PASR
Pennsylvania Association of School Retirees

Retirement Security for All Pennsylvanians

Part 2: Expand PSERS' Mission to Serve ALL Pennsylvanians

By Richard C. Rowland, Executive Director

There *IS* a pension crisis in Pennsylvania. In fact, there is a pension crisis in every state of this nation. The true crisis lies not with the retirement benefits provided for public retirees, and funding of those benefits, but in the absence of retirement benefits for workers in the private sector. The greatest problems facing most Pennsylvanians in the private sector are: 1) they do not have access to an effective and cost-efficient means of accumulating sufficient savings to sustain themselves in retirement; and 2) they have no effective means of insuring that they will not outlive their incomes in retirement.

The public employee defined benefit pension plans in Pennsylvania have been working and accomplishing their missions of providing adequate retirement incomes for state and public school employees at a relatively low cost to Pennsylvania taxpayers for more than ninety years. The current funding challenges for these plans are real and have become heightened by the dramatic market declines in this current economic recession. But the fact of the matter is, these retirement plans remain well funded by all actuarial standards, having more than 80 percent of the assets required to pay all of their existing liabilities.

In our prior publication in this series, titled "Eliminate the Contribution Rate Spike," PASR has outlined some ideas for increasing employer (i.e. taxpayer) contributions to the retirement systems, which ultimately must occur, in a more gradual manner. The necessary increases in employer contributions need not occur in the form of a spike, a dramatic increase in rates from one fiscal year to the next, as the law currently requires will occur in 2012. The increases can and should be structured to occur over an extended period of time, so as not to precipitate the need for massive tax increases.

The public is frightened, and rightfully so, by media reports of looming massive tax hikes to sure up the public employee retirement plans. The public is also angered by the thought that they might be required to pay more in taxes to compensate for public employee pension benefits when they, the nonpublic employee taxpayers, do not have adequate retirement benefits for themselves.

The statistics are startling. Fewer than one in five Pennsylvanians today will receive a traditional pension when they retire, providing a guaranteed monthly source of income throughout their years in retirement. Most companies that offer any retirement benefits at all provide voluntary participation, defined contribution plans, most often known as 401(k) plans. In such plans, the employee contributes whatever he/she chooses and the employer typically provides a matching amount up to a certain percentage of salary and/or the amounts contributed by the employee. The employee bears total responsibility for determining how the contributions are invested, for managing disbursements from his/her account in retirement, and for paying all fees.

Originally, 401(k) plans were designed as vehicles for individuals to save for retirement and *supplement* their employer provided pensions and Social Security income. Instead, corporations that offer retirement benefits have moved to terminate their traditional pension plans and offer 401(k) as replacements for the pensions, to serve as the individuals' primary source of income in retirement with Social Security.

Less than half (43 percent) of Pennsylvanians have access to and/or elect to participate in 401(k) plans through their employers. The minority of citizens who have access to such plans from their employers are accumulating nowhere near enough to serve their needs in retirement. Pennsylvania's true crisis lies in the fact that individuals with 401(k) plans, who are nearing retirement at ages (55-64), have a median balance in their retirement savings accounts of nearly $40,000. And that was before the current recession hit and wiped away half of everyone's savings!

This "experiment" with 401(k) plans as a primary source of income for individuals in retirement has failed. Pennsylvanians, indeed all Americans, need a more effective, cost efficient, and secure means of saving and providing for their income needs in retirement. PASR is advocating that the state turn to what has proven successful—its public employee retirement plans, for solutions. **Consider allowing all citizens, on a voluntary basis, to invest their retirement savings with the Public School Employees Retirement System (PSERS) and give these citizens who choose to participate the option of converting their accumulated balances at retirement into a monthly annuity.**

What we are advocating, specifically, is that the state design and make available to the general public a hybrid plan that combines the features of defined contribution (DC) plans with the group investment and annuity features typical of defined benefit (DB) plans. Give the public, on a strictly voluntary participation basis, access to the superior investment expertise and performance demonstrated over the past 90 years by the same retirement system that serves our members, the Public School Employees' Retirement System (PSERS). Enable all citizens the opportunity to pool their savings for investment purposes, earn higher rates of return at less cost than they can on their own with individual 401(k) accounts, and convert their accumulated account balances at retirement into a guaranteed monthly annuity backed by the assets of the annuity fund.

Help *ALL* Pennsylvanians earn more on their investments, pay less, and realize greater savings for their retirements!

