Pensions & Public Workforce Recruitment/Retention

Retirement Plan Preferences of Public Employees

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Unfunded pension liabilities are the largest liability for state governments in the U.S.

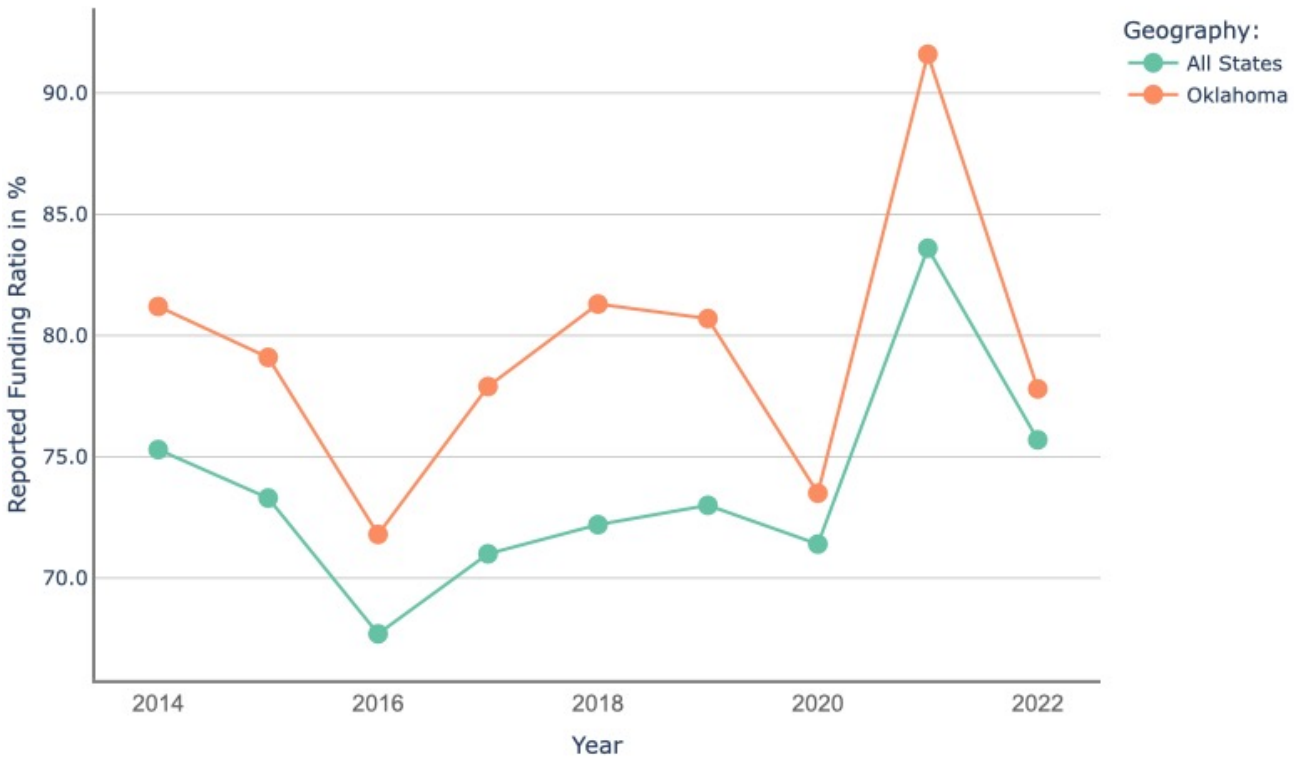
Pension Liabilities:

- Reported unfunded pension liabilities of 1.30 trillion USD, market value: 4.26 trillion USD as of Q2 2022 (Giesecke, Rauh (2024))
- Even larger than debt obligations in the municipal debt market which are approximately $1.2 trillion USD (Giesecke (2023))

Pension Cost:

- Ongoing average pension cost (service cost) of 22.5% of payroll (Giesecke, Rauh (2024)).
- For every $1 of payroll, states are required to make, on average, $22.5c in pension contributions. This compares to appr. 5% in the private sector.

How does Oklahoma compare?



