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MOTION

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Various state governments are converting to hybrid pension systems for their employees utilizing 401(k) plans popularly used in the private sector. Some new state workers in Michigan and Utah will soon begin to receive part of their retirement benefits from a 401(k)-type plan, after lawmakers there recently voted to adopt plans that combine a 401(k) component with a guaranteed benefit.

These hybrid plans are considered to be a cost-cutting measure for states seeking to pare back the guaranteed-retirement payments for government workers. The new plans shift more responsibility for funding retirement benefits to employees. Utah and Michigan join six other states that have some form of hybrid plans for public workers. Most of those states, including Oregon and Washington, created hybrid plans within the past 15 years. A number of other states have expressed interest in hybrid plans. Some officials in North Carolina and Pennsylvania, for instance, are contemplating a move to a hybrid plan.

Governments trying to rein in pension costs are hoping these hybrid plans can represent a middle ground because they maintain a defined-benefit plan for workers while they move some of the investment risk to employees.

In Utah, most current employees are in a pension where the state in 2010 contributes 16% of an employee's monthly income. Workers do not contribute. Faced with rising contribution rates, lawmakers voted to have new workers as of July 1, 2011 choose to enroll in a defined-contribution plan—like a 401(k)—or a hybrid plan. In the hybrid plan, workers can invest in a 401(k)-type fund. State and employee contributions to the defined-benefit portion of the hybrid plan fluctuate based on the financing of the pension fund. The state contribution is capped at 10% across both parts of the plan.

In Michigan, new school employees as of July 1 contribute 2% of monthly income to a 401(k)-type fund, with state employers matching up to 1% of pay. Employees are automatically enrolled in the fund but can choose to opt out or choose to contribute more. Public employers will contribute on average 2.5% of an employee's monthly income toward retirement, down from an average base of 4%. There is no longer a cost-of-living adjustment in retirement.

Given the City's increasing burden in meeting its pension obligations at a time of fiscal crisis and in balancing our annual budgets, it is appropriate that we explore the feasibility and applicability of hybrid pension systems to Los Angeles.

I THEREFORE MOVE that the City Administrative Officer, in consultation with the City's three pension systems, the Personnel Department and the Chief Legislative Analyst, be directed to report with recommendations relative to the feasibility and applicability of using hybrid pension systems for Los Angeles.

PRESENTED BY: Bill Rosendahl
BILL ROSENDAHL
Councilman, 11th District

SECONDED BY: Bernard C. Parks

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States Shift to Hybrid Pensions

Facing Shortfalls, Some Combine Guaranteed Plans With 401(k)-Like Options

By JEANNETTE NEUMANN

State governments, one of the last bastions of guaranteed pensions, are increasingly taking a page from the 401(k) plans that dominate the private sector.


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Ramin Rahimian for The Wall Street Journal

Utah state Sen. Dan Liljenquist pushed his state to move toward a pension plan more similar to those used in the private sector.

Some new state workers in Michigan and Utah will soon begin to receive part of their retirement benefits from a 401(k)-type plan, after lawmakers there recently voted to adopt plans that combine a 401(k) component with a guaranteed benefit.

These hybrid plans are a cost-cutting measure for states seeking to pare back the guaranteed-retirement payments considered a bedrock benefit for government workers. The new plans shift more responsibility for funding retirement benefits to employees and, some say, could make government jobs less attractive. In down markets, the plans could mean less-generous benefits for these workers, who have sidestepped the market volatility many of their private-sector counterparts endured in recent years.

Utah and Michigan join six other states that have some form of hybrid plans for public workers. Most of those states, including Oregon and Washington, created hybrid plans within the past 15 years.

A number of other states, facing looming pension-fund liabilities, have expressed interest in hybrid plans, industry participants say. Some officials in North Carolina and Pennsylvania, for instance, are contemplating a move to a hybrid plan.

"Reality is not negotiable," says Utah state Sen. Dan Liljenquist, a Republican who was instrumental in crafting the legislation for the state's pension changes. "The fact is somebody bears the risk. Ultimately, the state is bearing more risk than it can."

Total unfunded public-pension liabilities in the U.S. increased to \$457.8 billion in fiscal year 2008 from \$368.5 billion in 2007, according to a June report by Standard & Poor's. States have taken various measures to bridge that funding gap, including scaling back cost-of-living adjustments, increasing monthly contributions from employees toward their pensions or extending the retirement age.

Often the changes only affect new hires.

ASSOCIATED PRESS NEWSWIRES
North Carolina OKs Budget

Governments trying to rein in pension costs hope these hybrid plans can represent a middle ground. Since they maintain a defined-benefit plan for workers, the hybrid plans can help lawmakers skirt the political backlash that could accompany any threat to a pension, while they move some of the investment risk to employees.

Though not a booming trend, "hybrids are being looked at now more than ever before," said Cathie Eitelberg, senior vice president and public-sector practice leader at the Segal Co., whose clients include government pension funds.

In Utah, most current employees are in a pension where the state in 2010 contributes 16% of an employee's monthly income. Workers do not contribute. Faced with rising contribution rates, lawmakers voted to have new workers as of July 1, 2011 choose to enroll in a defined-contribution plan—like a 401(k)—or a hybrid plan.

In the hybrid plan, workers can invest in a 401(k)-type fund. State and employee contributions to the defined-benefit portion of the hybrid plan fluctuate based on the financing of the pension fund. The state contribution is capped at 10% across both parts of the plan.

In Michigan, new school employees as of July 1 contribute 2% of monthly income to a 401(k)-type fund, with state employers matching up to 1% of pay. Employees are automatically enrolled in the fund but can choose to opt out or choose to contribute more.

There is still a defined-benefit component, but it will cost the state less: Public employers will contribute on average 2.5% of an employee's monthly income toward retirement, down from an average base of 4%. There is no longer a cost-of-living adjustment in retirement.

Retirement officials hope that most new employees will contribute to the 401(k)-type fund to try to maximize their retirement benefits by taking advantage of the employer match, said Phil Stoddard, director of Michigan's Office of Retirement Services.

"We hope to create a culture of savings" with the defined-contribution component, Mr. Stoddard said. The 401(k) component becomes portable, which he said can make the benefit plan attractive for younger workers who are unlikely to remain in one job for 30 years, Mr. Stoddard said.

Some workers aren't enthralled. "It's less benefit overall because of the variability of that 401(k) component," said Doug Pratt, director of communications for the Michigan Education Association, a union representing 130,000 school employees.

The reduced benefits mean "we're going to lose some good people" who will find the benefits package less attractive, he said. But a hybrid plan is "certainly a better alternative than ditching pensions all together."

The vast majority of public sector employees have a defined-benefit plan-79% in 2008, according to the Employee Benefit Research Institute, a nonprofit research institute in Washington. In comparison, 33% of private-sector employees were enrolled in a pension plan in the same period.

Eighteen percent of state workers had a defined-contribution plan in 2008, compared with 55% of private-sector workers enrolled in a defined-contribution plan.

The heightened interest in hybrid plans doesn't appear to foreshadow a swift change toward defined-contribution plans. Though defined-contribution plans are often on legislative agendas, they rarely have been adopted in the public sector, says Ron Snell, director of the state-services division for the National Conference of State Legislatures.

Only Alaska and the District of Columbia have mandatory defined-contribution plans for all workers, according to a June report by Mr. Snell.