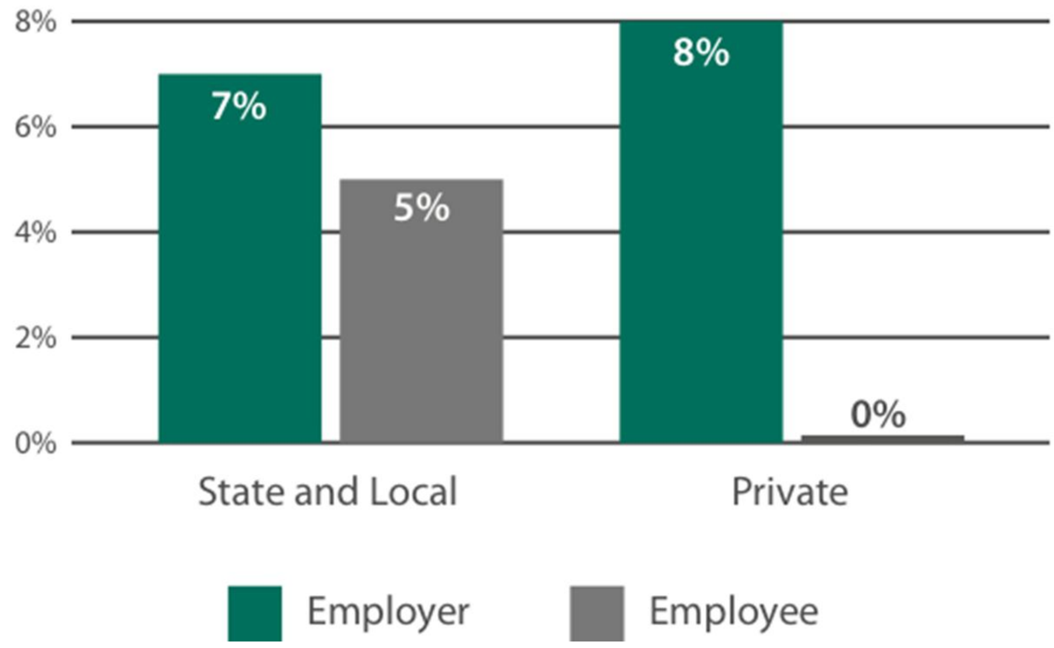
- A pension (or DB plan) is a group retirement plan that offers a predictable monthly benefit.
- Pension Benefit is based on a formula that takes into account years of service, final average salaries and a benefit multiplier.
- Provides a steady, predictable income stream in retirement that cannot be outlived.

How Are Pensions Funded?

- Pensions are "prefunded" systems.
- Receipts come from:
  - Employer (state or local government)
  - Employee, out of his/her own paycheck
  - Investment earnings

Pension Funding is a Shared Responsibility

Employer and Employee Contributions as a Percentage of Payroll, by Sector



NATIONAL INSTITUTE ON Retirement Security

Source: Center for Retirement Research at Boston College, *The Financial Crisis and State/Local Defined Benefit Plans,* 2008

Investment Earnings Do Much of the Work Over Time

- Pension fund receipts over the past 15 years have been composed of:

- Employers (taxpayers) contribute 21 cents on the dollar of total pension receipts.

NATIONAL INSTITUTE ON Retirement Security

Source: U.S. Census Bureau, *State and Local Government-Employee Retirement Systems,* 2010

How Are Contributions Determined?

- The Annual Required Contribution (ARC) is determined by actuarial analysis.
- The ARC consists of….

Normal Cost + **Payments on any Unfunded Liabilty** = **ARC**

- This is what the plan sponsor should pay to keep the plan healthy.

NATIONAL INSTITUTE ON
Retirement Security

What are Funding Gaps? Where do they Come From?

Budget Risk -Contributions into the plan are not adequate to cover promised benefits

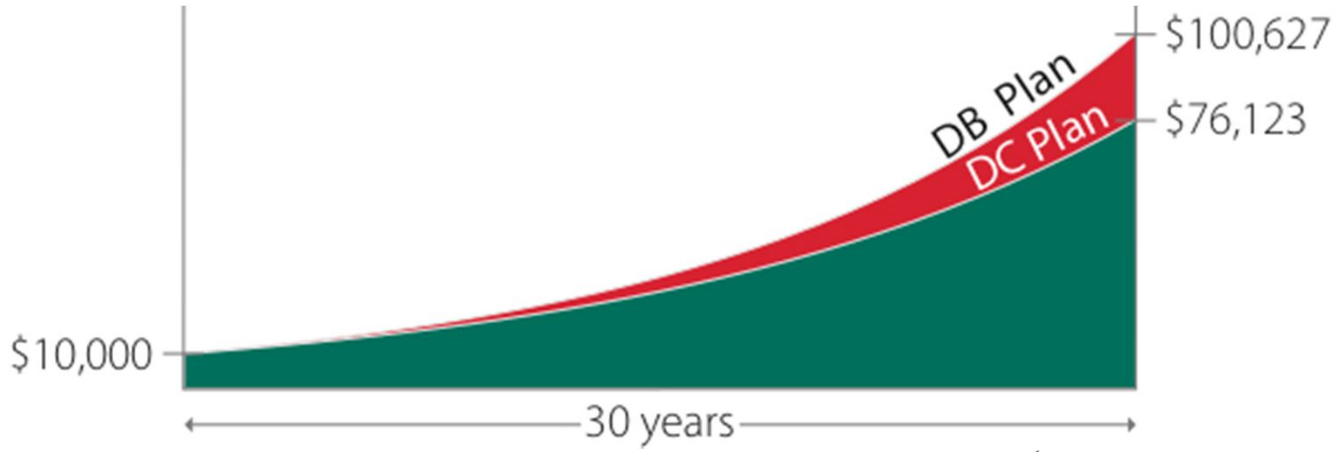
Investment Risk – Sharp downturns in financial markets employer has to make up for investment loss

NATIONAL INSTITUTE ON Retirement Security

Professional Investment Managers Achieve Higher Returns

- Pensions achieve better investment returns than 401(k) type plans.
- These additional returns really add up over time.

How $10,000 Invested Grows over 30 Years



NATIONAL INSTITUTE ON
Retirement Security

Source: Towers Watson (2011 & 2008), CEM Benchmarking, Inc. (2007) and Center on Retirement Research (2007)

Retirement Savings Plans 401ks (or DC plans)

- Employer-Sponsored Savings Plans provide tax incentives to save money for retirement through payroll deduction.
- Employees make contributions from paychecks which employers match, typically with a contribution of $.50 for every $1 the employee saved.
- About 30 percent of employees choose not to participate in employer sponsored plans.

NATIONAL INSTITUTE ON
Retirement Security

401ks (or DC plans) Portability and Leakage.

- Portability -- New employees find attractive the fact that if they leave their employer after 401(k) benefits vest they can take their full account to a new employer's plan.
- Leakage - 401(k) plans often provide for plan loans and employees can make withdrawals before retirement which can reduce their retirement income benefits.

NATIONAL INSTITUTE ON Retirement Security

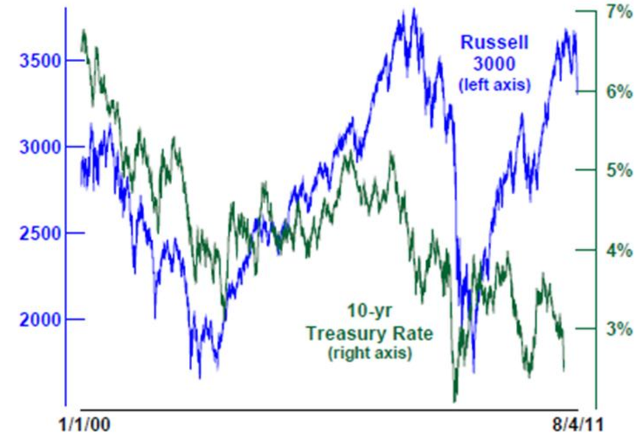
Retirement Savings Plans 401ks (or DC plans)

- DC plans have an easily predictable cost
  - if plan offers a 50% match of employee contributions up to 6% of pay then the maxiumum cost would be 3 percent of payroll.
- Employees bear the investment risk in a DC or 401(k) plan. If investment losses cannot be recouped by retirement age, they may delay plans or retire with much less income.
- Employees bear risk that inflation will erode income.