Analysis includes Oklahoma Firefighters Pension and Retirement System, Oklahoma Police Pension and Retirement System, Oklahoma Teachers Retirement System, Oklahoma Law Enforcement Retirement System, Oklahoma Public Employees Retirement Plan, Uniform Retirement System for Justices & Judges

Source: https://publicpension.stanford.edu/

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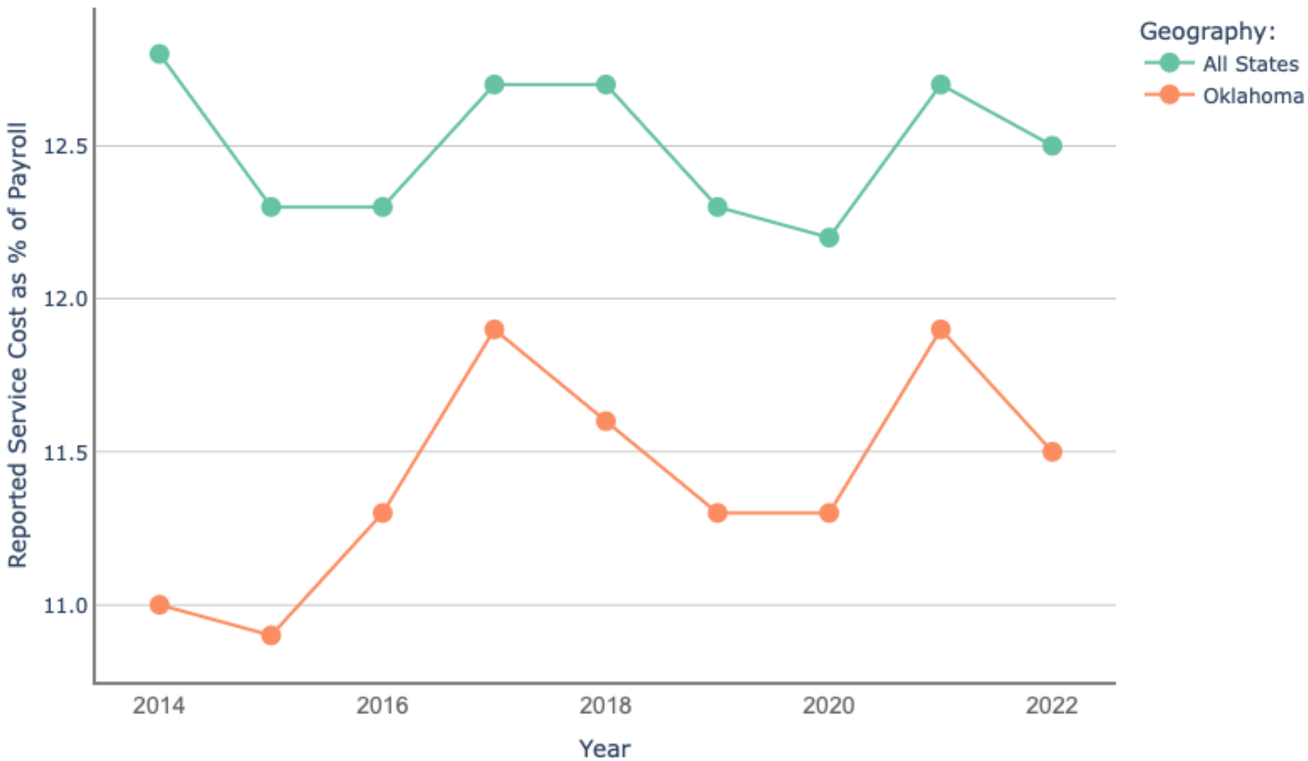

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Employer economics of DC vs DB plan are fundamentally different

Employer Cost of DB Plan:

- Ongoing pension cost (service cost) which is the present value of newly accrued benefits.
- Amortization of unfunded liabilities

➢ Employer carries the investment risk

Employer Cost of DC Plan:

- Basic (unconditional) percent of payroll
- Employer match as % of payroll
- E.g.: Oklahoma Pathfinder Plan: 6% employer contribution; 1% conditional match

