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Pension tension: Retired state workers fear future payments will be squeezed

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Ron Biendseil spent 25 years in public service, most of it as coordinator for the Dane County Youth Commission.

While with the county, Biendseil worked to curb teen violence, reduce alcohol and drug use and generally improve the lives of young people. In other words, hard work for a good cause.

Now retired, Biendseil counts on a monthly payout of $1,500 from the Wisconsin Retirement System to supplement his Social Security income.

But Biendseil and thousands of other current or retired public employees in Wisconsin are worried about their financial future — and with good reason. Employee pensions are the latest target of small-government advocates looking to cut taxes and reduce spending.

And although the WRS draws high marks nationally for its fiscal soundness, state officials are now drafting a report that will outline potential changes to the system, including moving workers from a defined benefit pension into 401(k)-like private accounts. That report, which was ordered by Gov. Scott Walker as part of his 2011-13 state budget, is due out June 30.

Despite ordering the report, Walker has said he has no plans to alter the system. Yet that hasn't eased retirees' concerns.

"My biggest worry is they are going to try to fix something that isn't broken," says Biendseil, 67, who retired in 2006 and lives in Middleton.

The stakes are high. With assets of some $77 billion, the WRS is the second-largest pot of money in the state, surpassed only by Milwaukee-based life insurance giant Northwestern Mutual and its $190 billion.

The system has been able to fund itself largely through investment income, with gains historically covering about 75 percent of the costs. But with the stock market lagging badly over the past decade, taxpayers are having to kick in more to keep the WRS on track to meet its commitment to participants.

Consider: The S&P 500 stock market index has averaged just a 2.3 percent return over the 2005-2011 period, well below the 7.2 percent the WRS needs. The city of Madison alone saw its pension costs for employees rise from $18.7 million to $24.9 million over the period, a 34 percent increase. Statewide, taxpayers last year contributed some $1.5 billion into the system.

Now, emboldened by the recent recall victory in Wisconsin — and two votes the same night in California to sharply curb pensions for municipal employees — anti-government forces are taking aim at public-sector retirement systems nationwide.

The argument is that cities, towns and villages are in a deep financial crisis brought on by unreasonable demands from state and municipal workers for pay and benefits. Accurate or not, that pitch has struck a chord with taxpayers, who are increasingly questioning systems that in some cases allow able-bodied workers to retire in their 50s with full pay and health benefits.

"No one in the private sector is getting a deal like that anymore and people are starting to say 'enough,'" says Chris Edwards, an economist at the libertarian CATO Institute in Washington, D.C.

Indeed, from California to Rhode Island, almost every state is looking at their public employee retirement system. Historically weak stock market returns over the past decade, coupled with the economic fallout from the Great Recession, have only added to the pressure on lawmakers to "do something."

The numbers are not pretty.

The Pew Center on the States in a report released Monday found the gap between promises made to public employees and the amount of money being set aside for them continues to grow. In fiscal year 2010, the most complete numbers available, the gap between assets and obligations for public-sector retirement benefits was $1.38 trillion, up nearly 9 percent from 2009. Of that, $757 billion was for pension promises and $627 billion was for retiree health care.

But the Pew report also heaps praise on Wisconsin, noting it is the only retirement system left among the 50 states that remains 100 percent funded.

"In 2000, more than half of the states were 100 percent funded, but by 2010 only Wisconsin was fully funded, and 34 were below the 80 percent threshold — up from 31 in 2009 and just 22 in 2008," Pew says.

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As one might expect, states are finding it takes a lot of political will to make significant changes to their retirement system. For example, in Illinois — a state where Pew says the retirement system is just 45 percent funded — lawmakers have been at each other's throats over a proposal to require local units of government to start paying into the system. The Illinois Legislature has avoided budgeting the needed contributions for decades, leaving the system some $83 billion in the hole.

Things are different in Wisconsin, where state law requires that pension contributions be kept current by local units of government. Moreover, Wisconsin uses a "smoothing" mechanism that reduces payouts to retirees in lean times when investments in the pension fund fail to meet the current target rate of return of 7.2 percent annually. It also caps payouts in good times when investments outperform their benchmarks.

In addition, Walker's Act 10 budget repair bill of 2011 made most public workers contribute 5 percent toward their retirement. In the past, those contributions were covered by the employer, an arrangement that dates to the 1980s when state employee unions agreed to accept pension payments in exchange for a pay freeze.

"Wisconsin has done a lot of things right, no question about it," says Keith Brainard, research director for the National Association of State Retirement Administrators.

