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BGR Media Release

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BGR Cuts Paths for Pension Reform in the Metro Area

Today BGR releases *Reducing the Cost of Tomorrow: A Practical Guide to Pension Reform in Jefferson, Orleans and St. Tammany Parishes*. The report explores in detail the changes to public pension benefits policymakers can make to reduce the costs and risks associated with the pension plans. The report is the fourth installment in a series of BGR pension reports.

The report takes as a starting premise that public retirement plans should aim to strike a balance between the need to provide retirement benefits and the efficient use of taxpayer dollars. From 2009 to 2016, the public's pension plan costs increased for all but one of the 18 plans in which the governments in Jefferson, Orleans and St. Tammany parishes participate (the Plans). The City of New Orleans alone will put $105.5 million toward pension costs in 2016, almost all coming from its general fund. In fact, pensions absorb 16 cents of every dollar citizens send to the general fund – a pot of money that also must be used to pay for basic municipal services.

In many cases, these same citizens are helping to pay for public sector retirement benefits that are far more generous and secure than their own. In the eight-parish New Orleans area, roughly half of the private sector workers lack access to any form of employer-supported retirement plan.

Options to Reform Defined Benefit Plans

The vast majority of public employees nationwide participate in defined benefit plans, which provide retirees with a specified level of annual retirement income. Employer contributions, investment earnings and usually employee contributions fund defined benefit plans. Market declines, unfunded liabilities and poor funding decisions increase a public employer's pension cost. But there is another key driver of pension costs: the generosity of plan benefits.

This report looks at the factors that determine the generosity of a defined benefit plan and presents options to align the Plans with national medians and other norms. Policymakers can reduce the costs and risks associated with public pension plans by making the following changes:

- Require employees to contribute at least the national median – 6% for Social Security-Supplemented Plans and 8% for Unsupplemented Plans. Employee contribution rates should be set above the median for the more generous plans.
- Set multipliers – the rate at which retirement benefits accrue – no higher than the national medians, 1.9% for Supplemented Plans and 2.4% for Unsupplemented Plans.
- Consider implementing a longer final average compensation period and cap year-over-year salary increases for benefit calculation purposes at 10%.
- Establish benefit caps on a sliding scale based on an employee's pre-retirement income – generally targeting 70% income replacement from pension benefits in an Unsupplemented Plan, with higher replacement percentages attainable for employees at lower salaries. Implement an absolute cap on benefits to prevent excessive payments to the highest paid employees.
- Establish a fixed retirement age more in line with the normal retirement age under Social Security, currently 66 for employees born after 1943 and 67 for employees born after 1959. Establish a sliding scale reducing benefits for those who wish to retire early. Limited exceptions could be provided for public safety personnel.
- Eliminate publicly-funded cost of living adjustments; instead, allow employees to arrange the payment of their benefits in a manner that steps up over time.

- Eliminate deferred retirement options.

Alternative Plan Structures

Even if a defined benefit plan were aligned with the national medians for public pension plans, it would still produce a retirement benefit more generous than the benefit received by a private sector employee contributing the same amount toward retirement. A hypothetical public sector employee hired in 2016 at a starting salary of $40,000 could expect a 27% higher retirement benefit in a defined benefit plan supplemented by Social Security, and an 11% higher benefit in an unsupplemented plan.

Importantly, the risks associated with defined benefit plans remain squarely on the shoulders of the public. This has prompted some governments nationwide to switch to alternative plan designs. The report explores the following alternatives:

- *Defined contribution plans*, the predominant private-sector model, shift all of the risks associated with investments to employees. Government responsibility ends with its upfront contributions to employee retirement accounts.
- *Hybrid plans* combine defined contributions with a reduced defined benefit component so that employers and employees share in the risks.
- *Cash balance plans* function like defined contribution plans but provide a guaranteed minimum return – a floor – on employee contributions. This protects the employee while reducing, but not eliminating, the employer’s risk.

The report finds that the Plans in which local governments participate are more generous than national public sector medians in most respects. That generosity has contributed to ballooning costs – with employer contributions as high as 118% of total employee pay – threatening state and local government budgets. In other words, the cost of yesterday’s pension promises can diminish government’s ability to provide public services today and in the future. Both public employees and private citizens alike bear the cost of past generations’ pension excesses.

The report calls on policymakers to consider alternative pension plan designs that, in the long run, halt this generational cost transfer. These plan designs would shift some, if not all, risk away from public employers. While employees take on additional risk, they also would enjoy greater plan portability. Under a defined contribution or cash balance plan, changing jobs would not mean having to start saving for retirement all over again. These plan designs may also better reflect the evolving expectations and career patterns of the work force.

The report further states that, at a minimum, policymakers should pursue reforms to the existing defined benefit offerings to bring them to a more reasonable level. That implies lowering multipliers to at least the national public sector median, raising the minimum retirement age, eliminating perks such as lump sum payment programs, limiting the income replacement to a need-based percentage of an employee's salary, implementing a cap on benefits and leaving it to employees to self-fund cost of living adjustments.

BGR President Amy L. Glovinsky said government pension plans in the metro area generally are "in obvious need of reform."

"When you compare the Plans to national norms in both the public and private sectors, it becomes clear that the public is carrying significant costs and risks," Ms. Glovinsky said. "It's time to consider solutions that halt the intergenerational transfer of pension costs and bring retirement plans in line with 21st-century work force expectations."

The report and a one-page summary are available on BGR's website, www.bgr.org.

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