



RESEARCH REPORT

# Reforming Government Pensions to Better Distribute Benefits

## What Are the Options?

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# Introduction

Efforts to reform the retirement plans provided to state and local government employees are gaining momentum across the country. From 2009 to 2011, 43 states significantly revised their state retirement plans (Snell 2012). Ten states made major structural changes to their plans in 2012 (National Conference of State Legislatures 2013). More recent reforms have passed in such states as Kentucky, Tennessee, and Illinois. Financial concerns have driven these initiatives. The 2007 financial crisis depleted much of the reserves many state and local plans held. By their own accounting, plans had set aside enough funds in 2012 to cover only about three-quarters of their future obligations, about a \$1 trillion shortfall (Munnell, Aubry, Hurwitz et al. 2013). Outside estimates, based on arguably more realistic actuarial assumptions, put the shortfall much higher (Novy-Marx and Rauh 2011). Absent any reforms, this funding gap will likely force state and local governments to increase their payments to pension funds, raising pressure on government budgets and threatening to crowd out other public services or lead to tax hikes. Government contributions to public employee retirement plans have already nearly doubled over the past decade (Johnson, Chingos, and Whitehurst 2013).

The focus on public pensions' financial problems has largely drowned out a broader discussion of how well these plans serve government employees, employers, and taxpayers. For example, the central mission of the public pension system is to provide retirement income to government employees, yet most public plans provide little retirement security to government employees who do not spend a full career in public service. Thus, these plans may not appeal to the increasing number of younger workers who expect to switch jobs several times over their career. Many traditional final average salary (FAS) pension plans penalize work at older ages by reducing lifetime benefits for employees who remain on the job past the plan's retirement age, encouraging them to retire even if they remain productive and want to keep working. These retirement incentives are increasingly problematic as the population ages and the pool of younger workers stagnates. Additionally, most public plans lock in mid-career employees—who might be more productive elsewhere—by providing lucrative benefits if they remain on the job for a certain number of years but few benefits otherwise.

A fundamental shortcoming of most state and local retirement plans is that they fail to treat government workers fairly. How much employees benefit from their retirement plans varies sharply depending on how old they are when they join the plan and how long they remain in the plan, regardless of their productivity. Two workers employed in the same plan can receive very different pensions if one works a year longer than the other or if they join at different ages—even if they worked the same number of years. This pattern violates the basic principle of equal work for equal pay.

This report highlights promising reform options that could more fairly distribute retirement benefits across the public-sector workforce and help governments recruit and retain productive employees. We begin by describing how traditional plans work and how they distribute benefits across the workforce. We then identify various reform options—such as changing the benefit formula in FAS plans, pursuing alternative plan designs, and extending Social Security to all government employees, many of whom are currently uncovered—that could improve the fair distribution of benefits. The final section discusses various challenges to pension reform.

## How State and Local Retirement Plans Work

There were 19.3 million state and local government workers employed in the United States in March 2012, 14.4 million of whom worked full time (Jessie and Tarleton 2014). Nearly three-quarters were employed by local governments, including counties, municipalities, townships, school districts, and special districts. More than half worked in education, and 7 percent worked in police and fire protection. Nearly all are covered by retirement plans that provide cash benefits to retirees. In 2013, 99 percent of full-time state and local government employees had access to employer-sponsored retirement plans, and 94 percent participated in these plans.<sup>1</sup> In the private sector, by contrast, only 74 percent of full-time employees had access to a retirement plan in the workplace, and only 59 percent participated. However, an estimated 28 percent of state and local government employees are not covered by Social Security (Nuschler, Shelton, and Topoleski 2011), which covers virtually all private-sector workers. As a result, many public-sector workers are more dependent on employer-sponsored plans for retirement income than are their private-sector counterparts.

In 2011, 3,418 state and local public employee retirement systems were operating, 222 administered at the state level and 3,196 administered at the local level (US Census Bureau 2012). Pennsylvania has by far the most local systems, accounting for nearly half of the nationwide total. However, locally administered plans are much smaller than state plans, which hold about five of every six dollars invested in these systems. Combined, they held \$3 trillion in assets in 2011 and covered 19.5 million members, including 14.5 million active members accruing benefits and 4.9 million inactive members. Another 8.6 million retirees received periodic benefit payments worth \$216 billion (US Census Bureau 2012), an average annual benefit in 2011 of about \$25,000.