But Walker's budget also mandated the departments of Administration, Employee Relations and Employee Trust Funds to consider jointly whether the WRS should offer a 401(k)-like defined contribution plan to employees. The study must also consider whether participation in the system should remain mandatory.

Once completed, the report will go to the Joint Finance Committee and governor for possible action. Any changes to the WRS would require approval by the full Legislature.

The fear among some WRS members is that if participation is made voluntary, younger workers will opt out and keep more of their money in salary. Fewer participants, coupled with the growing number of retiring public workers, will eventually bring down the entire system, warns Buzz Davis, a retiree from Stoughton.

"Why mess with a system that is working well and regarded as the best in the country?" asks Davis, a well-known progressive activist who heads a group called Protect Our Wisconsin Retirement System (POWRS).

Davis lays out a doomsday scenario in which the entire state retirement program is farmed out to money managers on Wall Street. As evidence, he points to the nearly $800,000 in campaign contributions to Walker from securities interests — a figure that does not include any money raised during the recall.

"We know ALEC wants all these things privatized," Davis says. "Once they are, then Walker can say 'Oh, by the way, I have these friends who can help you manage the money.'"

ALEC is the American Legislative Exchange Council, a group known for drafting boilerplate conservative bills for lawmakers to introduce in their own states.

But legislators in Wisconsin appear reluctant to make sweeping changes to a system that even Republicans admit is among the best in the nation.

Rep. Pat Strachota, R-West Bend, doubts there is much support for dismantling the WRS through drastic changes such as forcing all new hires into a 401(k).

"I think the intent is to simply provide some flexibility," says Strachota, who earlier this year caused a stir when she introduced a bill to allow new hires at UW-Madison to choose a defined contribution plan instead of a traditional pension.

Strachota, whose bill was not taken up, notes that 48 other states now allow similar choices for their public university employees.

"A lot of younger people seem to like the idea of having their own accounts that can go with them when they change jobs," she says.

Walker himself has said he doesn't support making changes for current WRS "annuitants," the technical term for retirees drawing a check from the state. In February, Walker sent a message to his Cabinet secretaries to allay fears among state employees that major changes were coming to the retirement system.

At the time, Walker spokesman Cullen Werwie said the governor has "zero plans" to change the system.

"We just thought it was prudent to take a look at it, see where we are at, and compare it to other states," Werwie explained.

But union leaders here aren't waiting to see. AFSCME is working with SEIU, WEAC, the Wisconsin Professional Police Association, the Professional Fire Fighters of Wisconsin, AFT-Wisconsin and the Alliance for Retired Americans on a campaign to fight any changes. They have secured a grant from the National Public Pension Coalition, with Madison-based lobbyist Susan McMurray coordinating the effort.

"AFSCME, along with other unions, supports enhancing retirement security for all workers," says McMurray. "The right-wingers try to pit worker against worker to keep us from seeing their real agenda: to enrich the big investment firms."

Davis, a former Dane County Board and Stoughton City Council member, isn't convinced of the governor's sincerity.

"My fear is that Walker will lie again about a big budget deficit, and then try to ram through more changes and one of those changes will be a set of changes to the WRS like what the Democratic governor of New York did," he says.

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Despite the political pressures and a lagging stock market, Wisconsin has one of the soundest public worker retirement plans in the country.

Established in 1951, it has grown into the nation's ninth-largest public pension fund and the 24th-largest pension fund of any kind in the world. Over 570,000 current and past public employees are covered — everyone except Milwaukee city and county workers, who have their own pension fund.

The WRS offers a variety of payout options for retirees under a complex set of calculations. Some options provide smaller payments to retirees but allow their spouses to continue receiving benefits after they die. Other options provide accelerated payments in the beginning and reduced payments when Social Security kicks in.

Public workers in Wisconsin can retire with full benefits at age 57 if they've logged 30 years of service. Otherwise, full benefits don't kick in until age 65. Protective services employees like firefighters or police can retire at age 53 after 25 years on the job.

The goal, according to the ETF, is to provide in retirement 75 to 80 percent of a person's wages, through a combination of a state pension, Social Security and deferred compensation. The average payout is about $1,700 per month.

WRS retirees saw their payouts go down for the first time in 26 years following the 2008 recession. In that year, the worst for financial markets since the 1930s. the state's Core Fund of stocks, bonds and other investments dropped a staggering 26.8 percent in value.

While WRS assets have since logged three straight years of positive returns, it hasn't been enough to offset the 2008 losses. Also, the 1.4 percent return for the state's Core Fund in 2011 did not meet the 7.2 percent assumed earnings rate — the figure actuaries set to estimate the fiscal stability of the fund.

