

# Evaluating Public Employee DC Options in Oklahoma

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Prepared by:

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# Pension Integrity Project at Reason Foundation



We offer pro-bono technical assistance:

- **Customized analysis** of pension system design, trends
- **Independent actuarial modeling** of reform scenarios
- Consultation and modeling around **new policy designs**
- Latest pension reform **research and case studies**
- **Peer-to-peer mentoring** from state and local officials who have successfully enacted pension reforms.
- Assistance with **stakeholder outreach**, engagement, and relationship management
- Design and execution of **public education programs** and media campaigns

# Objectives of Good Pension Reform

- **Keeping Promises:** Ensure the ability to pay 100% of the benefits earned and accrued by active workers and retirees
- **Retirement Security:** Provide retirement security for all current and future employees
- **Predictability:** Stabilize contribution rates for the long-term
- **Risk Reduction:** Reduce pension system exposure to financial risk and market volatility
- **Affordability:** Reduce long-term costs for employers/taxpayers and employees
- **Attractive Benefits:** Ensure the ability to recruit 21st Century employees
- **Good Governance:** Adopt best practices for board organization, investment management, and financial reporting



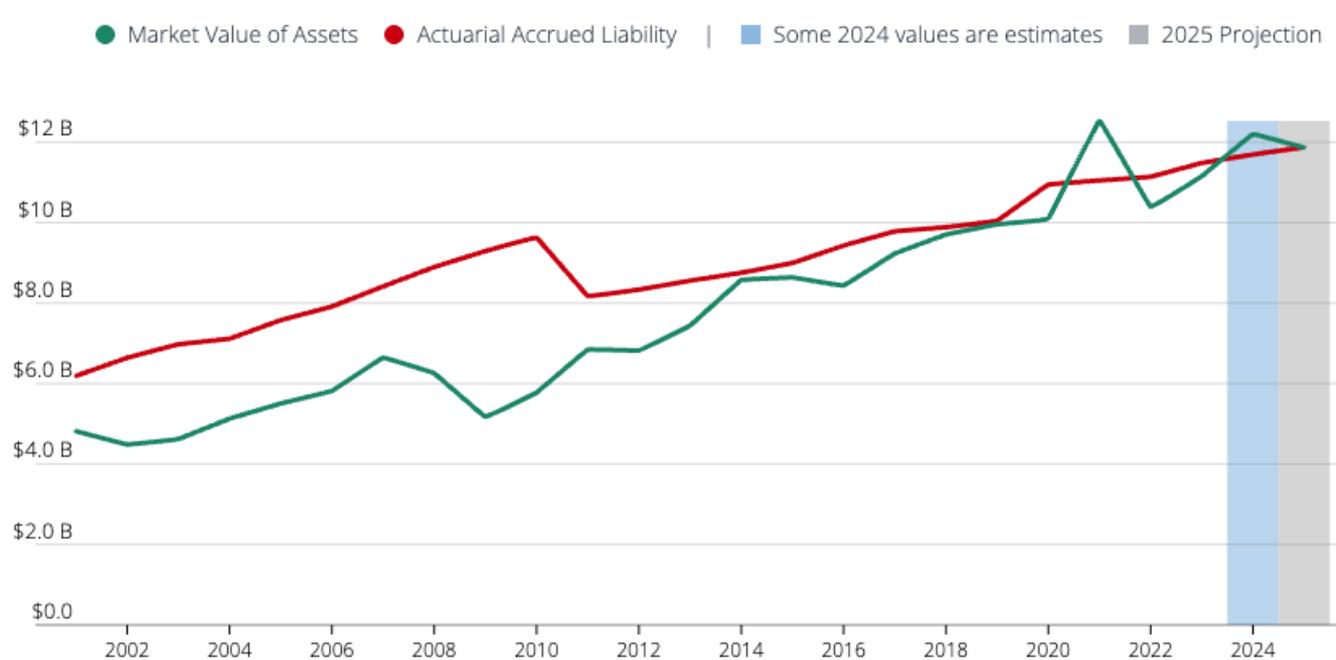
# HISTORY OF DC PLANS IN OKLAHOMA

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How Oklahoma became a leader in public sector DC plans

# History of DC Success in Oklahoma

- In 2014, lawmakers made Pathfinder the primary retirement plan for all new OPERS members.
- Pathfinder (in addition to several cost-saving and funding reforms made in 2011) was instrumental in reversing and maintaining course on OPERS funding.





# EVALUATING & STRENGTHENING OKLAHOMA'S DC OPTIONS

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What can be done to improve the DC plans offered to Oklahoma's public employees?

# Pathfinder Benefit Adequacy

- Best practice standards for Social Security participating DC plans call for contributions to total 10-15%
- Pathfinder Contributions:

	Min	Optional Max
Employee	4.5%	7.0%
Employer	6.0%	7.0%
TOTAL	10.5%	14.0%

- These contribution rates meet industry standards for adequate retirement savings
- Lawmakers should evaluate and seek to improve the adoption rates of the optional contribution.

