Does Arkansas' Teacher Retirement Plan Provide "Adequate" Benefits?

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TeacherPensions.org
FIXING AN UNFAIR AND INSECURE SYSTEM

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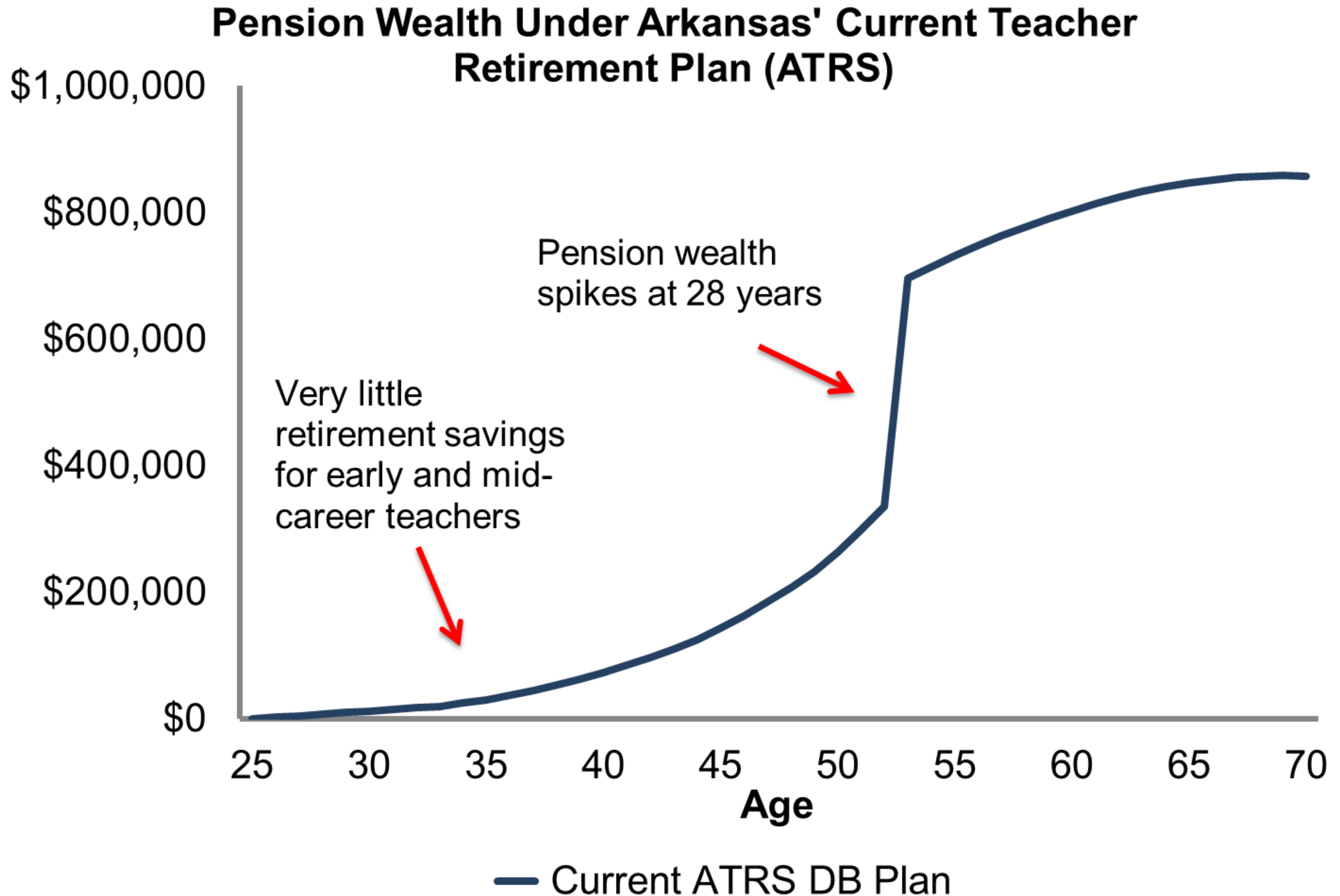
Two key takeaways about Arkansas' Teacher Retirement System (ATRS)

1. The current plan does not provide all Arkansas teachers with adequate retirement benefits. This is a function of how benefits are delivered, not the amount of contributions going into the plan.

2. Pension systems are not effective tools to attract and retain a high-quality workforce. Ultimately, retirement benefits should be designed for workers, not their employers.