There are two main types of retirement plans—defined benefit (DB) plans and defined contribution (DC) plans. DB plans, which have become less common in the private sector over the past generation, still cover most public-sector employees. In 2013, 92 percent of full-time state and local government employees were offered DB plans by their employers, compared with 22 percent of their private-sector counterparts.<sup>2</sup> The most common type of DB plan provides retirees with lifetime pensions based on FAS and years of completed service. The annual benefit is generally computed as a specified percentage of FAS—usually calculated over the last three or five years of employment—multiplied by completed years of service. That percentage sometimes varies with years of service, for example increasing with seniority. Some FAS plans also cap pension benefits so that they do not exceed a certain share of FAS, such as 75 or 80 percent.

Employees may begin collecting benefits once they have left the payroll and satisfied the plan's eligibility criteria, usually based on age but sometimes on service years. For example, half of the FAS plans in the Urban Institute's State and Local Employee Pension Plan (SLEPP) Database offer age-25 hires full retirement benefits that begin by age 55. Most FAS plans offer reduced benefits to employees who separate before the normal retirement age, as long as they meet certain age and years of service requirements. Sometimes the payment reductions are roughly actuarially fair, with the monthly benefit cut almost exactly offsetting the increased number of payments received by early retirees. In that case, the expected value of lifetime payments would be about the same if an employee who separated at the early retirement age immediately began collecting benefits or waited until reaching the normal retirement age. Many plans, however, subsidize early retirement, enabling employees to maximize their lifetime payments by collecting benefits early.

Once state and local government employees begin collecting their pensions, they are usually entitled to cost-of-living adjustments (COLAs) designed to help maintain their benefits' purchasing power in the face of inflation. Sometimes COLAs do not kick in until retirees have collected their pension for a few years or have reached a certain age (such as 65). However, many state and local plans have recently reduced or suspended COLAs as their financial problems have worsened.

In exchange for these benefits, most state and local government employees must contribute a portion of their salaries to their retirement plan. In 2013, 9 of 10 plans in our database required employee contributions, and the median amount was 7 percent of salary. Employee contributions totaled \$40.3 billion in 2011, accounting for 30 percent of all contributions to public employee retirement systems (US Census Bureau 2012).

Workers who leave the government payroll before they can begin receiving their retirement benefits may usually begin collecting their pensions once they are old enough, as long as they have worked enough years to “vest” in the plan. About half of the plans in our database vest employees after 5 years of service; about a third of plans require employees to have completed between 6 and 10 years of service. Relatively few allow employees to vest before they complete 5 years of service or require more than 10 years (except for plans covering police officers and firefighters).<sup>3</sup> Workers who separate before vesting usually have their retirement plan contributions refunded to them—usually with interest. Most FAS plans also give separating employees—even those who have vested—the option of collecting a refund of their required contributions and forgoing a future pension instead of waiting to collect their benefits.

A few state and local governments offer their employees DC plans. These are now the most common retirement plan provided by private employers, offered to 69 percent of full-time private-sector employees in 2013 (Bureau of Labor Statistics 2013).<sup>4</sup> Thirty-six percent of state and local governments offered DC plans to their employees in 2013, but only 17 percent of employees participated. Most DC plans in the public sector supplement DB plans that remain employees’ primary retirement savings vehicle, but a few public systems have replaced their DB plans with a stand-alone DC plan.

DC plans specify the contributions that employers make to retirement plans instead of promising lifetime retirement payments based on salary and years of service. Employers that provide 401(k)-type plans—the most common type of DC plan—contribute to a retirement account in a participant’s name, usually as a percentage of salary. Employees may also contribute to their retirement accounts and defer taxes on their contributions until they withdraw funds from their accounts. In the private sector, employer contributions sometimes depend on how much the participant contributes. Some employers, for example, match worker contributions up to a specified percentage of salary, providing little to employees who do not contribute much to their retirement plans. Balances grow over time with contributions and market investment returns and may continue to grow after employees separate from their employer as long as they do not spend their balances. As in DB plans, most DC plans specify a vesting period. Employees who separate before they have completed the minimum service requirement forfeit their employer’s contributions and associated investment returns. Employees manage their accounts, choosing among various investment options. Account holders may use the funds to purchase an annuity from an insurance company that provides lifetime retirement income.