NATIONAL INSTITUTE ON Retirement Security

DC or 401(k) plans Investing Assets

- Employee chooses how much to contribute to the DC or 401(k) plan and also decides how to invest the amounts contributed among the different funds offered in the plan.
- Individual account grows with contributions and compounding investment returns each year.
- Over time, earning generally represent a greater percentage of assets in accounts, especially as retirement nears. So, investment returns are more important then.



Russell Investments and Yahoo! Finance

NATIONAL INSTITUTE ON Retirement Security

Drawing Down Assets in DC or 401(k) plans

- Plans are not required to offer a guaranteed lifetime income option, and typically pay out benefits as a one-time lump sum.
- Income from DC plans depends on investment earnings both before and after retirement.
- No Spousal Protection of retirement income
- Financial advisors recommend moving to more conservative investments with age.

NATIONAL INSTITUTE ON Retirement Security

Drawing Down Assets in DC or 401(k) plans

Without lifetime income guarantees, the retiree must determine how much to take out of the account each year, if money is to last for as long as he and his spouse will live.

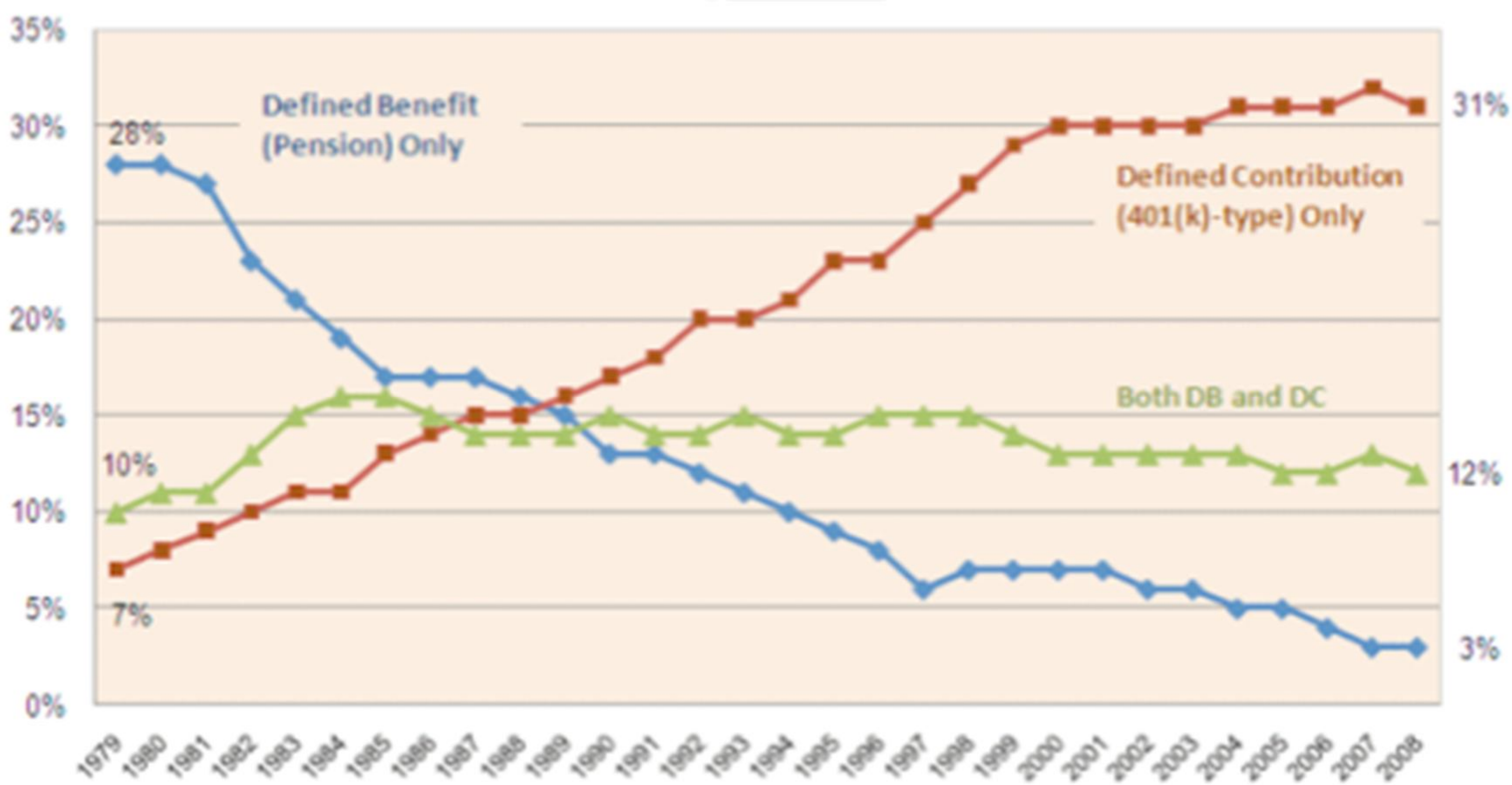
- Individuals underestimate life expectancy.
- Drawing income out over life expectancy still leaves retiree with a 50- 50 chance of exhausting money in the DC account.
- Can purchase annuity to get income guarantees but only a few do.

NATIONAL INSTITUTE ON Retirement Security

Selected Differences Between DB and DC Plans

	DB Plan	DC Plan
Contributions	In the public and private sectors, contributions are made by the employer. In the public sector, many pensions are employee contributory.	Employees make their own contributions to their savings account at whatever rate they choose. Employers will often make a match, but they are not required to contribute.
Investments	Contributions for all employees are pooled, and invested by professional asset managers in a diversified portfolio.	Investment portfolios consist of individual accounts. Employees make all investment decisions themselves, and can choose from a range of investment options offered.
Amount of Money in Retirement	The monthly benefit is determined by a set calculation, usually based on years of service and pay at the end of one's career.	The money available in retirement is the amount that one has accumulated through contributions and investment earnings.
Lifetime Income Guarantee	Payouts are provided as a monthly income stream that is guaranteed for the remainder of the retiree's life.	Plans are not required to offer a lifetime income option, and typically pay out benefits as a one-time lump sum.
Supplemental Benefits	Spousal benefits, disability benefits, and cost of living adjustments are common.	Supplemental benefits are not applicable, and generally not available.