➢ Employee carries investment risk; employer faces predictable pension cost

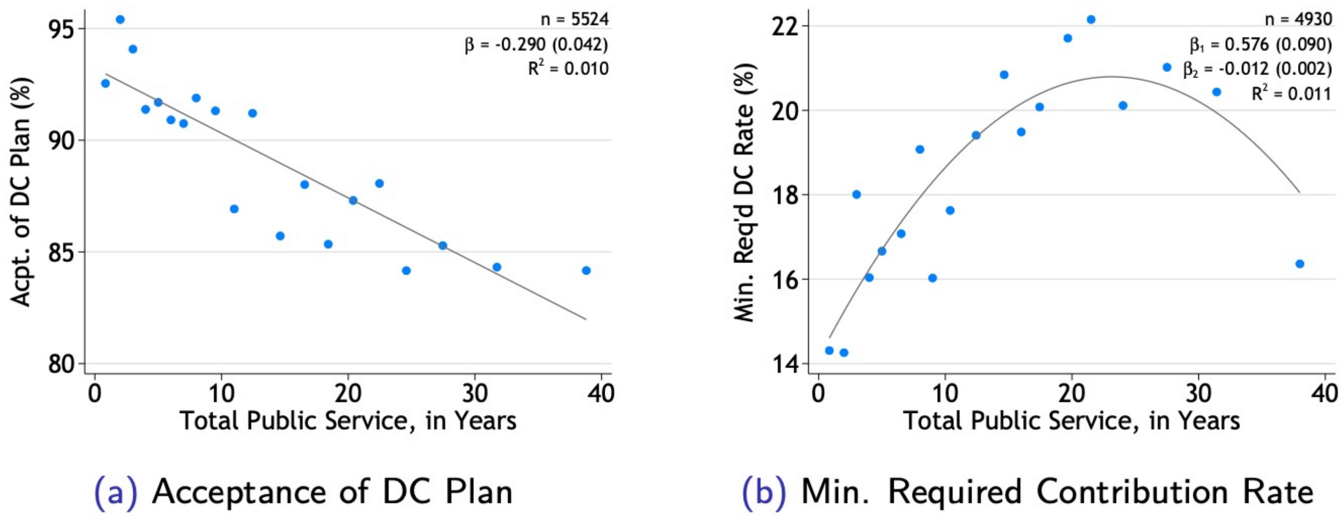
Recent survey evidence suggests that public employees are open to DC plans

- Giesecke and Rauh (2022) conduct large-scale survey across 16 states in the United States.
- The survey asks public employees of school districts, local and state governments in the United States about their retirement plan preferences.
- Key questions are about willingness to forgo future DB accruals in favor of a DC plan.

Results:

- About **89.2% accept DC plan** in lieu of a DB plan for future accruals at some % contribution level
- Median respondent willing to forgo future DB accruals in exchange for a DC plan with contribution rate of **10.0% as of payroll**

New employee accept DC plans at higher rate and require lower contribution rate



Source: Giesecke, Rauh (2022), "How Much Do Public Employees Value Defined Benefit versus Defined Contribution Retirement Benefits?", Figure 4

- Young employees have the highest acceptance rate of DC plans and require the lowest contribution rate to DC plan
- Acceptance Rate > 80% for employees with ≥ 30 years

Other contractual dimensions differ between DB and DC plan

- **Fixed annuitization of DB plans.** Division between take-home pay and pension benefits predetermined. This may not align with employee preferences. The fixed division of compensation is particularly burdensome for young employees who are liquidity constraint (Fuchsman, McGee, and Zamarro (2023); MissionSquareResearch Institute (2022); Brown and Weisbenner (2015); Cole and Taska (2022))
- **DB plans offer little discretion about investment decisions.** Employees who value flexibility in their investment decisions may accept lower contributions in exchange for the ability to allocate their assets based on their preferences (Beshears, Choi, Laibson, Madrian, and Zeldes (2014)).
- **Portability of pension benefits** is very limited for DB plans. This is important for young employees who prefer a more flexible career path (Cocco and Lopes (2011)).
- **Long vesting periods.** Average minimum vesting period for a state-defined benefit pension plan is 6.9 years (Equable (2022). 62% of public workers leave before vesting in their pensions (Reason (2024))

DB plans have mixed incentives for retention

- Convex accrual pattern (up to a point) makes staying with one employer attractive. For example: An employee with 2x 15-year employment spells receives lower benefits than an employee with 30 years at the same employer => penalty for mobility
- Milestones (e.g. “Rule of 55”) provide incentives to retire early
- Vesting periods are not effective in retaining employees. No change of retention rates at vesting cutoff (Reason (2024))

Conclusion

- Fiscal commitment between DB and DC differs significantly. DC plans provide a transparent and predictable alternative to conventional DB plans. DB plans pose risks of accumulating large unfunded liabilities.
- Survey evidence suggests that DC plans are particularly attractive to new employees. Other contractual dimensions of DC plans are important to new employees. DC plans may actually help to attract employees.
- Evidence about the incentives for retention of DB plans is mixed. The impact of DC plans on retention is unclear due to limited data (these plans have limited history).

Question?

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