North Carolina Chapter
NC APWA
AMERICAN PUBLIC WORKS ASSOCIATION

June 14, 2010

Future of Retirement Study Commission
325 North Salisbury Street
Raleigh, N.C. 27603-1385

Dear Commission Members:

We want to first thank you for allowing us this opportunity to address the Commission. The American Public Works Association is an educational and professional association of public works employees dedicated to serving citizens while successfully constructing, managing and protecting public infrastructure. APWA provides a forum in which public works professionals can exchange knowledge and advance professional competence while promoting and improving the effectiveness of their local agencies. The North Carolina Chapter is made up of over 800 such professionals from across our great state.

After extensive review, we are providing the attached information, taken from core readings, meeting minutes, etc. along with input from our Retirement Study Task Force, that focus on the association's viewpoint of three Charter issues: 1) providing a system of managing risks, 2) giving control over retirement planning decisions to those best able to make those decisions, and 3) funding benefits in a sound manner through an appropriate mix of employee and employer contributions. We respectively request your consideration from the perspective of this attachment.

While consideration of a defined contribution (DC) plan has been a major discussion issue, core readings along with other information provided to the commission clearly indicate too many reasons why employees should not take on the risks of a defined contribution plan. However, with the Charter given, we would suggest a strong educational effort be coupled with a defined benefit/defined contribution hybrid. To provide flexibility for the varied age groups and their retirement goals, a new hire would initially be required to contribute to the DB plan, and within a year, with appropriate level education and advisory time, would be offered the opportunity to contribute to a voluntary DC plan. Current employees could also be treated the same, providing the option of a DC plan, only after appropriate education.

Additional information of note indicates (1) a DC plan does not solve funding problems, and (2) DC plans generally have higher investment and administrative expenses over DB plans. In addition, very little information is known about the Cash Balance Plan brought up at the May 10$^{th}$ meeting; therefore, our recommendation should be considered preliminary.

Lastly, we would request the opportunity to address the commission when the subject of GS 128-27(k) is to be discussed, an issue we understand was added to your agenda by the Board of Trustees at their January 21, 2010 meeting regarding cost of living adjustments.

The attached provides a wealth of information but is a little lengthy. We would, however, invite you to at least read the "Executive Summary", core reading sections which are in bold print.

Sincerely,

Gary Smith
President
APWA, NC

Cc: N. C. Retirement Systems Director Williamson
Policy Director David Vanderweide

# FORS Report, Core Backup information

During the January 25, 2010 Future of Retirement Study Commission (FORS) meeting, a statement was made that the commission's undertaking was sort of a 50 year review of the North Carolina Retirement Systems. First, we'd like to stress that there are several independent retirement programs, with the Teachers and State Employees Retirement System and the Local Government Employees Retirement system being the largest. Based on the number of employees who retired from the above two systems during 2009, the **recommendations the Future of Retirement Study Commission makes have the potential of impacting the retirement lives of more than 600,000 teachers, state and local government employees.** With the volume of information presented during the first five meetings and the volume of variables, we do not envy the Study Commission's position. If a new retirement benefit plan is determined to be required, multiple decisions must be made across numerous and diverse but interconnected dimensions.

## OPENING FACTS AND STATEMENTS

**Based on a study released on April 28, 2010** and commissioned by the Center for State and Local Government Excellence and the National Institute on Retirement Security, the following information is provided:
(The study provides an original analysis of data from the U.S. Bureau of Labor Statistics)

1) Jobs in the public sector typically require more education than private sector positions. Thus, state and local employees are twice as likely to hold a college degree or higher as compared to private sector employees. Only **23% of private sector employees have completed college as compared to about 48% in the public sector.** (This leaves over half of the government workforce with a high school diploma to work with, in a very complex financial world.)
2) Wages and salaries of state and local employees are lower than those for private sector employees with comparable earnings determinants such as education and work experience. **State workers typically earn 11% less and local workers 12% less than private sector employees.**
3) **During the last 15 years, the pay gap has grown** - earnings for state and local workers have generally declined relative to comparable private sector employees.
4**) Benefits make up a slightly larger share of compensation for the state and local sector**. But even after accounting for the value of retirement, healthcare, and other benefits, state and local employees earn less than private sector counterparts.

**On average, total compensation is 6.8% lower for state employees and 7.4% lower for local government employees than for comparable private sector employees.**

Some proponents of defined contribution plans in the public sector contend that they will be more attractive to new and younger workers who might value the portability of benefits. However, the data, as of the date of another report on Defined Benefit (DB)/Defined Contribution (DC) plans did not show a groundswell of enthusiasm. With the challenge of filling various local government vacancies during "normal" times, when unemployment rates are around 5%, if even a small percentage of workers prefer the features of a defined contribution plan, such as portability or perhaps more control over one's investments, offering some form of this type plan as an option could perhaps serve as a useful recruitment tool.
However, in 1964, the state of Nebraska adopted a defined contribution plan for its state and county workers. Investment returns as of 2002 were so much lower than for other government employees in a defined benefit plan, that the state replaced the defined contribution plan with a cash balance plan. Their cash balance plan is a defined benefit plan where assets are managed by the employer, but participants have separate accounts. The Nebraska experience confirmed what has been learned in the 401(k) experience in the private sector**- individuals find investing very difficult and generally do not do a very good job**.

## RISK MANAGEMENT

Based on the April 28, 2010 study referenced above, it would appear unwise to make retirement plan changes that add risk and/or additional responsibility to employees.