Private Sector - Workers Participating in Retirement Plan by Plan Type, 1979-2008

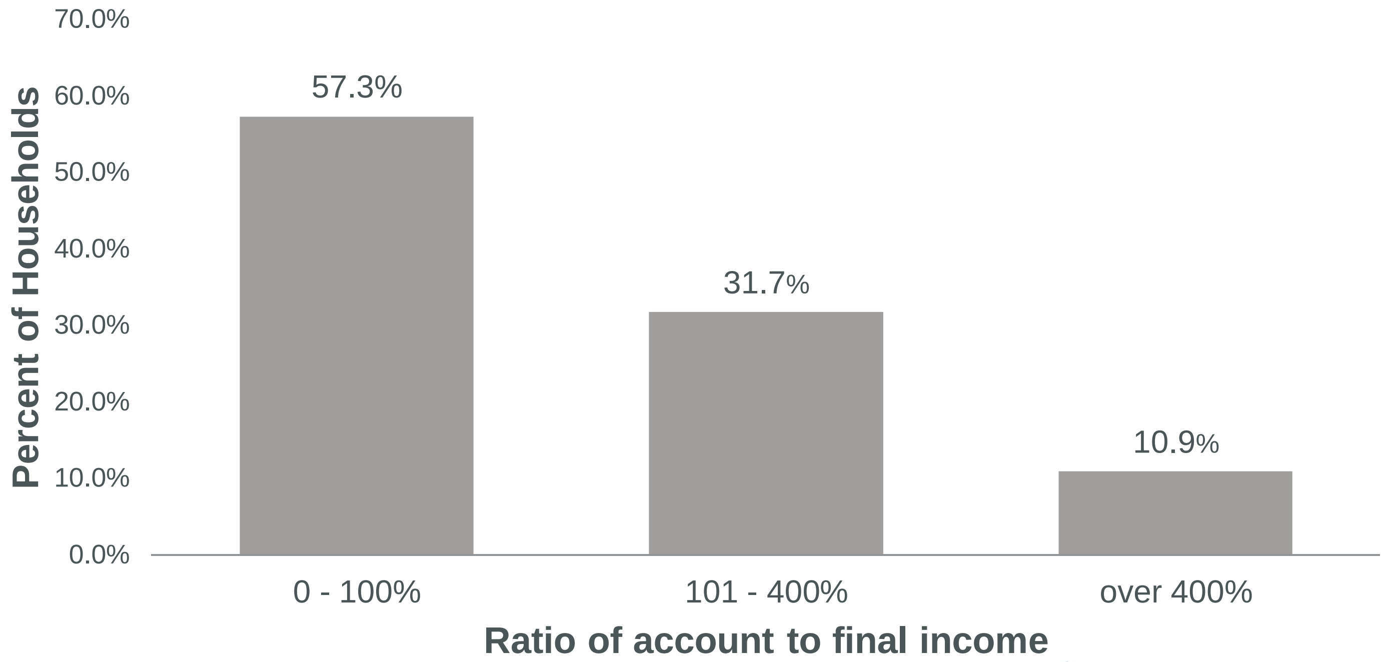


NATIONAL INSTITUTE ON
Retirement Security

Source: EBRI

Savings in Retirement Accounts Near-Retiree Households (age 55 - 64)

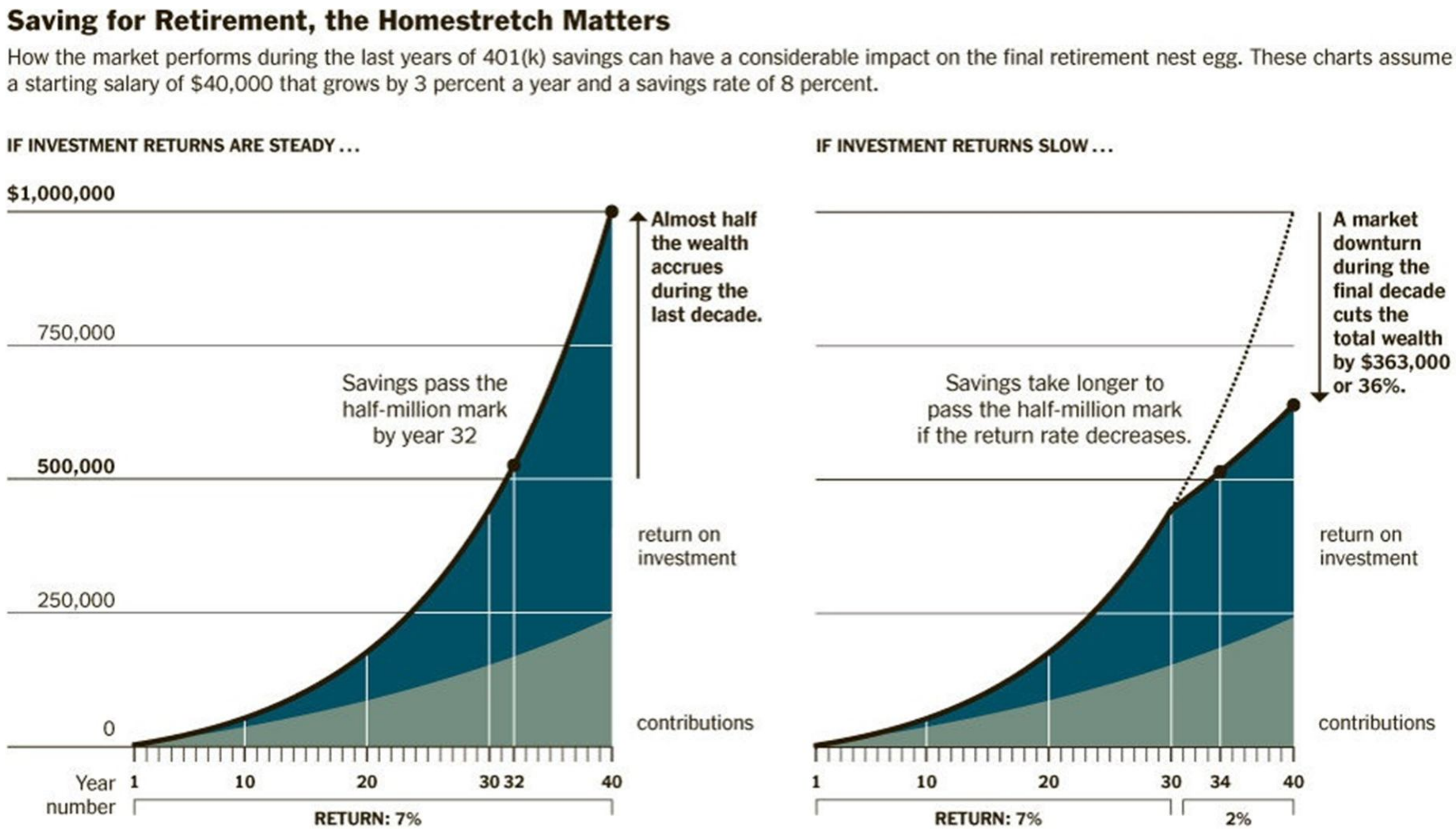
Retirement Account Ability to Replace Earnings



