**Issue: Teacher Pensions – Michigan**

# Michigan Republicans Fail Teachers With New Retirement System

The new retirement plan for Michigan's teachers fails to support them and will leave the state financially exposed when teachers find they have insufficient retirement funds in their future. It also hinders the ability of schools to hire and retain critically-needed teaching resources across the state at a time when the state has teacher shortages and teacher training programs are facing low enrollment numbers.

## Republicans Weaken Teachers' Security

In 2017, Rick Snyder and the Republican legislators passed Senate Bill 401 that weakens the retirement security of the state's public school employees. Following the 2010 trend when the traditional defined-benefit pension plan was changed to a hybrid defined-benefit/defined-contribution system, legislators were ready to move all members to a defined-contribution-only plan.

Thanks to the strong public outcry from Michigan Education Association's members, there are still two retirement plan choices: a 401(k)-style defined contribution plan and a hybrid defined-contribution/defined-benefit plan.

## Retirement Plans Explained

A defined benefit pension plan (DB plan) is one in which an employer promises a fixed amount when you retire (lump-sum or monthly payments) with the amount based on salary history and years of service. The employer contributes the money and hires professional money managers.

A defined contribution plan (DC plan) is a mix of contributions from the employee and employer. Investment decisions are made by the employee who is given an array of investment choices such as mutual funds, annuities or an option to invest directly in securities with or without a broker's advice.

Under a defined contribution plan, it is anyone's guess as to how much will be available at retirement. It is dependent on the teacher's salary and is subject to investment decisions made, how the market performs, and whether a teacher can afford to make the voluntary contributions into the system that get matched by their employer. It may be subject to high investment, recordkeeping, commission, and annuity fees.

## How Have Defined Contribution Plans Fared?

Twenty years ago, state employees (other than school employees) were converted under a defined contribution-only plan. How have they fared? Very poorly. The Michigan Office of Retirement Services reported that the median account balance for state employees is only $37,000 in total. This is entirely insufficient for retirement.

How have other states' defined contribution plans fared? Not well. In some instances, retirement plans have reverted back to the pension-style plans.

- In 2014, New London, Connecticut firefighters converted back to a pension plan when their defined contribution plan failed to provide the necessary level of financial security.
- After the recession, Connecticut's state employees successfully campaigned for the right to rejoin the closed state pension plan. Savings since this reversion are estimated at $10 million per year.
- In 2005, West Virginia reopened its pension system for teachers after closing the plan in the nineties. Why? The 401(k)-style plan used in the interim left thousands materially unprepared for retirement. Since reopening the pension plan, funding levels have doubled and teachers can now rely on secure retirement funds.

## Why Are Defined Benefit Pension Funds Unpopular with Employers and States?

One popular misconception is that pension funds lead to massively underfunded pension liabilities for the state.

How did so many pension funds become underfunded? Employers made promises, but failed to invest sufficiently to meet those promises. They knowingly underfunded the funds for decades. Employers made overly optimistic assumptions about investment returns and failed to respond as those assumptions proved wrong. When managed carefully, pension funds are not underfunded.

Another popular misconception is that DB plans are more costly than 401(k) style DC plans

In fact, DB funds drive several economic efficiencies that substantially lower costs. First, larger DB funds are charged much lower investment management fees than individual investors in DC plans. Second, large DB plans with many members allow professional money managers to use average life expectancies whereas individuals have to plan as if they will live beyond the average which increases the contributions levels. Third, individual investors are advised to de-risk their portfolios as they age (moving to lower return fixed income investments), whereas pension fund managers can keep the group investments in higher return diversified portfolios. Because costs can run 50 to 90 percent higher for DC plans, when tax dollars are spent on retirement benefits, a DC plan yields substantially lower value compared to a DB plan.

## If Most Businesses Have Shifted to Defined Contribution Plans, Why Shouldn't Teachers?

Michigan Institute of Research and Service (MIRS) has studied the differences between corporate business interests and the public sector. The public sector serves a different mission, focused on the public good, and favors lower turnover, longer tenure, and job ladders. Compensation policies have been tailored to encourage longevity, including defined benefit retirement plans.

