Local governments have faced fiscal pressures over the past decade, often exacerbated by higher pension and health care costs. They have made significant changes to their benefits, especially for new hires, and have increased employee and employer contributions to their pension and health care plans.

While defined-benefit pensions are still the norm for local government employees, they have become less generous for new hires. When retiree health insurance is offered, it has become more common for governments to shift retirees to Medicare when they become eligible. Governments also have increased deductibles and copayments for both active and retired employees. In order to have an adequate retirement income, it is important for employees to boost their retirement savings.

Values Drive Long-Term Trends
There have been pendulum swings in our society’s approach to retirement security, according to Dallas Salisbury, president and chief executive officer, EBRI, who spoke at the June 2015 Retirement Security Summit held by the Center for State and Local Government Excellence (SLGE) in Washington, D.C. (http://slge.org/events/retirement-security-summit-the-evolving-social-contract-video-and-presentations).

“From 1933–1980, defined-benefit plans and social insurance were seen as good public policy,” Salisbury said. “An individual’s health and financial well-being fit into President Roosevelt’s New Deal vision that established Social Security, as well as President Johnson’s Great Society push that established Medicare.” Salisbury characterized the era from 1980 to the present as one where the values of individual liberty and choice gained more traction. With the election of President Reagan in 1980, reducing taxes was a priority and the privatization of Social Security was first discussed. This era ushered in a movement toward defined-contribution plans and away from social insurance programs.

As employers grapple with retirement security issues today, they face competing objectives. Is the goal retirement income or portable savings? Should the employer focus on retirement income adequacy for long-service workers or instead, put aside a percentage of pay toward retirement for all workers? Should the employer bear the risk for market fluctuations or should the employee bear the risk? Or both?

Salisbury explained that EBRI did a study for CalPERS to model what the costs would be to shift to a defined-benefit plan with a defined-contribution component. The study found that it would require 16.2 percent of pay every pay period for 40 years to achieve the same outcome as the existing defined-benefit plan, using the same investment assumptions.

If the objective is to provide every employee a percentage of pay, regardless
of years worked, decisionmakers come to different conclusions. This approach led the state of Kentucky to move from a defined-benefit plan to a cash-balance plan, Salisbury said.

With more modest defined-benefit pensions in the public sector and relatively small defined-contribution savings in the private sector for lower and middle income workers, the importance of Social Security as part of the nation’s retirement system grows, Salisbury noted.

Some 25 to 30 percent of state and local governments are outside of Social Security, so the income from those pension plans and other savings becomes central to retirement security for those workers. “If Social Security is not stabilized, then there will be significant challenges for the public and private sector,” Salisbury observed.

And while private sector employees have become increasingly comfortable with a primary defined-contribution plan, public sector employees still prefer a defined-benefit retirement plan by a ratio of five to one, according to a March 2015 EBRI poll. The survey found that two out of every 10 employees left their job or accepted a new job because of the benefits offered.

“Benefit packages are always important to recruiting,” noted Salisbury. Public and private employees rated health insurance as the most important factor, followed by a retirement plan.

**Pension Funding**

Recognizing the importance of a competitive benefits package, local and state governments have taken steps to shore up, to contain costs, or to make changes in the design of their pension plans, thus reducing costs and employer risks. While the media has focused considerable attention on defined-benefit pension plan funding, many government and financial analysts would argue that health care costs pose the greater long-term challenge.

After the sharp decline in pension assets in 2009 due to the economic downturn, most governments have increased employee and employer contributions, reduced the benefit for new hires, and increased the retirement age or years required to vest in a plan. A few changed the cost of living adjustment (COLA) and some shifted to a hybrid plan, combining elements of a defined-benefit (DB) plan with those of a defined-contribution (DC) plan.

All of the hybrid plans—whether cash-balance or DB plus DC—have these core features: pooled assets invested by professionals, shared financing between employees and employers, and mandatory participation. The benefit cannot be outlived, and there are survivor and disability protections.

Generally speaking, pension plans that consistently have received their full annual required contribution show improved funded status. In 2014, 31 percent of state and local pension plans were 80 to 99 percent funded compared with 27 percent in 2013.

**Saving for Retirement: What Works?**

Because newer hires will need to work longer and save more to reach their retirement income goals, what can local governments do to make it easier for them to save?

Behavioral economists have offered automatic enrollment to their government made any changes to the health benefits you offer to your employees and retirees? (n = 332)

![FIGURE 1: Distribution of State and Local Pension Plan Funded Ratios.](image1)

**FIGURE 2: Health Care Plan Changes.**

*Over the past year, has your government made any changes to the health benefits you offer to your employees and retirees? (n = 332)*

![FIGURE 2: Health Care Plan Changes.](image2)

do to make it easier for them to save?

Inertia is a big part of the savings problem. Behavioral economists have found that an effective savings nudge is to automatically enroll people in a retirement savings plan. Instead of having to make an effort to sign up for the organization’s deferred-compensation savings plan, the employee is automatically enrolled and has to take action to opt out of the plan.

While automatic enrollment has worked well in the private sector, local and state governments have been slow to adopt it. Some government leaders worry that their employees might object to automatic enrollment or that they can’t afford to save.

SLGE partnered with researchers at the University of Georgia to examine the challenges that governments face in offering automatic enrollment to their employees, including legal constraints, perception, labor concerns, and administrative challenges.

Although only 11 states permit automatic enrollment for public sector defined-contribution plans, a few places have found a way forward. The Missouri State Deferred Compensation Plan, for example, uses automatic enrollment for state employees hired after January 1, 2012.

Multnomah County, Oregon, also was able to set up automatic enrollment in its supplemental deferred-compensation plan for new hires because the state’s anti-garnishment statues allowed automatic enrollment if approved in a labor contract.

Why did labor leaders support automatic enrollment in Multnomah County? A key reason was that the county had moved new employees into a hybrid pension plan in 2003, yet few of the union members were participating in the county’s 457(b) plan.

Recognizing the consequences of insufficient retirement savings when those newer hires reached retirement age, the union agreed during negotiations that automatic enrollment would apply to new unionized employees with the option available to others. Most employees who were automatically enrolled have stayed in the savings plan, rather than opting out.1

Similarly, the city of Los Angeles, California, has determined that automatic enrollment programs can be established as long as they are negotiated and included in collective bargaining agreements. Speaking at the 2015 Retirement Security Summit, Steve Montagna, chief personnel analyst, Los Angeles, raised the provocative question, “What should the retirement income goal be?”

After careful consideration of this question, Los Angeles came up with the concept of “lifestyle income replacement,” which is equal to 100 percent of income after adjusting for pension, savings, and Medicare deductions.

The city also created a retirement income calculator that allows participants to see what the gap is between their pension income and their lifestyle income goal. This information can help participants make better-informed decisions regarding their retirement savings strategies.

Preliminary data from participants show that they are making gradual increases in their supplemental savings plan as they gain more years of experience. Most participants start out contributing 5 percent of pay to savings and increase that amount to 9 or 10 percent of pay after 30 years of service.

Reflecting on the goal of 100 percent lifestyle income replacement, Gerri Madrid Davis, director, Financial Security & Consumer Affairs, AARP, remarked, “This is a blockbuster. More people are retiring with a great deal of debt so this [100 percent income replacement goal] is earth-shattering.”

Employees will need to adjust their retirement income replacement goals to match their personal financial reality if they want to maintain their standard of living. Local governments can help them reach their retirement goals by giving them the information, tools, and incentives so they can save what they will need.

ENDNOTE


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