NATIONAL INSTITUTE ON Retirement Security

Source: Towers Watson

DC Plan Individual Accounts
Investment Returns Matter in Last Years

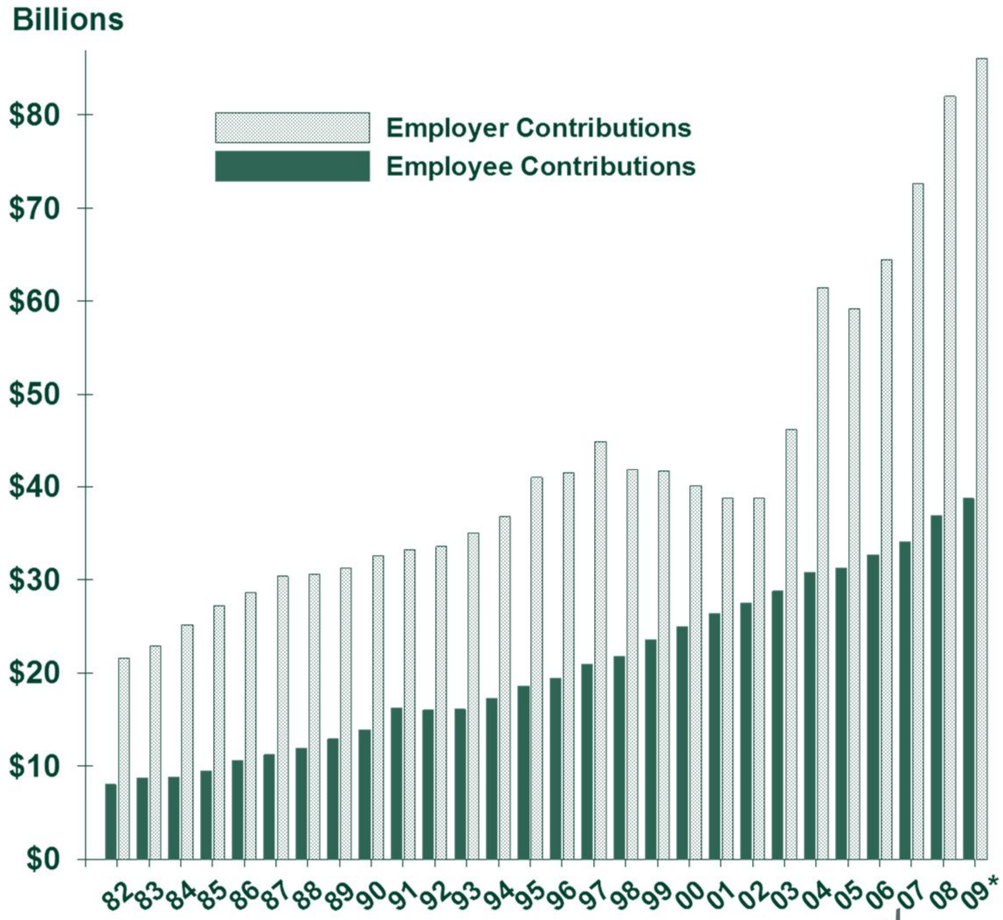


NATIONAL INSTITUTE ON Retirement Security

Source: Michael Kitces, The Nerd's Eye View in *The New York Times*

Public Pensions Typically Are Shared Funding Responsibility

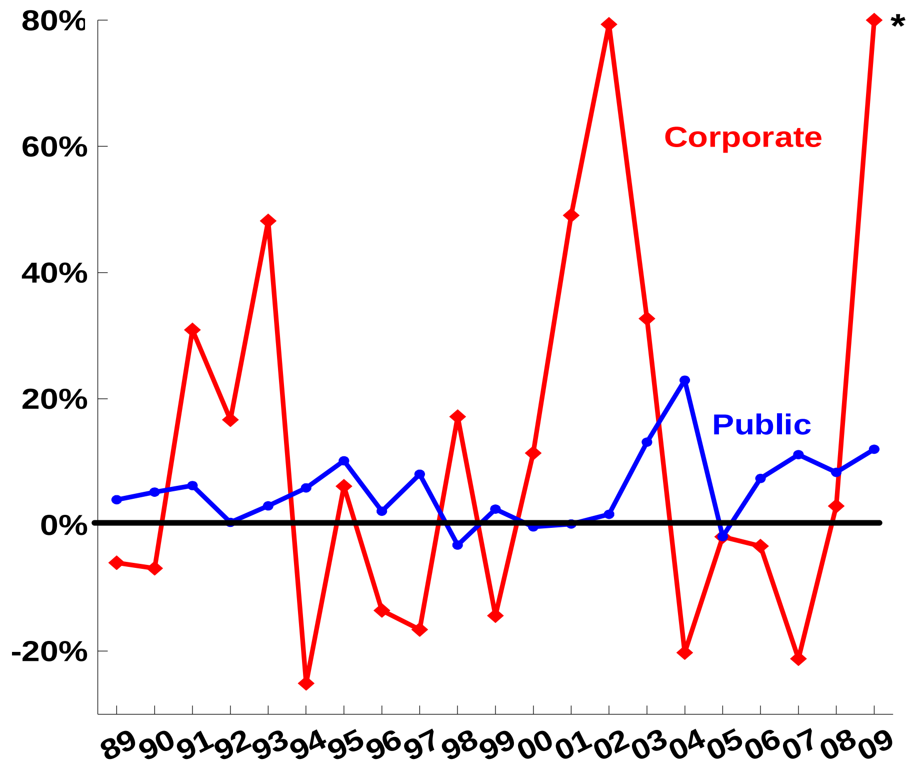
Employee and Employer Pension Contributions, 1982 to 2009



