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## **Senate Pension Bill Favors 401(k)-Type Retirement Option With Poor Florida Track Record**

*Proposal flies in the face of a decade of evidence showing lower investment returns for individual accounts than for state's traditional pension; shift would also cost taxpayers more*

TALLAHASSEE, FL (April 25, 2013) — A bill before the Florida Senate would shift more public employees into a 401(k)-like retirement plan even though a decade of Florida experience shows that the state's defined contribution plan has lower investment returns than its defined benefit pension, according to a Keystone Research Center study released today with the Florida Retirement Security Coalition.

The Senate plan would also increase the cost of both main retirement options for public employers, and ultimately for taxpayers.

"In weighing future retirement options," said Dr. Stephen Herzenberg, economist and author of the Keystone report, "Florida has the unique advantage of a decade-long natural experiment operating two retirement options side by side. The results are in: Florida's defined-benefit pension wins the battle of the retirement plans in a TKO, with superior returns that would translate into about 50 percent higher asset growth over 30 years." Given this track record, Dr. Herzenberg said it is puzzling that Florida lawmakers would want to tilt workers' choices towards the inferior of the two retirement plans.

Dr. Herzenberg also pointed out that the Senate pension proposal would cost taxpayers more money. It does this directly by raising by 1 percent of payroll the amount of money the state would contribute to the individual accounts of employees choosing the 401(k)-type plan. Removing more young employees from the state's defined benefit pension pool will also make that plan more expensive.

"The Senate proposal delivers a one-two punch to taxpayers," said Dr. Herzenberg. "Taxpayers will shell out millions more each year to persuade new employees to join the state's 401(k)-type retirement plan, making the state's traditional pension more expensive in the process."

Under current law, public employees can choose either the defined pension benefit plan or the defined contribution plan, which is similar to a 401(k) plan. Five out of six employees in the Florida Retirement System (FRS) currently enroll in the defined benefit plan, including three of four new employees.

The Senate proposal lowers the required employee contribution to the defined contribution plan from 3 percent to 2 percent, with employers—and taxpayers—picking up the slack. One percent of payroll in the defined contribution plan amounts to \$43 million today. The Senate would also automatically enroll

in the defined contribution plan any employees who do not make their own choice. Currently, employees who do not make their own choice are enrolled in the defined benefit plan.

The Florida Retirement System (FRS) actuary projects that the Senate bill will lower the share of new employees entering the defined benefit plan from three quarters to less than half (46 percent). The individuals who shift out of the defined benefit plan will be mostly younger workers with the lowest defined benefit pension costs—many of whom leave public employment before becoming eligible to receive a pension (i.e., before “vesting”). In addition, with fewer younger plan members, enrollees in the defined benefit plan will age and retire as a group, leading fund administrators to invest in a more conservative and liquid portfolio. This lowers investment returns and increases taxpayer costs.

Florida’s natural experiment with dueling pension plans provides fresh and compelling hard data for lawmakers, policymakers, and the general public to consider. From 2004 to 2012, the period for which the Florida Retirement System reports data on both retirement options, Florida’s defined benefit pension had a 6.84 percent annualized rate of return compared to 6.08 percent for the defined contribution plan. Taking into account inflation and slightly higher costs reported for the defined contribution plan, Florida’s defined benefit pensions would grow by 184 percent over 30 years, half as much as the 122 percent asset growth for the defined contribution plan.

This 50 percent difference in growth understates the retirement security gap between the two options because retirees with individual accounts pay a premium if they want to convert their pool of savings into an annuity that provides a monthly check until the end of life.

Florida’s actual experience accords with research showing that professional managers tend to earn higher returns than individuals making their own investment choices; and that individual accounts have higher administrative and management fees, slowing the growth of worker savings.

“The track record is clear: employees who end up in the defined-contribution plan will have a lower-quality pension,” said Alan Stonecipher, director of the Florida Retirement Security Coalition. “After they gain the seasoning to become effective in the classroom or the health clinic, a guaranteed pension will no longer retain them in public service at lower salaries than they could get in the private sector.”

“Changes proposed in the Senate are a lose-lose proposition for taxpayers and for public employees,” added Stonecipher.

Efforts to restructure Florida’s pension system are unnecessary, the Keystone study finds. Florida has one of the most well-funded pension benefit systems in the nation and is one of only 11 state plans to achieve the highest rating from the Pew Center on the States—“solid performer.” Changes made in 2011 to Florida pensions will also save money in the years ahead. Those changes included a phase out of automatic annual cost-of-living adjustments (COLA) for retirees, an increase in the retirement age, and a requirement that employees contribute 3 percent of their own salary towards their pensions.

“In public policy as in medicine, one guiding principle should be ‘first, do no harm,’” said Dr. Herzenberg, “Paying more for less is not the pension reform that most Floridians are looking for.”

*The Keystone Research Center is an independent, nonpartisan research organization that promotes a more prosperous and equitable economy. Learn more: [www.keystoneresearch.org](http://www.keystoneresearch.org). The Florida Retirement Security Coalition is a nonprofit organization fighting to protect the retirement savings of Florida's public employees. Learn more: <https://www.facebook.com/FloridaRetirementCoalition>.*