It has been well documented that DB pensions serve to recruit and retain valuable, high-quality teachers. Because a secure retirement is valued so highly, it provides some compensation for the fact that teachers accept lower salaries than what corporations might pay.

MIRS researchers Nari Rhee and William Fornia wrote that "public employee retirement policy provides an opportunity for policy makers to achieve multiple objectives by facilitating the ability of public employers to attract and retain skilled workers and provide public services in a high-quality and cost-effective manner, while also promoting the retirement security of the sizeable workforce that is employed by state and local government."

## What have other states done with their public sector retirement plans?

Most states have not closed their pension plans but have instead modified them. Texas, Minnesota and California each conducted studies to understand the costs and benefits of moving away from their DB plans. Among their findings were the following: closing a DB plan would be costly, possibly in the billions, using a DC plan would be inefficient and costly, an individually directed DC plan would only give participants a 50 percent chance of earning 60 percent of the value derived from the DB plan, and their state would face the risk of many more future retirees dependent on public assistance due to not just market risk, but higher management fees and lower returns in individual investment accounts.

## So why did Michigan defy the research and try to close the pension plan?

To his credit, Governor Snyder did not want to. Republican legislators insisted. Senate Majority Leader Arlan Meekhof said he'd refuse to pass a budget unless the teacher pensions were abandoned.

Governor Snyder compromised by keeping a smaller pension as one part of the hybrid plan with the other part being a DC 401(k) and 457 type plan. However, the hybrid plan is not the default. If a teacher fails to make a choice within the time given, they are defaulted to the strictly defined contribution 401(k)-style plan only.

## Who Promotes the Misinformation About Teacher Pension Plans?

There has been a well-funded, well-orchestrated countrywide attack on pension plans from entities like the Koch brothers' Americans for Prosperity, the American Legislative Exchange Council, and the Laura and John Arnold Foundation (built by Enron fortunes). Efforts have included campaign contributions, ballot initiatives, lobbying, lawsuits, proposed legislation, and the financing of academic and judicial conferences.

In Michigan, organizations funded by the DeVos family including the Mackinac Center and the Reason Foundation have pushed for conversion of public DB plans to 401(k)-style DC plans.

The fake and misleading statements of these groups have become accepted wisdom in many places. They say that pensions are in crisis and that 401(k)-type plans are the answer.

David Webber, a law professor at Boston University, writes in the New York Times about the reasons the investor class hates pensions. "Substantial empirical evidence shows that America's favored retirement vehicle — the 401(k), recently renounced by its own inventors — is grossly inadequate and will leave tens of millions of Americans with insufficient retirement assets. And yet states and cities are busy converting traditional pensions into these failing 401(k)'s or equivalents, to the great benefit of money managers and the finance class."

Webber goes on to explain that pension plan managers are instrumental in representing the interests of the pension members in their role as corporate shareholders. Most workers with 401(k)-type plans have no one to represent them and do not always have the time or expertise to represent themselves.

Pension funds have been very successful in reforming the role of shareholder rights. They lobbied for disclosure of the CEO/worker pay ratio and for significant shareholders to be able to put board candidates on corporate ballots. Pension funds have led some of the most successful lawsuits against companies engaged in wrongdoing, including Enron, Wells Fargo and Worldcom.

When pension funds are all shuttered, who will hold the corporations accountable?

John Arnold, a former Enron Corporation executive contributed $50 million to the anti-pension efforts. He denied that this was true, but is it any surprise to find that he wants to close pension funds that brought the misdeeds of Enron Corporation to justice?

## What will happen to teachers?

Teachers represent the largest single workforce in America. When teachers have insufficient retirement funds, it is going to be a drain on the resources of the country and the states that have ignored teachers. The Michigan Republican legislators have put teachers in a tenuous position, which ultimately will affect not just all the teachers but also the taxpayers of our state.

Additionally, the change in teacher retirement benefits will hinder our ability to hire new and experienced teachers. In-state teacher preparation programs are experiencing steep declines in enrollment numbers. This can only worsen that trend.

Michigan has a long way to go to achieve a goal of being in the top 10 percent for educational performance of schools. This is just another step in the wrong direction.

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