NATIONAL INSTITUTE ON Retirement Security

Source: U.S. Census Bureau

Change from prior year in corporate and public pension contributions, 1989-2009

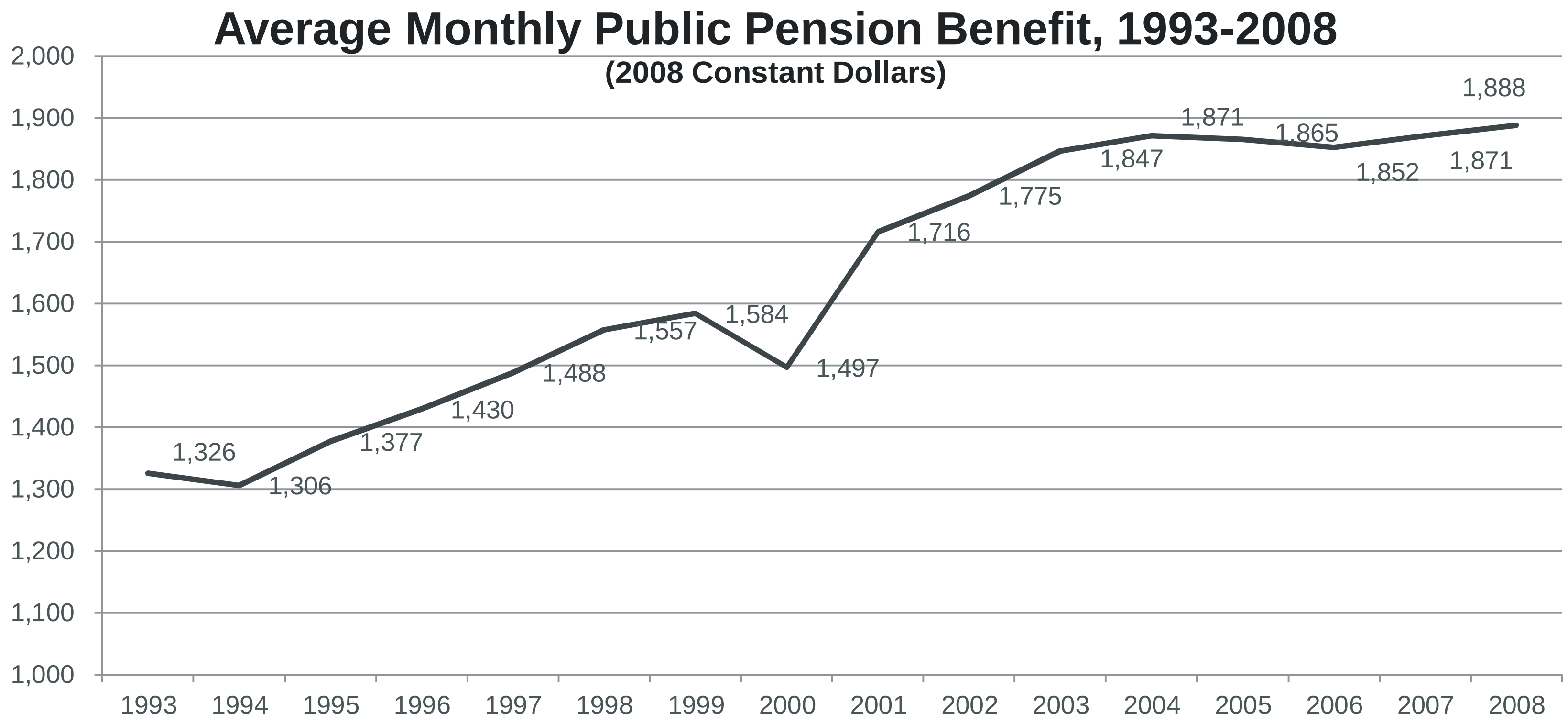


US Dept of Labor,
US Census Bureau,
Milliman

*Estimate

NATIONAL INSTITUTE ON
Retirement Security

Average Public Pension Benefits
30% of Workers Not Eligible for Social Security



NATIONAL INSTITUTE ON Retirement Security

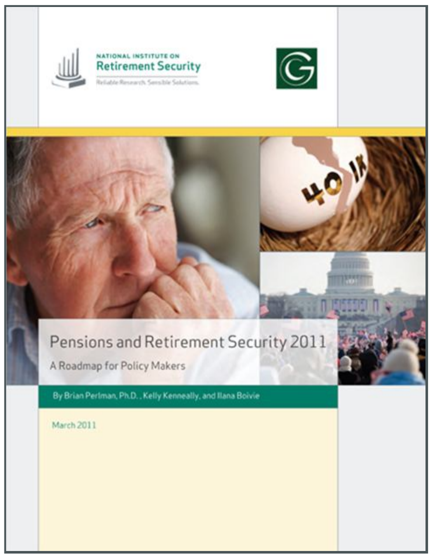
Source: U.S. Census Bureau

Lessons Learned Study

1. Employer pension contributions that pay the full ARC, and that at least equal the normal cost;
2. Employee contributions to help share the plan cost;
3. Benefit improvements that are actuarially valued before adoption and properly funded upon adoption;
4. COLAs granted responsibly;
5. Anti-spiking measures that ensure actuarial integrity, transparency;
6. Economic actuarial assumptions that can reasonably be expected to be achieved long term.

NATIONAL INSTITUTE ON
Retirement Security

NIRS Public Opinion Research



- Americans highly anxious about retirement.
- Americans have low retirement expectations.
- Pensions relieve anxiety, are reliable.

Opinion Research Methodology

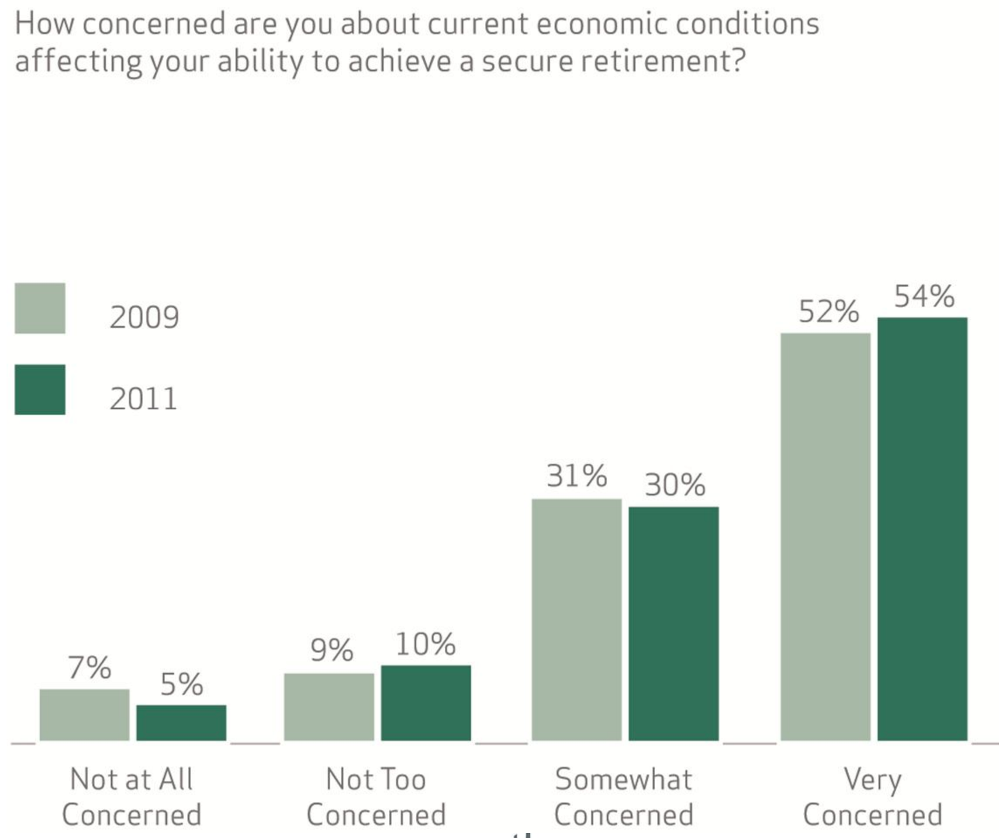
- The survey was conducted as a nationwide telephone interview of 800 Americans age 25 and older.

- Matthew Greenwald & Associates balanced the data to reflect the demographics of the United States for age, gender and income.

- The margin of error is plus or minus 3.5%

Retirement Security Breakdown

84% of Americans concerned about ability to achieve a secure retirement.



NATIONAL INSTITUTE ON Retirement Security

Source: NIRS

Open Ended Question

How would you personally define what a financially secure retirement means to you?

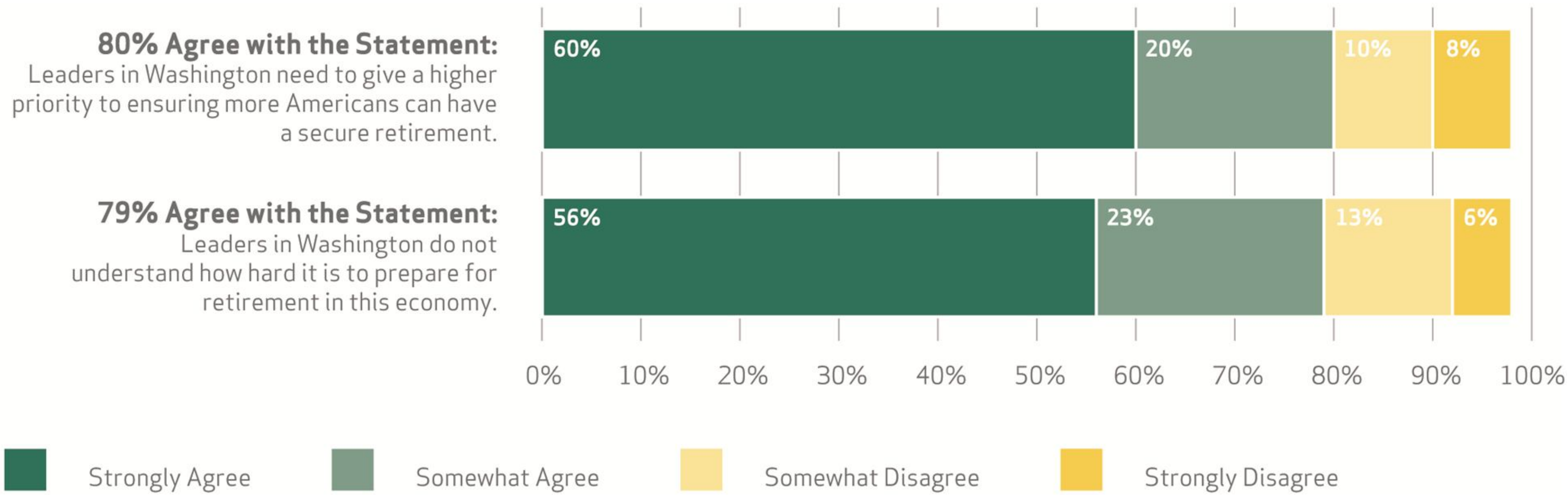
NATIONAL INSTITUTE ON Retirement Security

Covering Basics, Not Luxuries

- Surviving, living comfortably (34%).
- Paying the bills (17%).
- Maintaining pre-retirement lifestyle (11%).