That has left the Core Fund with a current negative balance of $1.68 billion, meaning retirees are going to take another hit when new payouts are calculated in early 2013.

The large number of recent retirees — a record 15,274 in 2011 — is also stressing the payouts for longer-term annuitants.

The WRS sets a "floor" when a worker first retires, meaning that person's monthly payouts can never fall below that level. But because so many retirees are at the floor or have fallen to that level over the past three years, 71,000 of the system's 167,000 retirees are no longer subject to any reduction in benefits. That puts the burden to absorb the investment losses on a smaller and smaller number of people who are still being paid above their floor level.

"Announcing a sizeable decrease in annuities is not how I had hoped to begin my term as secretary," ETF chief Bob Conlin wrote in the latest WRS newsletter. He replaced longtime Secretary Dave Stella earlier this year.

But ETF Deputy Secretary Robert Marchant says the flexibility in the payouts works to protect the pension fund's health.

"The WRS has always been able to pay reasonable benefits, in part due to solid investment management and in part due to the manner in which employees, retirees, and taxpayers share the risks of the system," Marchant says. "As painful as it is, retirees contribute to the stability of the WRS by giving back previously granted investment dividends when investments fail to perform sufficiently. Investment expectations are reviewed regularly to help ensure not only that the system is adequately funded but also that the amount of taxpayer and employee dollars being invested is prudent."

In an effort to juice returns and avoid additional pension cuts, the State of Wisconsin Investment Board, which manages WRS monies, has joined other states in using more aggressive money-management techniques — including alternative investments in real estate, private deals or hedge funds.

But while many pension funds are taking bigger risks, those bets aren't necessarily paying off. Moreover, the higher fees associated with alternative investments are further weighing down returns.

Those issues were detailed in a New York Times story earlier this month that described some of the worst cases of pension funds paying high outside management fees for spotty performance.

The investment board has gradually increased its position in alternatives to about 12 percent of total assets, putting Wisconsin on the lower end of the range compared to funds like the Dallas Police & Fire fund, which had a 56 percent share in non-traditional investments as of 2011, according to the Times.

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In addition to reaching for higher yields, states are also making changes in their overall systems to better reflect the realities of a new global economy. Governments worldwide are struggling to meet promises made to their citizens. Think Greece or Spain. Or, closer to home, think Wisconsin Rep. Paul Ryan, who has warned about pending Social Security and Medicare shortfalls.

Rhode Island in 2011 passed a set of reforms to its public retirement system that go further than any other state. The effort drew praise from small government advocates who say the changes will help the state avoid severe effects down the road in a system that is an estimated $7 billion short of its obligations.

Rhode Island changed the rules for all current workers and retirees — not just new hires. Included are limits on cost-of-living adjustments, a rise in the retirement age for new employees to 67 and a shift of some of the risk of investment losses from the state to employees and retirees.

Utah is putting all new hires into 401(k) accounts, a move that absolves state or local governments from any future pension obligations since the accounts belongs to the individual. Other states are going with hybrid retirement plans that offer both defined benefit and defined contribution options.

In total, 43 states including Wisconsin have made significant changes to their pension systems since 2009.

"The bottom line is that people are being asked to work longer and will get less in benefits," says Ron Snell of the National Conference of State Legislatures, which tracks government policies.

Even New York has taken painful steps to try to avoid shortfalls in its $140 billion program, considered with Wisconsin among the most solvent of the giant public retirement systems.

Earlier this year, over the vocal objection of public employee unions, the New York Legislature, with the backing of Democratic Gov. Andrew Cuomo, approved changes that push back the retirement age from 62 to 63 for new hires and require employees to increase their pension contribution by up to 3 percent. Some higher-paid new hires are allowed to opt out of the system entirely in favor of personal accounts.

Other states are looking at going even further.

Pennsylvania is considering closing its defined benefit pension plan and creating a new defined contribution plan for state and public school employees.

"Over the past few decades, virtually all of the private sector has shifted to defined contribution retirement plans," Sen. Dominic Pileggi, state Senate majority leader and co-sponsor of the bill, said in a news release. "It's time for Pennsylvania government to do the same."

That same argument has been heard in Wisconsin, despite the state's solid performance and uniquely structured retirement system. Whether the Legislature here has the energy and political capital to make those kinds of changes remains to be seen.

To retired Dane County social worker Biendseil, a better solution would be to allow more people into the WRS rather than to reduce the number of participants by making the system voluntary.

"I think every working person deserves to have some security in their old age," he says.