# How FAS Plans Distribute Benefits

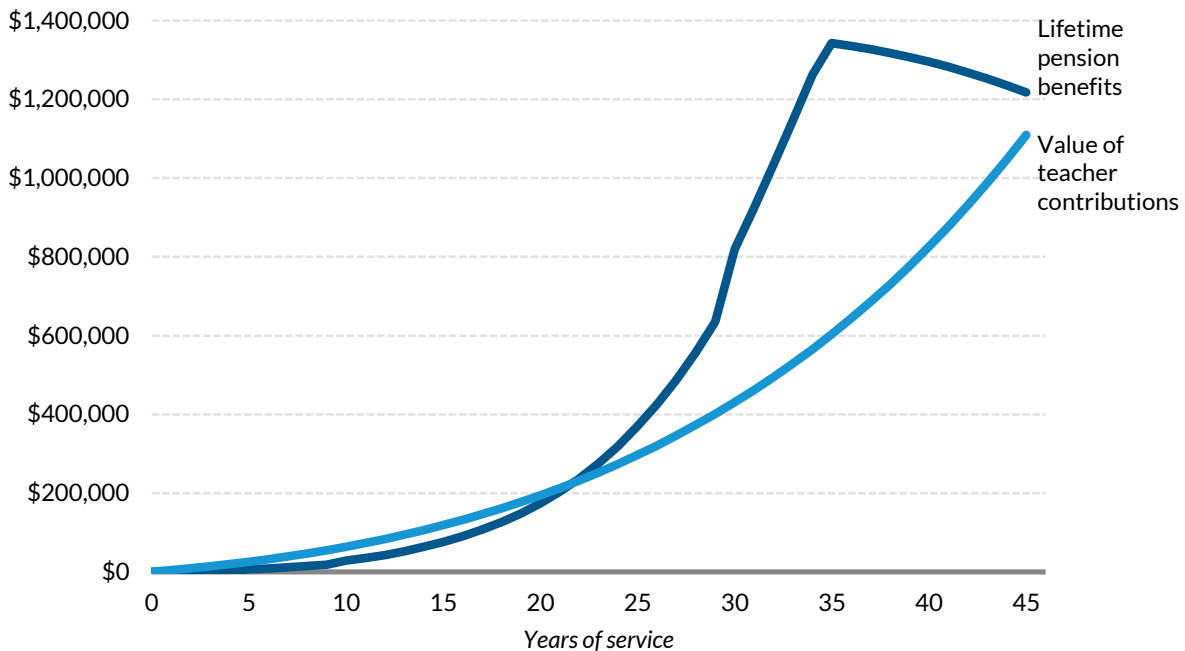
FAS plan benefits grow erratically over a participant's career—a drawback of this type of plan. Typically, benefits accumulate slowly early in a career, surge as a participant approaches the plan's retirement age, and then fall if participants work past the retirement age. This pattern creates unusual recruitment and retention incentives that do not serve employers or employees well. Participants are often treated unfairly, as one might reap large benefits from the plan while another equally productive participant with a similar employment history might get little from the plan.

To see how benefits generally accumulate in an FAS plan and how work incentives and participants' retirement security are affected, consider the Teachers' Retirement System of the State of Illinois, which provides a typical FAS pension to Illinois public school teachers.<sup>5</sup> Teachers hired before January 1, 2011 receive lifetime pensions equal to 2.2 percent of their FAS multiplied by completed years of service, capped at 75 percent of their FAS. The benefit formula calculates FAS over teachers' 4 consecutive highest-compensated years of service during their final 10 service years. Teachers may begin collecting full benefits at age 62 if they have completed at least 5 years of service, at age 60 if they have completed at least 10 years of service, or at age 55 if they have completed at least 35 years of service. Reduced early pensions are available at age 55 for teachers with at least 20 years of service who do not qualify for full benefits. (Only those teachers still employed at age 54 and six months may take early retirement, however.) Early-retirement benefits are reduced 6 percent for each year that they are collected before age 60. Once retirees begin collecting, their pensions automatically rise 3 percent each year, regardless of the inflation rate. These escalators, however, do not begin until age 61. In exchange for these benefits, the plan requires teachers to contribute 8.4 percent of their salaries each year. When teachers separate, they may elect refunds of their contributions instead of receiving future pension benefits, but they do not receive any interest on those past contributions.