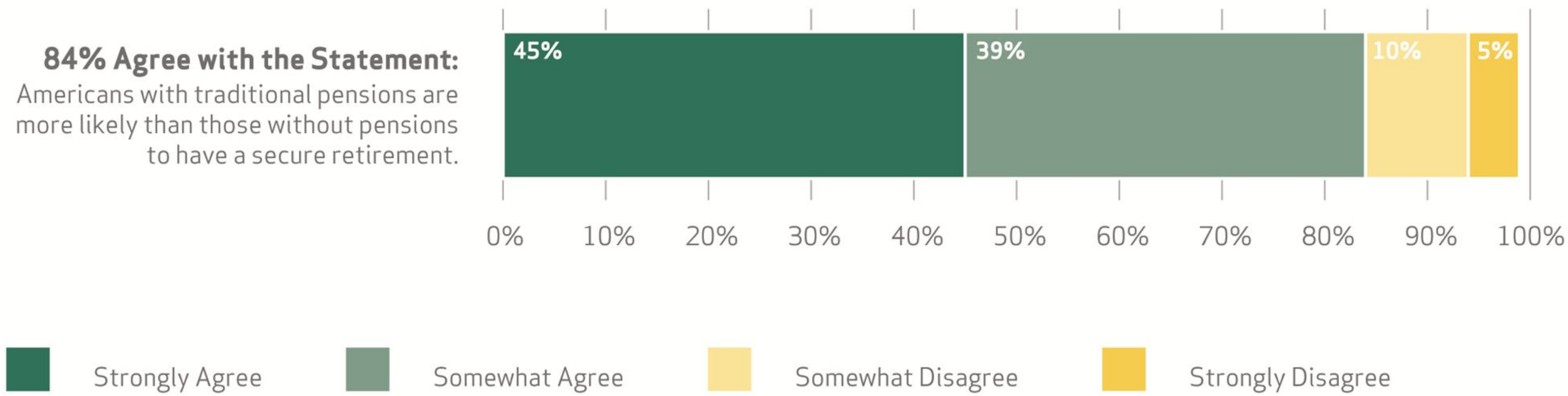
NATIONAL INSTITUTE ON Retirement Security

80% Agree Leaders Need to Give Retirement Higher Priority



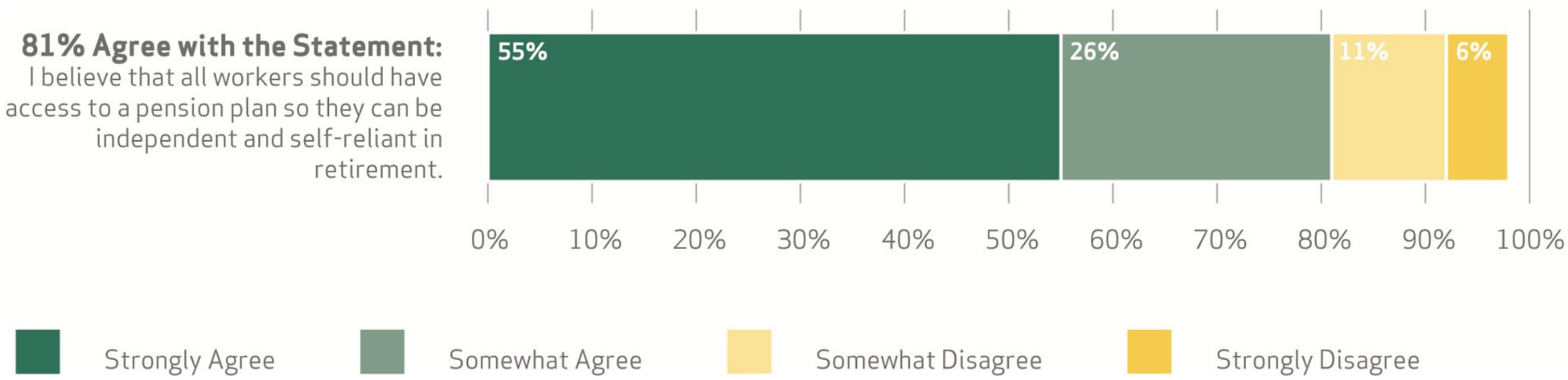
NATIONAL INSTITUTE ON Retirement Security

84% Agree Americans With Pensions More Likely to Have Retirement Security



NATIONAL INSTITUTE ON Retirement Security

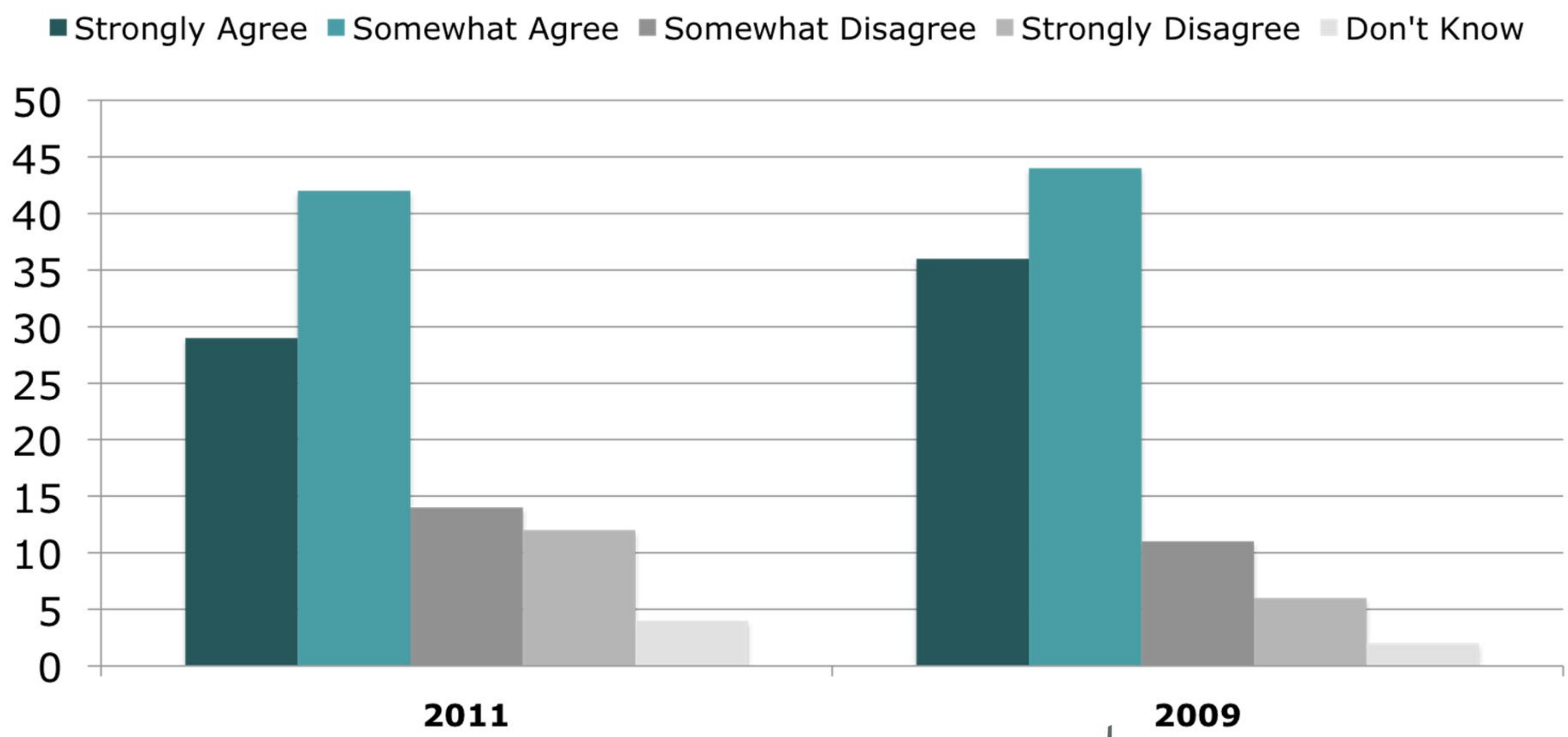
81% Say All Americans Need Pension For Independence, Self-Reliance



