The 21st-century retirement model

By Richard Hiller

The ongoing challenges in the public sector's retirement model have left many workers feeling insecure about their futures. Although 99% of full-time public sector employees have access to an employment-based retirement plan,[1] a recent study from the TIAA-CREF Institute and The Nelson A. Rockefeller Institute of Government showed that only 19% were very confident that they'd have enough money to live comfortably throughout their retirement years. Just 22% were very confident that they would have enough money to take care of medical expenses during their retirement.[2]

As governments grapple with the changing retirement landscape, workers often fear a shift from defined benefits to defined contributions, worrying that the responsibility for funding retirement will land entirely on their shoulders. But the challenge of unfunded liabilities for state and local pension systems means that workers should perhaps fear the status quo even more than a shift in plan design.

Fortunately, governments and their employees are not forced to choose between all-encompassing defined benefit plans or 401(k)-style defined contribution plans. As TIAA-CREF CEO Roger Ferguson pointed out during the recent National Conference of State Legislatures 2013 Legislative Summit, states like Tennessee and Rhode Island are taking the lead in finding a new way that combines the best elements of defined contributions and defined benefits to provide sustainable lifetime income security for state and municipal employees.

Retirement for the 21st century

There is ample evidence that the current model for retirement is not getting the job done in terms of adequately preparing workers in all professions all across the country.

- Many eligible workers don't participate in their workplace retirement plans.
- Many employers and employees don't contribute enough.
- Many employees don't implement an appropriate asset allocation strategy.
- Many employees get caught up in the size of their account balance, with no real or informed knowledge of the income flow they will need in retirement.
- And finally, many fail to preserve assets for retirement; rather, they borrow against their account or liquidate it for living expenses.

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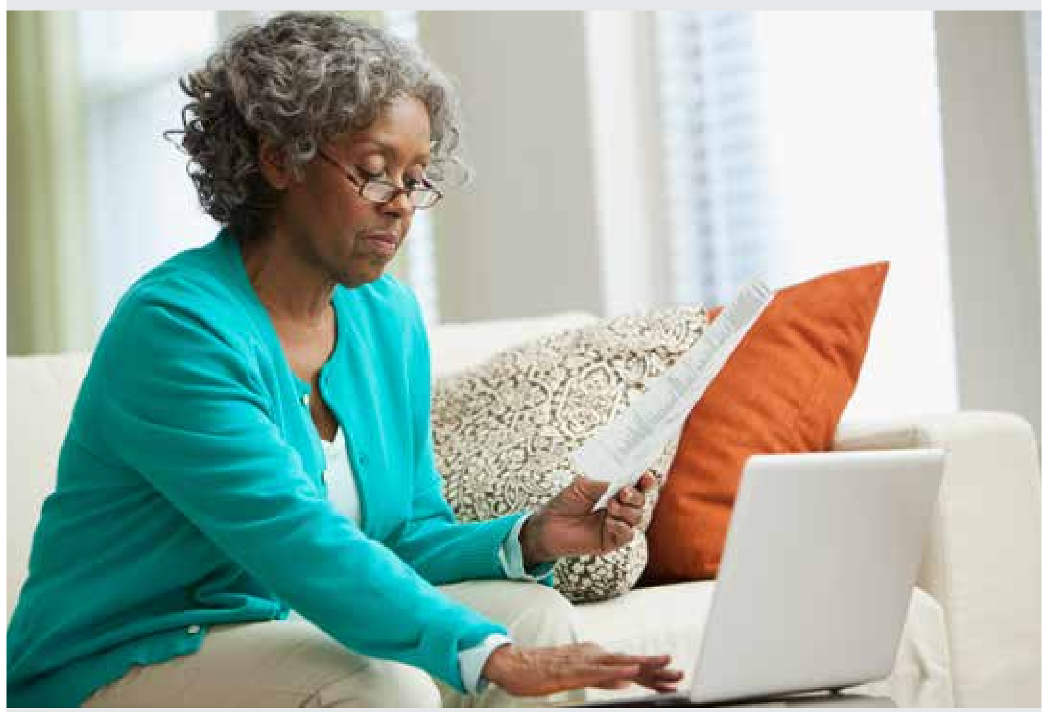
What would an ideal 21st century retirement system look like?