Figure 1 shows how the expected value of lifetime pension benefits provided by the plan changes with years of completed service for Illinois teachers hired at age 25 who earn average salaries for their experience over their careers. Teachers who separate before completing about 15 years of service receive few pension benefits over their lifetimes. After 10 years of service, for example, teachers hired at age 25 receive lifetime benefits worth only \$28,000 in 2014 dollars. This value is low because they must wait 25 years to begin collecting their pension and their benefits are based on the relatively low salaries they earned in their mid-30s. Additional years of service, however, raise benefits substantially. They rise to \$174,000 after 20 years of service, \$557,000 after 28 years of service, and peak at \$1.3 million after 35 years of service. However, the value of lifetime benefits falls if teachers hired at age 25

work more than 35 years. Because such long-tenured teachers have already reached the 75 percent replacement-rate cap specified in the benefit formula, annual pensions do not increase much with additional years of service. Moreover, teachers forgo a benefit check each additional year they remain in state employment past the benefit-eligibility age. As a result, age-25 hires with 35 years of service forgo \$49,000 in lifetime pension benefits by working an additional 5 years, while contributing an additional \$222,000 to the plan.

**FIGURE 1**  
**Expected Value of Lifetime Teacher Contributions and Pension Benefits**  
*Illinois public school teachers hired before 2011 at age 25*



**Source:** Johnson and Southgate (2014).

**Note:** All monetary figures are in constant 2014 dollars. Future benefits are discounted at 8 percent and the annual inflation rate is assumed to be 3.25 percent, the rates adopted by the teacher retirement system.

Illinois teachers must work many years before their future retirement benefits are worth more than what teachers could have earned on their required plan contributions if they instead invested those contributions outside the plan. If teachers could receive the same returns outside the plan as the plan trustees assume the plan receives, teachers' contributions would be worth three times as much as their future pension benefits after 9 years of service, twice as much after 12 years of service, and 1.5 times as much after 16 years of service. Age-25 hires must remain in the plan for 22 years before their future benefits are worth more than their contributions. Teachers who separate earlier essentially lose money

by participating in the mandatory teacher pension plan because they could have earned more by investing their contributions outside the plan. Using the plan trustees' investment-return assumptions, Illinois teachers hired at age 25 who separate with 13 years of completed service forfeit \$37,000 by participating in the plan. These teachers, even those who serve for many years, are essentially subsidizing the large pensions long-tenured teachers receive.

Restricting employer-financed retirement benefits to long-serving employees, as in the Illinois teacher plan, is common in the public sector. In half of the state-administered FAS plans in the Urban Institute's SLEPP database, participants must work at least 20 years before they get anything out of their pension plans other than their own contributions (Johnson et al. 2014b). Only 19 percent of plans enable state and local government employees hired at age 25 to accumulate any employer-financed pension benefits within the first 10 years of employment, including only 14 percent of plans covering public school teachers. In more than a fifth of plans age-25 hires must work more than 25 years before their future pension benefits are worth more than their plan contributions.

