



# Retirement News Highlights

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## Public sector employees don't seem aware of major pension reforms over the last decade

*Particularly new hires, whose defined benefit plans are likely to be less generous than their longer-tenured co-workers, are not preparing adequately for retirement, says report.*

By Scott Wooldridge

**Benefits Pro**

October 17, 2022

Most public sector workers in the U.S. have seen their retirement benefit packages change but appear not to have changed their spending and saving behavior to fit these new retirement saving strategies, a new study has found.

The findings were published in a new study by the Public Retirement Research Lab and J.P. Morgan Asset Management. The Public Retirement Research Lab (PRRL) is an industry-sponsored collaborative effort of the Employee Benefit Research Institute (EBRI) and the National Association of Government Defined Contribution Administrators (NAGDCA).

Officials with the groups said the study shows that many in the public sector have not adapted to a pension landscape that has evolved in recent years.

“It appears that households with public sector employees participating in a defined contribution (DC) plan whose primary employer-sponsored retirement plan is a defined benefit (DB) plan feel more comfortable spending than those whose primary employer-sponsored retirement plan is not a DB plan,” says Craig Copeland, EBRI Wealth Benefits Research Director. “This comfort level may be short-sighted for households with newly hired public sector employees, as the generosity of the DB plan is likely to be less than what it is for longer tenured employees or was for retired individuals. As a result, the households with new hires may not be preparing adequately for retirement.”

### A changing landscape

Since the recession of 2008–2009, states have made many reforms to the pension plans offered to public sector workers. More than a decade ago, in 2010 and 2011, a total of 45 states enacted major pension reforms in this area, the researchers noted. Workers did not come out ahead with these changes. The report's authors said that there are estimates that newly hired workers who end up having

30 years of tenure would have an average reduction in benefits of 7.5% relative to those hired before the changes.

“As a result of these structural changes, newly hired public-sector employees’ benefits will often be different (lower in most cases when different) than their longer-tenured colleagues’. In addition, the presence of DC plans allows these employees to save on a tax-preferred basis to supplement their DB plan,” the report said. “Therefore, it would be expected that public-sector employees under newly reformed retirement plan regimes would have spending and saving behaviors that differ from those of public-sector employees under the older and, typically, more generous benefit regimes.”

## Key findings

The study listed a number of key findings, which include:

- Households with a primary defined DB plan spend more than households with a hybrid or primary DC plan.
- Public sector households are, at the median, spending at or above their net income.
- Savings rates in DC plans are correlated with the type of primary employer-sponsored plan (e.g., defined benefit, defined contribution, or hybrid).
- Households with employees with a primary employer-sponsored DB plan are less likely to contribute to a DC plan.
- The presence or absence of Social Security coverage appears not to have an impact on spending behavior.

The study concludes by saying the public-sector employees could benefit from more education about retirement plan offerings, especially newer employees. Financial wellness or similar programs would be beneficial to helping employees understand how the benefit plan structure can impact spending now and, in the future, and the potential need to save more.

“These research findings point to the importance of public sector employees understanding their retirement benefits package holistically to make an informed decision about spending and saving in order to achieve retirement success,” says Kelly Hahn, defined contribution strategist at J.P. Morgan Asset Management. “Plan sponsors have an important role to play here, by helping their employees understand the generosity of their DB plan and any lack that may need to be addressed through the use of a DC plan.”

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## How Pension Plans Evolved Out of the Great Financial Crisis

*Despite the recession and subsequent loss of assets value, pensions plans continued to pay out over a trillion dollars in benefits to stakeholders over the recessionary era.*

By Dusty Hagedorn

**Chief Investment Officer**

October 17, 2022

Public pension funds were not spared from the carnage of the Great Financial Crisis, as assets and funding statuses eroded between December 2007 and June 2009. From 2009-2013, there was a significant dip in the aggregate percentage of required contributions paid. When the economy recovered, states and other plan sponsors normalized their contribution levels.

A recent webinar held by the National Institute on Retirement Security, in conjunction with consulting firm Segal and Lazard Asset Management, reviewed *Recession*, “which examines how public retirement plans weathered the period’s market and made subsequent changes to public pension funds to ensure their long-term sustainability.

Most plans recovered their losses between 2011 and 2014, three to six years after the market bottom. Despite the recession and subsequent loss of value, plans continued to pay out over a trillion dollars in benefits to subscribers during the period.

Todd Tauzer, vice president at Segal, says that since 2008, the models and risk assessment strategies of public plans have evolved greatly. Tauzer says, “funding status alone does not indicate health of a public pension, after all, one cannot see the underlying assumptions used. A plan’s funding status can be measured in many different ways, and the ways we measure can change over time.”

“Plans today are on a much stronger measurement of liability than they were 15 years ago,” according to Tauzer. Adjustments to the assumption of the models in mortality, the assumed rate of return, general population counts, and the assumed rate of inflation are a few of the assumptions modified which give greater clarity into pension health post-GFC.

The adjusted model assumptions made in the past 15 years, see that public pension funds are more conservative in their actuarial book-keeping than they were prior to the Great Recession. “For many of the plans, we find that the assumption changes are what makes up a large portion of unfunded liabilities,” he says. Typically assumptions have a much larger impact than investment gains and losses on overall funding status, Tauzer says.

In addition to adjusting assumptions in models, since 2009, plans have moved toward a shortening of amortization periods. Prior to 2009, over 70% of plans utilized a 30-year amortization schedule. These changes help to decrease unfunded liabilities, helping plans arrive at, or approach, full funding status.

In 2008, before the GFC, the median assumed investment return was a bit above 8%, whereas today the median investment assumption return is 7%. According to Tauzer, “plans have used the past 10 years of recovery and equity growth to introduce more conservative assumptions to their models.”

Over the same period innovations to plan actuarial accounting had been enacted, plans performed positively in the era following the GFC, capturing alpha while weighting the risk of the overall portfolio. Ron Temple, managing director at Lazard Asset Management, says that “pension plans have delivered for their stakeholders very well over the past decade, and this goes underappreciated altogether.”

Temple emphasized that the recent performance of plans, following through with assumed rate of returns and benefits being paid out, has been due to great professional management in the sector.

Dating back to the 1970s and 1980s, the investing environment was vastly different; U.S. Treasury bond yields were above 10%. Back then, to get an 8% annual return did not take much thinking outside of fixed income and public equities. Temple explains, “until the TMT (tech, media, telecom) bubble burst in

2000, there was no reason for public pensions to allocate money into private equity or hedge funds. It was in this era where public plans began to change how they allocate their assets.”

Since the GFC, plan allocations have shifted away from 80% of assets being invested in public equity and fixed income, to only about 70%. Indicating that since the GFC, public funds have shifted towards alternatives including private equity, real estate, hedge funds, cash, and commodities.

“Private equity is a levered play on equity markets, with a trade-off being higher risk and higher return potential but with less liquidity,” Temple explained. “In the past 30 years, there has been a greater shift [to allocate] to private equity, which is usually not accounted on a mark-to-market basis like public equities. Plans like private equity investments due to private equity holding value, while public equity value fluctuates.”

Graphs presented during the webinar showed that total assets of U.S. state and local pension plans have doubled since 2009. Temple commented on the success of professional management saying, “we saw equities rally 113% from the lows in 2009. From 2009 to 2015, plans allocated away from public equities to other asset classes, moving their gains, selling high and buying low, [and by doing so] serving their stakeholders very well.”

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