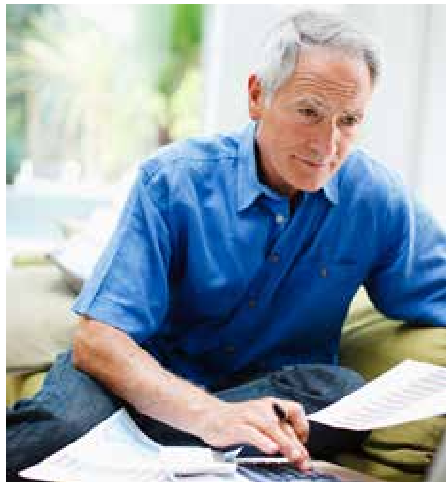
- It would continue to recognize that helping employees achieve financial security during retirement is a shared responsibility of employers and employees.
- It would provide income that can last a lifetime – through decades of retirement.
- It would help retirees meet their uninsured healthcare expenses, which loom as a large financial burden as people live longer and with chronic illnesses.
- It would recognize that a "one-size-fits-all" approach won't work, given the demographic and other changes in our society.
- It would be sustainable even as the nearly 80 million Baby Boomers head into retirement over the next two decades.
- And it would include strong education and advice components, recognizing that most people need help in making decisions about achieving retirement security.



One model that is working well, and that can therefore inform our thinking, is the model commonly used in higher education and many parts of the nonprofit world, which was pioneered by TIAA-CREF.

- Although there are differences between plans, most feature mandatory participation.
- Employees have access to an appropriate mix of investment options that help them to build savings.
- Institutions contribute to employees' retirement security.
- Employees typically have access to either a defined benefit plan or an annuity that provides a level of guaranteed income in retirement.*
- And finally, they have access to education and advice programs to help support their decision-making.

We believe this model is, on the whole, serving the academic community quite well. **Research from the TIAA-CREF Institute found that 75% of higher education workers are confident they will have enough money to live comfortably in retirement.**[3] By comparison, just over 50% of all U.S. workers have that same level of confidence.



States like Tennessee and Rhode Island are taking the lead in finding a new way to provide sustainable lifetime income security for employees.

The right solution for the public sector

Our long experience informed our thinking as we've pioneered a new model in the public sector – a hybrid defined contribution/defined benefit plan for clients like the state of Rhode Island and Orange County, California. We believe that both defined benefit plans and defined contribution plans have strengths and weaknesses. Neither is perfect, but neither deserves to be demonized. It's important to be open to taking the best from both worlds in order to get workers to lifelong financial security.

Rather than advocating any single approach, we are proponents of lifetime income. We believe strongly that retirement systems should be about one thing only: helping workers to achieve financial security in retirement, even as they are living longer and longer in that stage of life.

A hybrid DC/DB model brings greater cost certainty to public employers while providing retirement security to workers, and it addresses the challenge of lifetime income. It also brings an element of portability to retirement savings, which is increasingly important for state government employees, who have an average tenure of just over six years.[4] Such innovative solutions will be critical for the public sector to continue attracting talent and supporting their employees to and through retirement.

[1] National Compensation Survey, March 2011 (Washington, D.C.: Bureau of Labor Statistics, U.S. Department of Labor, March 2011), **http://www.bls.gov/ncs/ebs/benefits/2011/ownership/govt/table02a.pdf**.

[2] "Public Sector Pension Reform: Addressing Pressing Fiscal Realities from a Long-Term Perspective," June 2013 (TIAA-CREF Institute and The Nelson A. Rockefeller Institute of Government), **http://www.tiaa-crefinstitute.org/institute/research/trends_issues/ti_sunyrock_publisectorpensionreform_0513.html**

[3] "Retirement Confidence on Campus: The 2010 Higher Education Retirement Confidence Survey," TIAA-CREF Institute, June 2010.

[4] According to the US Department of Labor, Bureau of Labor Statistics, 2012, 6.4 years was the figure for median years of tenure with current employer for employed wage and salary workers in state government.

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