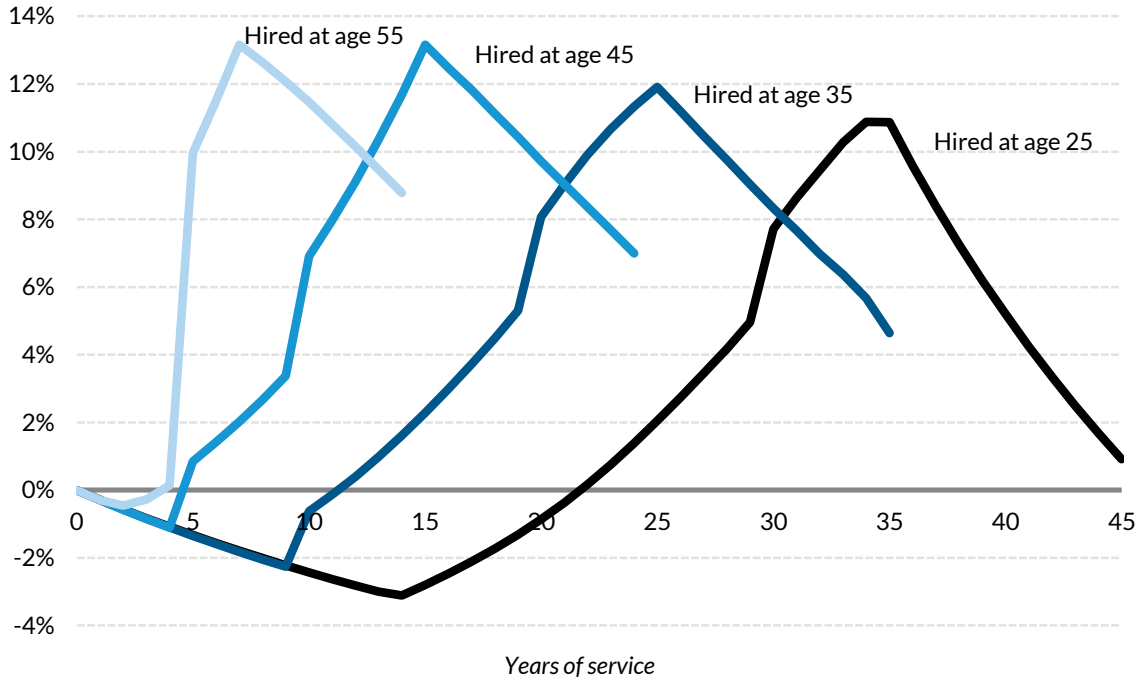
One way of assessing how much state and local employees benefit from their retirement plan is to measure the expected value of their lifetime pension payouts net of their required contributions and express it as the portion of salary that their employers would have to set aside each year to finance, with employee contributions, the promised stream of future benefits. These calculations show how much retirement benefits supplement employee salaries, averaged over their careers (figure 2).

The Illinois public teacher plan significantly reduces salaries for teachers hired at age 25 who separate before completing 22 years of service because, as we saw earlier, future pension benefits for teachers with less seniority are worth less than their required contributions. For age-25 hires who leave after completing 14 years of service, for example, the retirement plan reduces their salaries by 3 percent each year they worked. The plan supplements salary for those who remain on the job for at least 22 years, but how much they benefit depends on how long they stay. For instance, the plan supplements salaries 2.1 percent each year for those who separate after 25 years of service and 10.9 percent each year for those who separate after 35 years of service.

FIGURE 2

**Career-Average Annual Employer Cost as Share of Salary**

*Illinois public school teachers hired before 2011*



Source: Johnson and Southgate (2014).

Note: All monetary figures are in constant 2014 dollars. The figure reports the fixed percentage of teachers' salaries that the state would have to contribute each year to finance promised benefits. The analysis assumes an annual interest rate of 8 percent and inflation rate of 3.25 percent, the rates adopted by the teacher retirement system.

There is a sharp rise in the salary supplement for age-25 hires who complete 30 years of service. The plan supplements salaries by 5.0 percent each year for teachers who separate after 29 service years, but by 7.7 percent each year for those who separate after 30 years. For an age-25 hire, teaching the 30th year boosts the lifetime pension value net of a teacher's contributions from \$234,000 to \$389,000, a 66 percent increase for just one additional year of service. The reward stems from the plan provision that allows teachers to begin collecting reduced benefits at age 55, which age-25 hires reach after 30 years of service. This spike in pension benefits creates strong incentives for plan participants to remain on the job until they collect this windfall, even if they are not necessarily a good fit and would be more productive elsewhere. Such spikes in pension benefits are common in FAS plans provided to state and local employees. Maximum single-year increments to pension wealth in the public plans in the Urban Institute's SLEPP database average three times salary (Johnson et al. 2014a).