NATIONAL INSTITUTE ON
Retirement Security

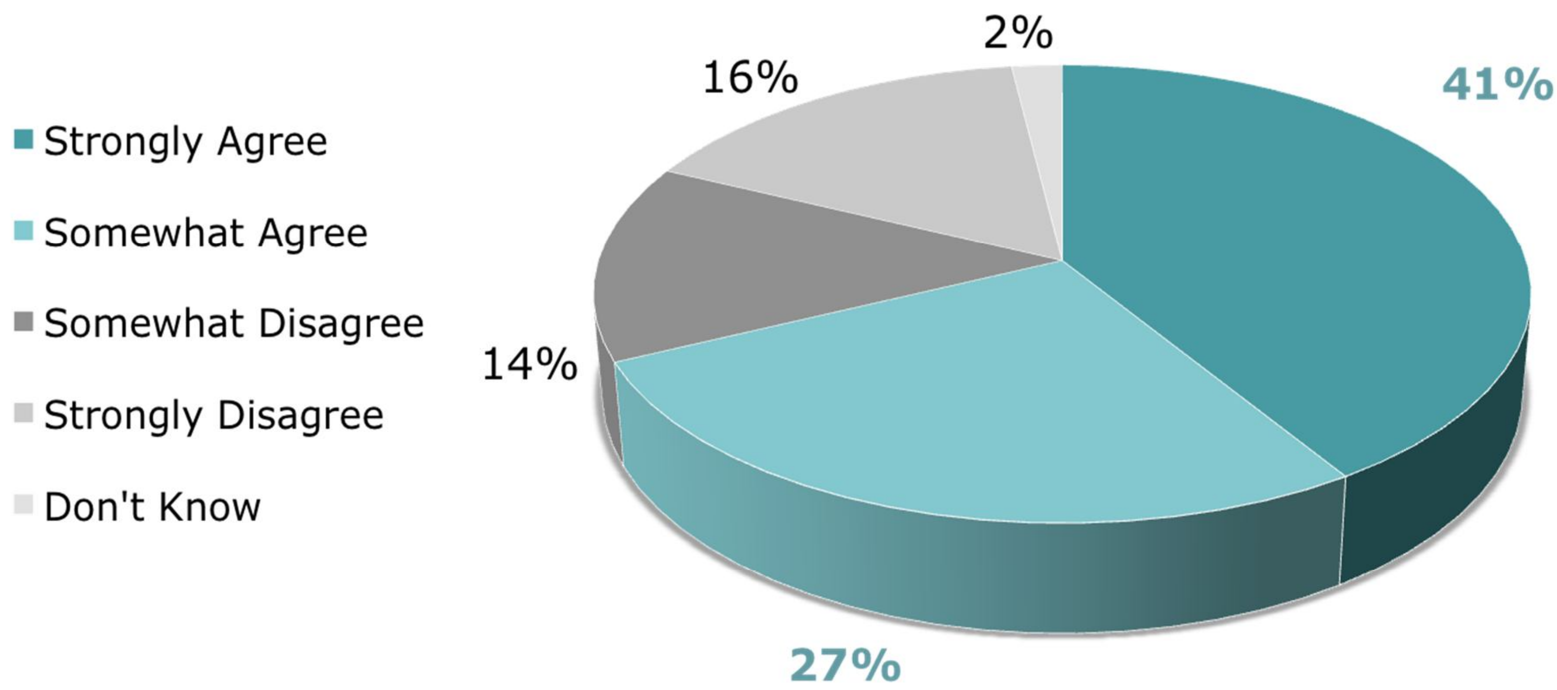
Knowledge of Employee Contributions Increases Support for Public Pensions

Public employees deserve benefits because they help finance cost from every paycheck. 71% Agree ('11), 70% Agree ('09)



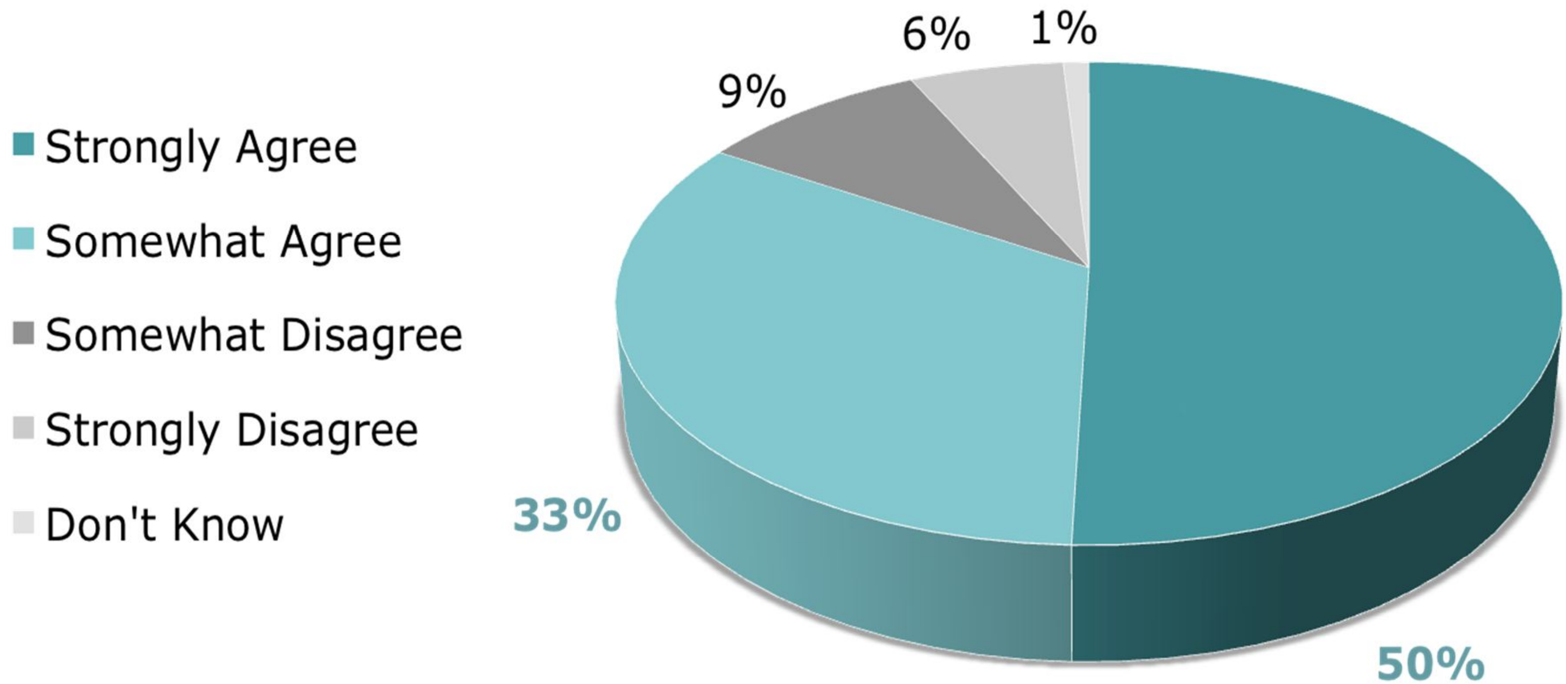
NATIONAL INSTITUTE ON
Retirement Security