The National Institute on Retirement Security noted in a recent study ("A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans" available online at www.nirsonline.org) that defined benefit (DB) plans achieve higher rates of return over time, a full percentage point higher per year than typical 401(k) plans. The reason is that when investing on behalf of a large group of people, DB plans can assume an indefinite lifespan and continue to invest more aggressively than plans established for individuals. Also, individuals need to invest aggressively early in their careers (and earn higher rates of return), then shift to more secure investments (providing lower rates of return) as they get closer to and move into retirement.

This same study points out, as numerous other studies have as well, that the investment costs for DB plan are considerably lower than that charged by commercial entities providing 401(k) plans. This is because, again, in DB plans the individual contributions to the plan are pooled for investment and the costs associated with investing the contributions are shared by hundreds of thousands of plan participants. There are significant economies of scale achieved by DB plans, such that their costs to invest and manage the retirement savings of plan participants is one-fifth the amount that the 401(k) plan administrators are charging individual participants, at least a full percentage point lower per individual.

Earning just one percentage point more each year on investments and saving 1 percent per year in fees may not sound significant, but over a 40-year period of employment, the accumulated balance a person seeks to obtain at retirement can be secured with far less contributions from the individual during his/her working career. According to the NIRS study, the employee could obtain his/her target balance at retirement with a third less contributions during his/her career than what the employee would need to contribute to an individual 401(k) account.

Give ALL Pennsylvanians the opportunity to convert their accumulated balances at retirement into a monthly annuity!

Another highly significant advantage that DB plans provide is the ability to pool what is called “longevity risk,” which is the risk of a person outliving his/her retirement savings.

A fundamental problem with 401(k) plans is that individuals need to save more than what they are likely to need. They do so in order to insure that they do not outlive their savings, because no one knows how long they will live and must anticipate that he/she will live well beyond the average life expectancy.

In DB plans, the amount needed at retirement to insure that all participants never outlive the monthly annuities they draw from the annuity fund is based upon the average age and life expectancies of the persons participating in the fund. Individuals who pass away before the average age of life expectancy produce surpluses in the fund, which are then used to continue paying the monthly annuities to those who live beyond the expectancy.

Pooling very large numbers of people in an annuity fund eliminates longevity risk for all of the individual participants, and enables each individual to receive a higher monthly annuity with smaller balances in their accounts at retirement than the individuals can secure for themselves on their own.

Give ALL Pennsylvania businesses the opportunity to help their employees save for retirement!

As noted above, less than half of all Pennsylvania citizens have access to a retirement savings plan through their employers. A principal reason for this is that small business owners lack the capacity to identify, set up, and manage retirement savings plans for their employees.

PSERS is currently set up to collect, invest, and manage retirement contributions from the individual plan participants and the contributions made on behalf of the individuals by their multiple employers. Most small businesses in Pennsylvania will never be able to offer retirement savings plans to their employees. The administrative burdens are too great. Why not let an existing entity like PSERS handle the administrative burdens, and enable small business owners to simply contribute whatever amounts they might want to help their employees save for retirement?

This further reduces the expense of investing and administering the existing PSERS plan and save more taxpayer dollars!

The costs of investing the retirement contributions for public school employees, and for administering their annuities in retirement are already very low in comparison to the costs and fees charged to individual participants of 401(k) plans. These costs can be further reduced, saving PSERS' members and ultimately the taxpayers of Pennsylvania even greater amounts, by spreading the costs among an even greater number of participants.

Act now!

Ultimately, for citizens in the private sector, the benefits they will obtain for themselves in retirement will depend upon how much they and/or their employers are willing to set aside for investment during their working careers. The state cannot, nor should it dictate the amounts its citizens and/or their employers contribute to a retirement plan. The state cannot provide or guarantee a certain level of benefit in retirement for private citizens, as it can for its own employees.

The state can, however, help its citizens maximize the benefits derived from their contributions by giving them access to the investment expertise that it has in PSERS, and by giving them the opportunity to annuitize their accumulated balances at retirement through PSERS.

We urge the General Assembly to act now and seek to avert the real pension crisis that is looming in Pennsylvania. Direct PSERS to study, develop, and propose a plan to offer its professional investment services to all citizens and to give all citizens the ability to secure a monthly annuity based upon their accumulated balances at retirement.

Pennsylvania Association of School Retirees
878 Century Drive ■ Mechanicsburg, PA 17055
717-697-7077 ■ pasr@pasr.org ■ www.pasr.org