The annual salary supplement falls each year that age-25 hires remain on the job beyond 35 years, declining from 10.9 percent of salary after 35 years of service to 5.2 percent after 40 years of service to

0.9 percent after 45 years of service. Because such long-tenured teachers have already reached the 75 percent replacement-rate cap specified in the benefit formula, annual benefit payments do not increase much with additional years of service. Moreover, teachers forgo a benefit check each additional year they remain in state employment past the benefit eligibility age. As a result, age-25 hires with 35 years of service forfeit \$49,000 in lifetime pension benefits by working an additional 5 years, while paying an additional \$222,000 in required contributions to the plan.

Like the Illinois teachers' plan, most state and local FAS plans penalize work at older ages by cutting lifetime pensions for employees who remain working past a certain age. In 63 percent of public plans in the Urban Institute's SLEPP database, employees hired at age 25 maximize their lifetime benefits, net of their own contributions, by age 57 (Johnson et al. 2014c). Net lifetime benefits fall when employees in these plans work longer, effectively cutting their annual compensation and encouraging them to retire. Such incentives are problematic as the population is aging and the pool of younger workers is stagnating. Only 6 percent of plans maximize lifetime benefits for age-25 hires at age 65 or older.

Figure 2 also shows how much Illinois teachers hired after age 25 benefit from the pension plan. Older hires get much more out of the plan for each year of service than those hired at younger ages. For teachers who separate after 7 years of service, for example, the plan supplements salaries 13.2 percent each year for age-55 hires and 2.0 percent each year for age-45 hires, but it reduces salaries for age-35 and age-25 hires. The wide variation in how much the plan supplements salary for members—ranging from a high of 13.2 percent for members who join at age 45 and separate after 15 years of service to a low of -3.1 percent for members who join at age 25 and separate after 14 years of service—illustrates the unfairness of the typical FAS plan. The Illinois teacher plan, like most FAS plans, does not provide equal pay for equal work.

## Promising Reform Options

There are several ways in which state and local governments might reform the retirement plans they offer to their employees so as to distribute benefits more fairly across the workforce and create workplace incentives that better serve their needs. Options include revising the benefit formula in an FAS plan, offering plans that deviate from the traditional FAS design, and extending Social Security coverage to all state and local government employees. We discuss these various options below.

**Revise the FAS benefit formula.** States and localities can change the FAS benefit formula in employee retirement plans to ensure that shorter-term employees hired at younger ages reap some rewards from the plan and that lifetime benefits do not fall when older employees continue working, thus distributing benefits more fairly across the workplace and eliminating early-retirement incentives. Possible changes include the following:

- *Reduce the vesting period.* Many FAS plans require employees to serve for 10 years—or even 20 years in many plans covering police officers and firefighters—before they qualify for pension benefits. Shortening vesting requirements would allow shorter-term employees to earn limited retirement benefits.
- *Credit employee contributions with the actual return earned on plan assets when providing refunds.* State and local plans generally refund member contributions to separating employees who waive future retirement benefits or leave before they vest in the plan. However, most plans credit less interest to refunded contributions than what the plan actually earned on its investments. Crediting refunds with actual plan investment returns would prevent most shorter-term employees from losing money when they participate in the mandatory retirement plan; such returns provide employees with the same financial benefit as they would earn if they could instead invest their required plan contributions outside the plan.
- *Increase annual benefits for employees who separate before they may begin collecting their pensions.* Employees who separate before they may begin collecting their pensions generally receive small retirement benefits because their pensions earn no interest and erode with inflation while they are waiting to collect, and their benefits are based on the generally low earnings they received at younger ages. A better approach would be to index the starting benefit to changes in the consumer price index or, better yet, changes in average salaries, from the year employees separate until they begin collecting. That feature would raise annual retirement benefits for employees who separate before reaching the retirement age.
- *Eliminate early-retirement subsidies.* Many plans allow employees to collect reduced retirement benefits at early ages, but the benefit reductions are often too small to fully offset the additional payments early retirees receive. As a result, many plans reward early retirement. Additionally, these bonuses often lock in mid-career employees who reap substantial rewards by remaining in the plan until they qualify for early retirement. Ending early retirement subsidies would eliminate incentives to retire early, better reward those

employees who work longer, and help prevent mid-career employees from feeling locked into their jobs.

