Nevada toying with changing retirement system

By Sean Whaley, Nevada News Bureau

CARSON CITY – Scott Beaulier is no fan of states borrowing money, but in his new working paper on transitioning public pensions to 401(k) style plans to reduce taxpayer liabilities to pay retirement benefits, the Troy University professor says it is an option worth considering.

In his paper “From Defined Benefit to Defined Contribution” for the Mercatus Center at George Washington University, Beaulier said the benefits of paying the upfront costs of transitioning pension plans from defined benefit, where employees are guaranteed a set amount at retirement, to defined contribution, where employees are responsible for their investment choices, outweigh the disadvantages.

“The borrowing should be one-time, and it should total the present value of all future payments owed to all retirees who do not transition to the 401(k) system,” Beaulier said in his report released last week.

The state of Michigan opted to borrow when it converted to a defined contribution plan in 1997,” he said.

“Thanks to one-time borrowing, the transition was a smooth one, and Michigan covered with debt the billions of dollars in defined benefit liabilities that it was responsible for paying,” Beaulier said. “The move, which involved taking on debt and significant political risk, has proven successful and has saved Michigan taxpayers billions of dollars in unfunded liabilities.”

Beaulier is executive director of the Manuel H. Johnson Center for Political Economy at the Sorrell College of Business at

Troy University in Alabama.

Defined benefit plans create long-term liabilities for states and taxpayers, while defined contribution plans carry no such risk. Because of this, and the concern over the health of public pension plans nationwide, there is a growing chorus of groups advocating for the change.

Nevada lawmakers plan to study the PERS defined benefit retirement plan that covers most state and local government employees in the next 16 months before the 2013 legislative session. The legislation authorizing the study allocates $250,000 from the general fund, but requires a $250,000 match from outside sources before the work can begin.

Gov. Brian Sandoval has advocated for a switch for new employees to a defined contribution 401(k)-type retirement plan to address the long-term liability concerns.

Supporters of Nevada’s existing defined benefit plan, including public employee groups and many lawmakers, say it is well managed and will be fully funded over time. They argue no such major changes are needed.

Nevada’s Public Employees’ Retirement System had an analysis performed of the costs of switching to a defined contribution plan for new employees in 2010. The report by the Segal Group Inc., the PERS actuary, said it would cost $1.2 billion in just the first two years to begin making such a transition.

The costs are due to the need to fully fund the existing defined benefit plan for current state employees. One option would be to raise contribution rates paid by public employers and their employees, but the cash-strapped state and local governments would be hard-pressed to come up with the money to pay for it.

In an interview with the Nevada News Bureau, Beaulier said: “Those costs have to be incurred because when you reform usually what you’re doing is offering new retirees the option to go with defined contribution. But by becoming fully funded you’re guaranteeing all of those pensioners who are retiring in the future under the old system that guarantee that their money will be there.

“Borrowing in this case would actually make a lot of sense because it is borrowing to put us on a much more sane fiscal path,” he said. “So one-time borrowing that says we are converting from defined benefit to defined contribution would be a way to deal with this.”

If revenue can be found elsewhere, such as selling off resources, that would be preferable, Beaulier said. Or participants could contribute more to help fully fund the plan as well, he said.

Nevada’s existing public employee retirement plan was 70.5 percent fully funded on June 30, 2010, down from 72.5 percent in the previous year. At its high point in 2000 the plan was 85 percent funded.

A study of state and local government pension funds by the Pew Center on the States released in February 2010 identified Nevada as one of 19 states where “serious concerns” exist about the long-term health of the retirement plan.

Beaulier said the key to ensuring taxpayers don’t end up on the hook for billions in pension payments when the plans run out of money is to make the change to defined contribution.

There are problems with making such a transition, one example being if a state issues bonds to finance the up-front costs, he said. A state would have to find the money needed to repay the bonds.

But making modest changes to the existing plans, as the Nevada Legislature did in 2009, is not enough, he said.

“I think that the fiscal challenges are forcing state administrators to look closely at how to shore up the financing of their defined benefit plans,” Beaulier said. “But my guess is most of them are just going to chip away at the promises that have been made and not engage in the kind of radical reform that is needed.

“Maybe some of them need to be asking: ‘How do we save taxpayers a lot of money long term,'” he said.