Public Pensions Still Need a Long-Term Fix

LB533, which made several changes to the retirement funds for school employees, judges, and the Nebraska State Patrol, was Governor Heineman's first veto, and the Legislature's first veto override, during the 2013 legislative session.[1]

Specifically, LB533 creates a reduced tier of benefits for school employees, including those at Class V schools, hired on or after July 1, 2013. Those employees will have a final salary estimate averaged over a five year period instead of three, and a maximum cost of living adjustment (COLA) of 1 instead of 2.5 percent (1.5 percent for Class V schools). The school employee contribution rate also remains at 9.78 percent and eliminates the previous 2017 sunset while increasing the state contribution rate from 1 to 2 percent beginning on July 1, 2014 (the contribution rate for Class V employees is 1.5 percent). Similarly, the sun-setting provision for the school budget and lid exclusions for expenditures above the employer contribution rate of 7.35 percent (7.37 percent for Class V schools) would also be eliminated. Additionally, eligibility for membership in the system was raised from 15 hours per week to 20. Finally, starting July 1, 2013, amortization-the process of accounting for an amount for a period of time-will also change from a level dollar to a level percent of pay for school employees, Class V school employees, Nebraska state patrol personnel, and judges.[2]

Supporters and opponents of the bill note it is little more than a short-term fix. For instance, while Gov. Heineman applauded the short-term aims, which the Legislative Fiscal Office estimated would save the state approximately $50.4 million for FY2013-14 and $43 million for FY2014-15,[3] he vetoed the bill based on its long-term fiscal impact, estimated at $500 million over 25 years.[4] Supporters such as Omaha Sen. Bob Krist acknowledged the bill was a short term fix, and introduced a resolution to analyze all state retirement plans for the long-term.[5]

The long-term impact should be most worrisome to taxpayers. LB553 did not address the underlying flaws in the system; particularly, the projected 8 percent return on investments for defined benefit plans, the primary reason the system faces such a large shortfall. As LB553 supporter Columbus Sen. Paul Schumacher noted, "When you tell people you're going to calculate their retirement on 8 percent return and make promises to them, that means we're going to be facing these issues repeatedly."[6]

There are two methods that would help Nebraska have a sustainable pension system designed for long-term solvency. The first is accurately projecting rates of return. Nebraska's traditional defined benefit plans-utilized by the School Retirement System, State Patrol Retirement System, and Judges' Retirement System[7]-all estimate an 8 percent rate of return on investments, while

Nebraska's cash balance plans-used by the State and County Employees Retirement System[8]-estimate a 7.75 percent rate of return.[9] When Nebraska's portfolio was cross-referenced with investment firm Willshire's, projections for average asset returns, by asset class, show the expected average rate of return going forward would be around 6.1 percent. If that return becomes the norm for the long term, Nebraska could see the present value of their liabilities increase by 30 percent, with unfunded liabilities increasing by 120 percent.[10] Such an increase would either force taxpayers to foot the bill or raise employees' annual contributions significantly, which may force state employees to drop out of the program altogether. Similar projections from the Pension Consulting Alliance (PCA) are worse, estimating Nebraska's pension investments would only have an annual 5.8 percent return. Economist Andrew Biggs notes in the study that projecting investment returns is not an exact science, but these and other studies appear to show that planning for 7.75 and 8 percent returns is a very optimistic goal, and likely to increase state liabilities and future problems.[11]

Another method that could assist in shoring up pension solvency would be transitioning to a defined contribution (DC) model, often used in the private sector. DC plans provide portability to the employee and transparency to the taxpayers because the employee can take it from job to job. Additionally, the employer only provides a match to employer contributions based on a set formula, leaving little opportunity for additional liability through over-promised actuarial assumptions. The Thrift Savings Plan (TSP) models, used by the federal government, counter some of the criticisms that DC plans often face. For example, the federal TSP automatically enrolls new hires with a default contribution rate of 3 percent of salaries and offers the "life cycle" option in which investments shift from the riskier stocks to more stable bonds as the worker nears retirement.[12]

Nebraska should live up to the promises made to its employees; however, those promises should be realistic and achievable. If Nebraska's public pension system is to avoid the massive liabilities and financial strain experienced by other states, then structural changes need to be made, starting with the unrealistic investment returns and a shift to the more solid and transparent DC plans.

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[1] Martha Stoddard, "Senators override Heineman's veto of retirement plan bill," *Omaha World Herald*, May 14, 2013. Accessed May 23, 2013,http://www.omaha.com/article/20130514/NEWS/705159985.

[2] Kathy Tenopir, "LB553: Fiscal Note," Legislative Fiscal Analyst Estimate, April 19, 2013. Accessed May 24, 2013,http://nebraskalegislature.gov/FloorDocs/Current/PDF/FN/LB553_20130419-145304.pdf.

[3] Ibid.

[4] JoAnne Young, "Lawmakers override teacher retirement veto," *Lincoln Journal Star*, May 14, 2013. Accessed May 24, 2013, http://journalstar.com/legislature/lawmakers-override-

teacher-retirement-veto/article_4db4674d-0201-512d-8d58-e2d9e607dfde.html.

[5] Ibid.

[6] Schumacher qtd. in Unicameral Update, "School retirement plan changes advanced," April 19, 2013. Accessed May 24, 2013, http://update.legislature.ne.gov/?p=11516.

[7] Nebraska Investment Council, "Defined Benefit Plans: School, State Patrol, & Judges." Accessed May 24, 2013, http://www.nic.ne.gov/defined_benefit.html.

[8] Nebraska Public Employees Retirement Systems, "About Nebraska Public Employees Retirement Systems." Accessed May 24, 2013,http://npers.ne.gov/SelfService/public/aboutus/aboutus.jsp.

[9] Andrew G. Biggs, "Honest Accounting and Public Employee Pensions in Nebraska," Platte Institute for Economic Research May 2013. Accessed May 24, 2013,http://www.platteinstitute.org/docLib/20130520_Platte-Pension_(3).pdf.

[10] Ibid.

[11] Ibid.

[12] Andrew Biggs, "Public Sector Pensions in Nebraska: Are Cash Balance Plans the Answer?" Platte Institute for Economic Research, October 2011. Accessed May 24, 2013,http://www.platteinstitute.org/docLib/20111212_Public_Sector_Pensions_in_Nebraska.pdf.