- *Boost the benefit multiplier for employees who work beyond the plan's retirement age.* Employees who work past the retirement age often receive fewer retirement benefits over their lifetime than their counterparts who retire earlier because their annual payments are not large enough to compensate them fully for the fewer payments they receive. The plan could better reward work at older ages by raising the benefit multiplier for employees who delay retirement. The increase should be tied to a retiree's age, as in Social Security's benefit formula, not years of service.
- *Provide COLAs that are tied to changes in the consumer price index.* To provide retirees with adequate financial security, plans must ensure that inflation does not erode the pension's value. Many—but not all—plans offer benefit escalators to retirees, but these adjustments are sometimes ad hoc. Other plans provide automatic escalators that are not tied to inflation. Increasing retirement benefits by the change in the consumer price index, as Social Security does, would protect retirees and restrict benefit raises to periods when retiree's financial security would otherwise be jeopardized.

**Add a DC component to the FAS plan.** Moving to a 401(k) plan, either as a replacement to the FAS plan or a supplement to it, can also help equalize retirement benefits among state and local government employees. All participants in these DC plans can receive the same employer contribution relative to their salaries, regardless of age or years of service, and their retirement accounts can continue to grow until they begin collecting benefits, even after they leave public employment. Transitioning to a 401(k)-type plan would also prevent governments from underfunding future pension obligations and shifting costs to future generations. By definition, 401(k) plans are fully funded, because employees own their account balances as soon as they vest.

Critics of DC plans note that these plans have not worked well in the private sector, where they now dominate. Many employees offered such plans by their employers do not participate and few participants contribute enough to generate significant retirement income in old age (Munnell 20014; Munnell and Sunden 2004). Additionally, relatively few 401(k) participants annuitize their balances, exposing them to the risk of depleting their retirement funds before they die (Johnson, Burman, and Kobes 2004). These potential shortcomings can be easily overcome in the public sector, however, by requiring employees to contribute to their retirement plans (which is already commonplace among public employers) and to annuitize their account balances through the retirement plan.

**Replace the FAS plan with a cash balance plan.** Another promising reform is to replace the FAS plan with a cash balance plan, which combines features of standard DB and DC plans. These plans are already available to public-sector workers in some states, such as Kentucky, Nebraska, and Texas. As in a DC plan, employees and employers contribute a certain percentage of salary to employee accounts each period. Benefits are expressed as individual account balances, but employee accounts are pooled and professionally managed, as in traditional DB plans.<sup>6</sup> Depending on plan rules, the accounts earn fixed returns, market returns, or market returns that cannot fall below some minimum or exceed some maximum. Employees can typically either withdraw their account balances when they separate from government employment, or convert their balances into a lifetime annuity at or after the plan's retirement age.

Cash balance plans treat all employees fairly because employers can contribute the same share of an employee's salary to all employee retirement accounts, regardless of an employee's age or years of service. Employees who separate from public employment at relatively young ages fare better in a cash balance plan than an FAS plan because their cash balance accounts may continue to earn interest after they separate. By contrast, the FAS plan freezes benefits for employees who separate before they may begin collecting their pensions. Additionally, cash balance plan participants do not forfeit retirement benefits by remaining employed at older ages because they continue to receive employer contributions throughout their careers and their account balances can continue to rise.

**Use plan contributions to purchase private-sector annuities.** A more fundamental change to retirement plans provided to public-sector employees would involve using plan contributions from employers and employees to purchase annuities from private insurance companies. Republican Senator Orrin Hatch has proposed such a plan.<sup>7</sup> Under his plan, employees and employers would contribute a fixed percentage of employee's salary each year, as in a cash balance or 401(k) plan. But instead of depositing those funds into the public pension plan, employers would use them to purchase a deferred fixed-income life annuity contract for each employee. These deferred annuities would continue to earn interest until employees retire, even after they have left public service, so employees who separate at young ages could benefit from the plan. Additionally, the plan would not penalize older workers by reducing their lifetime benefits, as in FAS plans. Another feature of this approach is that it prevents governments from underfunding retirement benefits, because insurance companies will not accept IOUs when issuing deferred annuities. Finally, because the plan issues deferred annuities throughout participants' careers, instead of all at once, participants do not face the risk that their annuity might be smaller than expected because it was issued when interest rates were unusually low.