Investment risks involve non systematic risk which is the risk that a single investment will drop in value vs. having a well diversified portfolio of stocks and bonds, and can be handled by pooling. Systematic investment risk is the risk taken with a well diversified portfolio and is sometimes called market risk. It was noted that a preliminary vote on these issues is to be taken at a later date.
**Investors expect to be rewarded for taking on more systematic risks**. Under certain conditions, generally where an employee is well educated in financial investments, parties involved in a public pension plan may wish to bear systematic investment risks in order to get higher returns. **If their assets decline in value, they must make adjustments** in one, two, or all three of the following: 1) Plan to spend less in retirement, 2) plan to work longer, 3) spend less now and save more. In many cases, this results in negative impacts on immediate as well as short to long term financial plans.
From the Aon Ratio Replacement Study, **retirees w/o DB plans not only have to plan for their retirement but also to live off their account after retirement. Market lows and other uncertainties make planning withdrawals from defined contribution plans very challenging. As reported in another study, the distribution phase and the loss of longevity risk pooling in retirement is probably the most difficult obstacle for DC plans to overcome.**

There are 2 major factors to consider in managing inflation risks. They are the actual impact of inflation on retirement benefits and, perhaps just as important, is the cost of providing cost of living adjustments (COLA's). Currently, inflation is projected to be 2.5 – 3% over the next 10 - 30 years. It is important to note that retirees have fallen over 8% behind increases in the Consumer Price Index over the last 7 years.
Finally, if a new system is required, choices are needed where risk is shared, or better yet reduced, and adequate retirement benefits are provided at a reasonable cost.

## RETIREMENT PLANNING DECISIONS

An Aon study indicates a need for 76-89% of pre-retirement salary, with variation primarily depending on pre-retirement salary (the lower the salary, the higher the percentage, the higher the salary, the lower the percentage).
**At the February 22 FORS meeting**, 70% of the commission members indicated the target replacement rate (retirement benefit/pre-retirement salary) should be 80-90%. In addition, **80% of the commission members indicated COLA's should be the same or greater than increases in the Consumer Price Index.**

The right retirement incentives include job attraction and the desire to stay with the agency (retention). **Core reading indicates pension plans do not play a significant role in attracting workers, but as they age, pension plans play a larger role in retaining employees. Coverage by a DB plan raises tenure by 4 years** as compared to no pension**. Under a combined DB/DC plan, tenure goes up 5.8 years** while **under a sole DC plan, tenure increases by only 2.7 years**. From the University of North Carolina presentation on April 19, 2010, we must remain competitive, and it would be advisable to provide the younger generation some measure of portability. However, again from the core reading, it has been shown that **there is a reduction in average tenure for U.S. employees related to the shift from DB plans to DC plans, implying that the portability of DC plans increases worker turnover.**

## EMPLOYEE/EMPLOYER CONTRIBUTION DECISIONS

Per Dr. Clark, **North Carolina's Defined Benefit multiplier is slightly below the national average while the employee contribution rate is above average.**

The May 10 FORS meeting presented participant decision making with 3 of the 4 alternative viewpoints being reasonable. View B spoke to education and guidance. With APWA being an educational association, we strongly support this view; however, we do not agree with this alternative being sufficient (even if the program were similar to Weyerhaeuser's) for our current 450,000+ employees to enter the financial field with the idea of creating a diversified portfolio which would meet financial needs. Ever changing market conditions and withdrawals after leaving employment (almost 50% withdraw from 401(k) plans, defeating the whole purpose of retirement planning) are 2 major factors against employees taking on the risks associated with a defined contribution plan. Core readings along with other information provided the commission clearly indicate too many reasons why employees should not take on the risks of a defined contribution plan. **Based on the information available thusfar, we recommend, preliminarily, consideration be given to the following: If view B were coupled with a combination of views, C (default choices) and D (mandatory benefits), a workable plan <u>may</u> be possible. The suggestion is the employee would first enroll in the mandatory plan and later, once sufficient education is achieved and with assistance from an advisor, the defined contribution plan could be <u>added</u> only if the employee desired, and as much as a year later. The percentage contribution in each of the two plans would be up to the employee. This defined benefit/defined contribution hybrid plan would give maximum flexibility to the varied generations of employees, whether they are young or old, like to change jobs or stay put, or are well educated in investment finance or not. "Do overs" are also considered important for those who need to reverse a bad decision or have major life changes requiring retirement plan modifications.** Lastly, as stated in President Smith's letter, **more information on the cash balance plan is needed** before a final recommendation can be made.

## <u>OTHER CORE/CRITICAL ISSUES</u>

A study conducted by the Center for Retirement Research at Boston College, dated January, 2008 is entitled "Why Have Some States Introduced Defined Contribution Plans"? As of the time of the report, **within the last decade, only twelve states had adopted some form of a Defined Contribution Plan**. Two states mandated the Defined Contribution Plan for all new hires, two mandated participation in both a defined benefit and defined contribution plan, while **the remaining eight (67%) offered the defined contribution plan as an option. At that time there was a flurry of activity towards defined contribution plans, with**, after study by the authors, **the most important explanation turning out to be political rather than economic.** States where the governor and the majority of the legislature were republican were the ones most likely to introduce a defined contribution plan.

**North Carolina and local government employers must** continue to maintain competitiveness through their total compensation program and **recognize their employees are their most valuable asset.**

It is interesting to note that for any given level of benefits, **<u>defined contribution plans generally have higher investment and administrative expenses than defined benefit plans</u>**. As of 2006, administrative costs for public defined benefit plans was 0.3%, while the same costs for both public and private defined contribution plans was 1.1%.

**Thank you for reading this far!** In closing, we'd like to provide the following item of interest. According to a study that AARP printed the results of in their Jan.-Feb. 2010 "Bulletin", in 2008 S&P 500 companies that had pension plans provided their top executives with $44.5 Billion in stock grants and options. For all the rest of their employees, they contributed just $39.5 Billion to the pension funds. We are proud to say we serve the public without worry over profits and the morale deflating ways they are sometimes spent.