A Cautionary Tale on Pension Reform

Here in Florida we have thousands of educators, school, police, public and fire department employees who are enrolled in the Florida Retirement System (FRS) pension fund. A pension fund which is one of the best-funded in the country. When they retire, their pensions will help support the economic health of our communities and state.

However, there is a new bill in the Florida Senate, SB 84, that will remove choice and force new-hire state employees into 401(k)-type defined contribution (DC) plans. New hires will no longer be allowed to enter the (Defined Benefit or DB) pension fund. This a mistake that will likely cause taxpayer costs to skyrocket, as has happened in other states, and hurt Florida's ability to recruit and retain high quality teachers. Also, even if the amendment under discussion exempts police and fire department employees from the DB to DC switch, the future unavoidable erosion of the pension plans funds would erode their future pensions also.

It is important to note that education employees contribute 3% of their pay to their retirement fund from every paycheck. The Florida Retirement System's funding shortfall was primarily caused by legislators moving Florida Retirement pension fund dollars to the General Fund System in 2007-8. Legislator's used educator's retirement savings to balance Florida's budget. However, it was at the expense of the Florida Retirement System's Pension Fund. This money has not been fully returned to the educator's retirement plan, and now legislators are looking to weaken educator's financial security in retirement, with a costly DB to DC switch.

Other states have given proof of what pension reforms have and have not worked. Some states have implemented contribution rate changes or retirement age modifications.

One reform that has been avoided is shifting from pensions (DB) to 401(k) type DC plans. Why? Because EVERY time this has been implemented, taxpayer costs ballooned, and unfunded liabilities increased. Here are three examples:

- **In Alaska,** legislation was signed into law in 2005 to move new employees into 401(k) type DC plans. Then, the state faced an unfunded liability of $5.7 billion for its DB pension plans and retiree health care trust. The unfunded liability was the result of the state's failure to adequately fund pensions over time, stock market declines and actuarial errors. **The DB to DC switch was touted as a way to close the unfunded liability, but instead the total unfunded liability more than doubled** – to $12.4 billion by 2014. In 2014, the state made a $3 billion contribution to reduce the underfunding. Legislation has been introduced to move back to a DB pension plan.

- **In Michigan,** the DB pension plan was on strong footing – overfunded at 109% in 1997. The state closed the pension plan to new state employees in favor of 401(k) type DC plans. **The state thought it would save money with the switch, but the DB pension plan became significant underfunded following when the DB pension plan was closed**. By 2012, the funded status dropped to about 60% with $6.2 billion in unfunded liabilities. In recent years, the state has been more disciplined about funding the closed DB pension plan, making nearly 80% of the annual contribution from 2008-2013.

- **In West Virginia**, the state closed the teacher DB pension plan in 1991 to new employees to deal with the underfunding caused the state and school boards failure to make contributions to the DB pension plan. **Legislation was enacted to move back to the DB pension plan after a study found that providing equivalent benefits would be less expensive in the DB pension plan than in the 401(k) type DC plan**. By 2008, new teachers were again covered by the DB pension plan, and most teachers who were moved to the 401(k) type DC plan opted to return to the DB pension plan. After reopening the DB pension plan, the state was disciplined about catching up on past contributions, and the DB pension plan's funding level has increased by more than 100 percent since 2005. The teacher DB pension plan is on target to be fully funded by 2034.

As policymakers move forward, these past three case studies can serve as a cautionary tale. Clearly, closing a DB pension plan to new employees did not magically fill funding shortfalls. Instead, the switch had the opposite impact and increased costs to taxpayers.

States across the country realize that the best way to address unfunded liability is to responsibly fund the plan with full annual required contributions while evaluating assumptions and funding policies over time to make needed adjustments. Policymakers should take a closer look at the taxpayer impacts of a pension fund to investment plan switch.

Florida is already in a hiring crisis in education; SB 84 if passed, would make it worse. Moreover, we certainly cannot afford to lose teachers here in **Florida** to other states that offer sound retirement plans.

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