**The Case for Adjustable Defined Benefits**

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Monday, August 4th, 2014

Notwithstanding the fact that “adjustable defined benefits” might constitute an oxymoron, as a concept it represents the only way that defined benefit plans can be sustained. Rather than throwing new employees into individual 401K plans, while they effectively subsidize legacy defined benefits for veteran employees and retirees, why not adjust defined benefits down to a financially sustainable level and let everyone participate?

Let’s set aside for a moment the debate over whether or not defined benefit plans are just fine the way they are, and can survive with merely incremental refinements – eliminating spiking, raising contributions a bit, bumping the retirement age a few years. Those solutions buy time, but unless the investment market roars for another 30 years, they will not solve the problem. And in the context of equitable policy, that debate is moot, because if these plans are just fine, than nobody should object to reforms that will make benefits adjustable if and when they are no longer fine.

Three good examples of how adjustable defined benefits can be implemented are the proposed “[Government Employee Pension Reform Act of 2012](http://www.californiapublicpolicycenter.org/wp-content/uploads/2012/08/State_Initiative_filed_Nov_2011_Gov_Empl_Pension_Reform_Act_v1_Text.pdf),” an California citizen’s initiative proposed by pension reformer Dan Pellissier that failed to qualify for the ballot, the City of San Jose’s “[Measure B, Public Employee Pension Plan Amendments](http://www3.sanjoseca.gov/clerk/elections/2012Election/fulltextmeasureb.pdf),” passed overwhelmingly by voters in 2011 and currently deadlocked by union court challenges, and the “[Fifth Amended Plan for the Adjustment of Debts of the City of Detroit](http://www.kccllc.net/detroit/document/1353846140725000000000004),” submitted to the court on July 25, 2014.

Here are summaries of what these plans do:

California’s proposed 2012 initiative, the Government Employee Pension Reform Act of 2012, would have allowed emergency changes – adjustments – to pension benefits if the pension system was deemed to be less than 80% funded. It would limit employer contributions to 6.0% of payroll for non-safety and 9.0% for safety, then add an additional employer contribution (approx. another 6.0%) to match what an employer would be required to contribute to social security. It then would have required employees to either contribute through withholding the balance of necessary funding required to maintain pension fund solvency, or participate in a new benefit plan as defined for new hires if they didn’t want to increase their pension contributions.

San Jose’s 2011 Measure B would gradually increase current employee pension contributions to 16% of pay, and offer “Voluntary election plan” (VEP) for current employees who don’t want to pay 16% for their pension. This plan limits – adjusts – an employee’s pension accrual for future years of service to 2.0% of final compensation times years worked and gradually raises age of retirement eligibility to 57 for safety and 62 for non-safety personnel. Measure B also revised the defined benefits for new employees to cap city contribution to 50% of plan cost or 9%, whichever is less, raised the retirement age to 60 for safety and 65 for non-safety personnel, and capped pension benefits at 65% of final compensation. It then authorized the city to suspend cost of living adjustments if the city declares a “fiscal emergency.”

Detroit’s proposed solution to their pension challenges takes place against a dire backdrop of economic and demographic implosions decades in the making and unlikely to ever confront a major California city. But the “triggers” they built into their revived plan, which retains defined benefits, provide useful ideas for Californians. Reviewing the “New GRS Active Pension Plan – Material Terms” (above link, page 58-59, item 12), the plan calls for implementing “risk shifting levers” at any time the funding level goes below 100%. They include, in order of application, and for as long as necessary, (1) no COLAs will be paid, (2) employee contributions will increase by 1% to 5% of base compensation, (3) most recently awarded COLAs will be rescinded, and (4) the benefit accrual rate will be decreased from 1.5% to 1%.

To reiterate: If defenders of California’s 83 public employee defined benefit systems are confident that incremental reforms as previously noted are sufficient to guarantee the financial solvency of these plans, then they should make no objection to permitting more drastic means – that effectively make defined benefits adjustable – should incremental reforms be insufficient.

Saving the defined benefit by introducing flexibility to the formulas accomplishes important goals. It protects taxpayers. It allows new employees to also have a defined benefit plan. It ensures veteran employees and retirees that the plan will never collapse completely in a financial downturn, leaving them with nothing. As an element of retirement security, a defined benefit system, because it pools the ongoing investments of thousands of participants, provides insurance against market downturns, as well as against unanticipated individual longevity. Anyone relying on an individual 401K must live with the dismal hope there will not be a severe bear market during their retirement, and that they die before they run out of money. The most compelling reason to advocate individual 401K plans for government workers is to protect the taxpayer. Making defined benefit plans modest and adjustable solves that problem in a more elegant way, but it may be naive to hope stakeholders can negotiate the necessary adjustment triggers in good faith, and implement them with integrity in the long run.

The best retirement security plan of all, implemented already for federal employees, and originally advocated by Gov. Brown before he settled for the decidedly incremental [AB 340](http://www.californiapublicpolicycenter.org/wp-content/uploads/2012/11/California_AB-340_Sept_2012_Public_Employee_Retirement.pdf), is the “three legged stool.” That is (1) a modest – and adjustable – defined benefit, (2) a contributory 401K, and (3) Social Security. Requiring high income government workers participate in Social Security, because of its progressive benefit formulas that penalize higher income workers vs. lower income participants, would go a long way towards further stabilizing that system.

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