68% Say Teachers Deserve Pensions To Compensate for Lower Pay



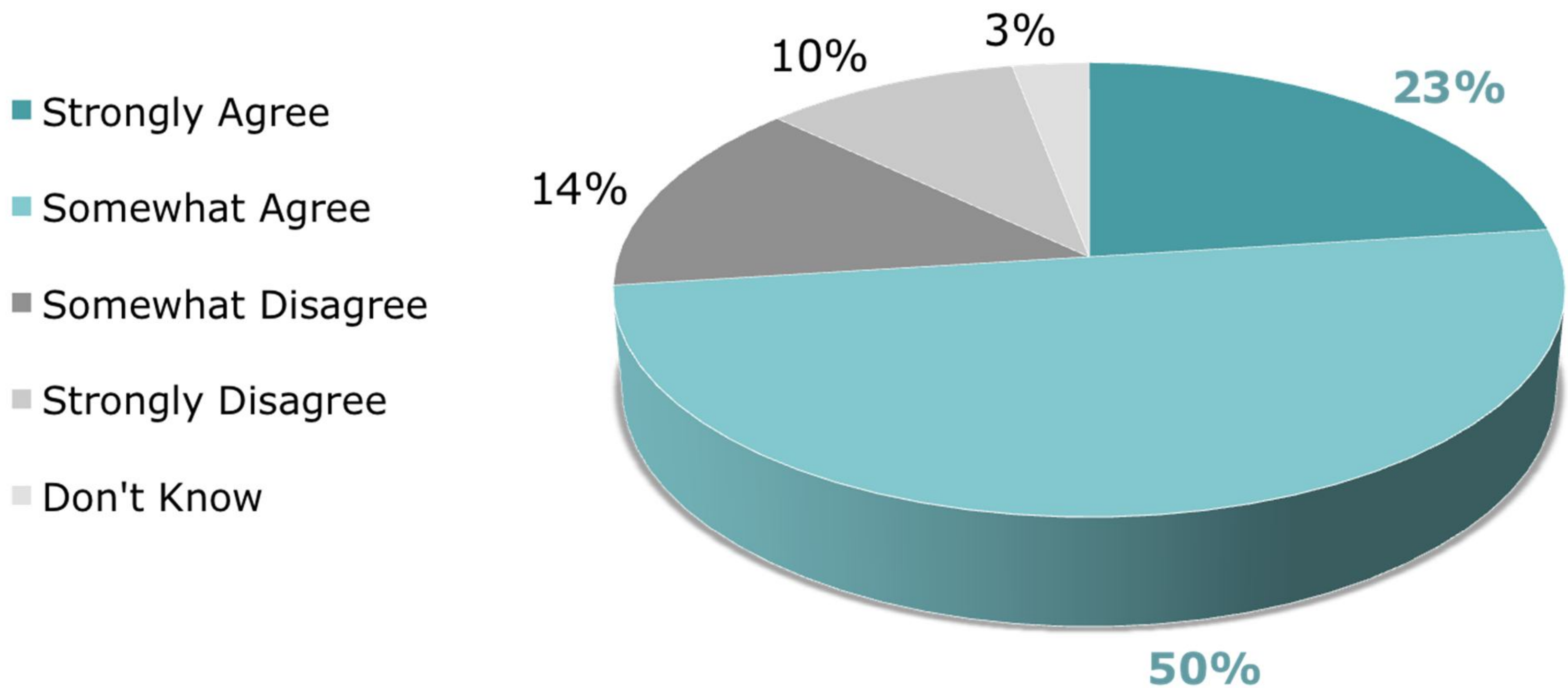
NATIONAL INSTITUTE ON Retirement Security

83% Say Police/Firefighters Deserve Pensions Because of Job Risks



NATIONAL INSTITUTE ON Retirement Security

73% Say States Should Sponsor Retirement Plans Small Employers/Individuals Can Join

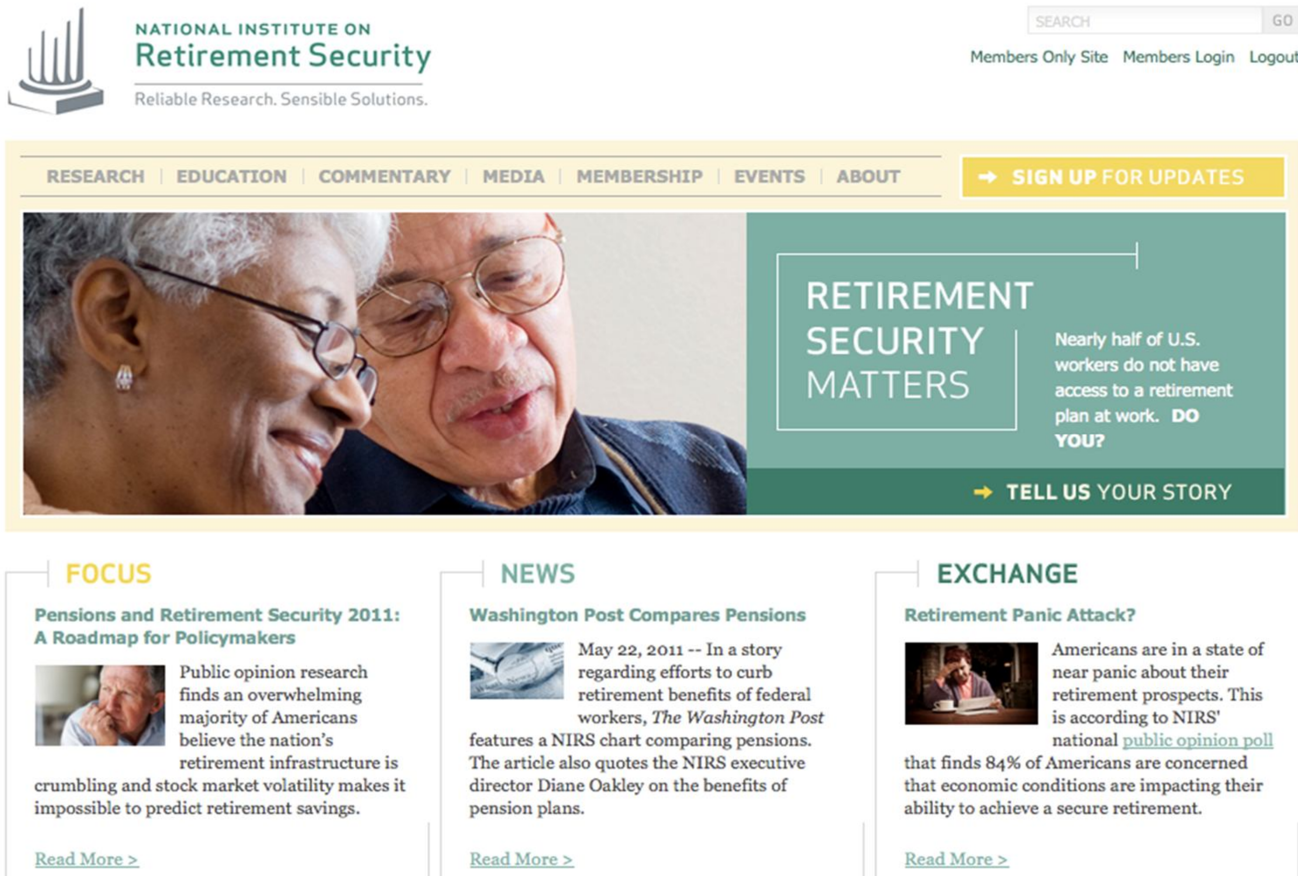


NATIONAL INSTITUTE ON
Retirement Security

Questions?

NATIONAL INSTITUTE ON
Retirement Security

www.nirsonline.org



Diane Oakley
202.457.8190
doakley@nirsonline.org

NATIONAL INSTITUTE ON
Retirement Security