***Extend Social Security coverage to all state and local government employees.*** Nearly 30 percent of state and local government employees are not covered by Social Security (Nuschler, Shelton, and Topoleski 2011). Extending Social Security coverage to all public-sector employees would improve their retirement income security. Social Security provides an inflation-protected lifetime annuity. It rewards work at older ages by increasing annual payments for beneficiaries who delay retirement. It bases benefits on lifetime earnings and rewards work at younger ages by indexing earnings to changes in the economy-wide average salary. As a result, earnings early in one's career—when salaries were lower—count just as much as earnings late in the career.

## Challenges for Pension Reform

States and localities can take a number of steps to improve the distribution of retirement benefits offered to public-sector employees, make retirement plans more appealing to young workers, and create better retention incentives. However, reform efforts face several obstacles. For example, the most promising pension reforms would not improve benefits for every public-sector employee. Rather, certain government workers, especially long-term employees and employees who begin public service relatively late in their lives, would experience benefit cuts. These groups would likely oppose such reforms. Any proposed changes to pension benefits are sometimes viewed as a subterfuge for cutting benefits, even if average benefits remain unchanged, generating further political opposition. Some reforms we have outlined would require governments to fully fund state and local retirement plans. But state and local governments may prefer the option they currently hold of deferring pension funding when budgets are tight. Additionally, pension reform is complicated and does not directly affect the lives of most taxpayers. Thus, it is often difficult to galvanize public opinion around the issue and force change in the face of strong opposition from relatively small groups.

An important question is how reform efforts would treat incumbent employees. Most reforms have grandfathered existing workers, leaving their benefits unchanged and revising plan provisions only for new hires. As a result, most reforms do not have much immediate impact on plan finances. More importantly, shielding incumbent workers from any reforms creates different classes of employees, which violates norms of basic fairness and may create morale problems.

# Notes

1. Bureau of Labor Statistics, "Employee Benefits Survey: Retirement Benefits, March 2013," accessed February 17, 2015, Washington, DC: US Department of Labor, [http://www.bls.gov/ncs/ebs/benefits/2013/benefits\\_retirement.htm](http://www.bls.gov/ncs/ebs/benefits/2013/benefits_retirement.htm).
2. Ibid.
3. About one in eight plans covering police officers and firefighters in our database require more than 10 years of service for participants to vest.
4. Between 1990 and 2011, the share of all private-sector employees covered by DB plans fell from 35 to 18 percent (Wiatrowski 2012); see also Bureau of Labor Statistics, "Employee Benefits Survey."
5. Illinois's teachers' retirement system is one of the worst-funded plans in the nation. In 2013, it held enough assets to cover only 41 percent of future liabilities (Buck Consultants 2014). Among major state and local pension plans, only Kentucky's plan for state employees and Illinois' plan for state employees were more poorly funded in 2013 (Munnell, Aubry, and Cafarelli 2014). However, the benefits promised to Illinois public school teachers are typical of those provided to teachers and other public-sector employees in other states.
6. Cash balance plans are classified under federal law as DB plans.
7. SAFE Retirement Act of 2013. S. 1270 113th Congress.

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# About the Author

**Richard W. Johnson** is a senior fellow in the Income and Benefits Policy Center at the Urban Institute, where he directs the Program on Retirement Policy. His current research focuses on older Americans' employment and retirement decisions, long-term services and supports for older adults with disabilities, and state and local pensions. Recent studies have examined job loss at older ages, occupational change after age 50, employment prospects for 50+ African Americans and Hispanics, and the impact of the 2007–09 recession and its aftermath on older workers and future retirement incomes. He has also written extensively about retirement preparedness, including the financial and health risks people face as they approach retirement, economic hardship in the years before Social Security's early eligibility age, and the adequacy of the disability safety net.

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