State	Plan	Employee Type	Does Not Participate in SS	Employee Contribution	Employer Contribution	Total Contribution
OH	STRS	Teacher	X	14.00%	9.53%	<b>23.53%</b>
CO	PERA	General	X	10.50%	10.50%	<b>21.00%</b>
AZ	PSPRS	Safety		9.00%	9.00%	<b>18.00%</b>
OH	PERS	General	X	10.00%	7.50%	<b>17.50%</b>
MT	PERA	General		7.90%	8.63%	<b>16.53%</b>
AK	TRS	Teacher	X	8.00%	7.00%	<b>15.00%</b>
ND	PERS	General		7.00%	7.12%	<b>14.12%</b>
SC	SCRS	General		9.00%	5.00%	<b>14.00%</b>
OK	PERS	General		7.00%	7.00%	<b>14.00%</b>
AK	PERS	General	X	8.00%	5.00%	<b>13.00%</b>
FL	FRS	General		3.00%	8.30%	<b>11.30%</b>
PA	PSERS	Teacher		7.50%	3.50%	<b>11.00%</b>
PA	SERS	General		7.50%	3.50%	<b>11.00%</b>
OK	PERS	General		4.50%	6.00%	<b>10.50%</b>
MI	PSERS	Teacher		3.00%	7.00%	<b>10.00%</b>
MI	SERS	General		3.00%	7.00%	<b>10.00%</b>
UT	URS	General		0.00%	10.00%	<b>10.00%</b>

Pathfinder members have the option to contribute an extra 2.5% for an additional 1% employer match.

Source: Pension Integrity Project analysis of government DC plans.

# Pathfinder Vesting

- Employee contributions vest immediately
- Employer contributions vest gradually over five years

Year 1	Year 2	Year 3	Year 4	Year 5
20%	40%	60%	80%	100%

- Best practice for DC plans is to have all contributions vested within three years.
  - Long vesting requirements leave many new hires without adequate retirement savings.
  - Reason analysis estimates that 64% of new hires leave OPERS before their 5<sup>th</sup> year.

# Clarifying Objectives of Pathfinder

- Retirement security and guaranteed lifetime income goals for Pathfinder should be codified into law through a clear objective statement.
  - Useful as policy guidance to the OPERS Board for the ongoing design features and administration of the Plan

# Investment Focused on Achieving Lifetime Retirement Security

- The OPERS Board offers a participant-directed investment menu of mutual funds with a target date series. The default investment is a custom balanced fund. According to the most recent annual financial report, about 81% of assets are in the default balanced fund.
- Lawmakers should direct OPERS to modernize these options:
  - Set a default investment option that adjusts investment allocation over an individual's career with the intent to accumulate assets at retirement sufficient to provide the retirement income objectives of each participant.
  - Require regular individualized investment advice and retirement income planning services based on measurable lifetime-income goals.

# Individualized Financial and Retirement Income Planning Services

- Direct the OPERS Board to provide individualized education and planning services to help set, measure, and adjust personal retirement income and savings goals as needed during their working years to help participants meet their financial objectives in retirement.

# Lifetime Benefit Guarantee

- One of the advantages of a DC plan is the wide range of options available to members at retirement, but modernized DC plans are optimizing and promoting products that ensure a retiree does not outlive their benefit.
- Pathfinder should offer in-plan selected annuity options that provide guaranteed benefits for life.
- The default distribution form should be one that secures a lifetime income with survivor benefits.

# Main Takeaways

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- OPERS' Pathfinder has been a leader among government-sponsored DC plans.
- Lawmakers should seek to further modernize Pathfinder
  - Reduced vesting requirements would ensure that more of Oklahoma's government employees are building adequate retirement savings.
  - Defaults for investment options should reflect retirement security goals.
  - To make Pathfinder an effective source of guaranteed lifetime income, benefit distribution options should include an in-plan lifetime annuity, and this should be the default distribution method.
  - Pathfinder would benefit from a clear and actionable "objectives" statement in law, setting "lifetime retirement income" as the end-goal of the plan.

# Questions?

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# EXHIBIT: IN-PLAN LIFETIME INCOME OPTIONS FOR DC PLANS

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# In-Plan Advantages vs Retail Annuities

- Priced on group mortality, not individual mortality
- Priced on unisex basis
- Potential for less adverse selection bias
- Can offer cash withdrawal flexibility during deferral periods
- Pricing can reflect competitive bidding advantages
- No commissions or sales charges

# In-Plan Lifetime Income Options for DC Plans

- **Single Premium Immediate Annuities (SPIAs)**
  - Annuity contract purchased at time of retirement – payments start immediately
- **Deferred Income Annuities (DIAs)**
  - Annuity contract(s) purchased with payment deferred to future date/age
- **Qualified Longevity Annuity Contracts (QLACs)**
  - Specialized form of DIA with benefits starting around 80-85
  - Used to purchase longevity risk protection and avoid IRC required minimum distribution rules that would otherwise apply before the delayed start date
  - \$200,000 max purchase limit

# In-Plan Lifetime Income Options for DC Plans

- **Guaranteed Lifetime Withdrawal/Income Benefit (GLWB or GLIB)**
  - A form of optional DIA with cash withdrawal option and investment return downside protection for the annuity base benefit
  - Accumulation stage and cash withdrawal similar to standard DC plan
  - Lifetime income amount based on a “benefit base” that can have a “high water mark” that protects from investment losses.
  - Lifetime income based on a % of the benefit base (e.g., 5% of benefit base at age 65)

Example: Benefit Base at age 65 = \$500,000

- Guaranteed income:  $5\% \times \$500,000 = \$25,000/\text{year}$  for life
- Cash withdrawals reduce lifetime income amount