The current plan does not provide all Arkansas teachers with adequate retirement benefits.

Due to a back-loaded benefit structure, Arkansas teachers suffer from attrition risk, the risk that they might leave.



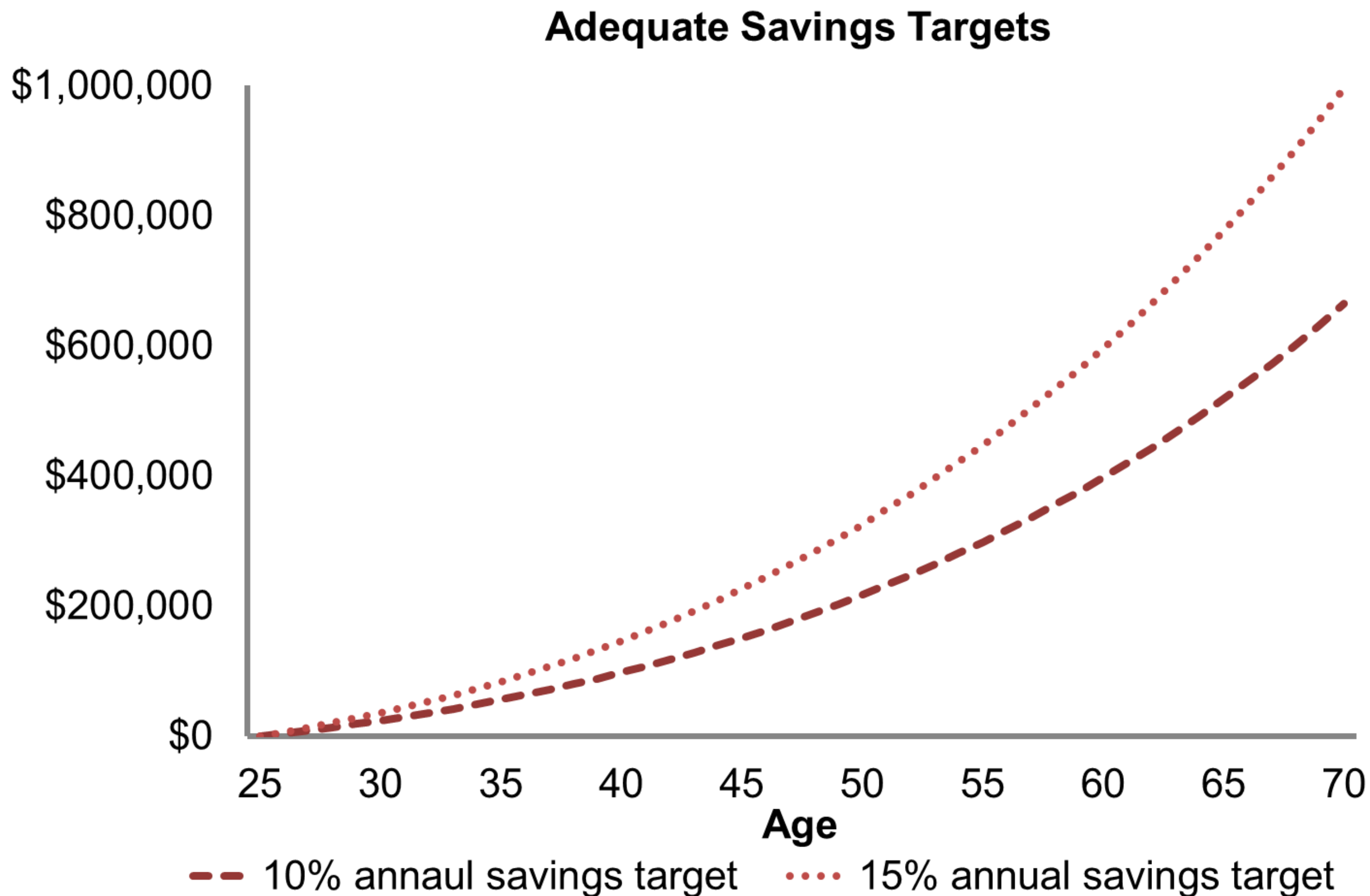
Are Arkansas’ benefits adequate? For how many teachers?

- Defining adequacy:

  Workers should strive to replace 60-80% of their pre-retirement income, including Social Security.

  To accomplish this, workers need to save 10-15% of their annual salary and earn a 4% real rate of return on those contributions.

The adequate savings lines help establish targets for retirement savings by age.

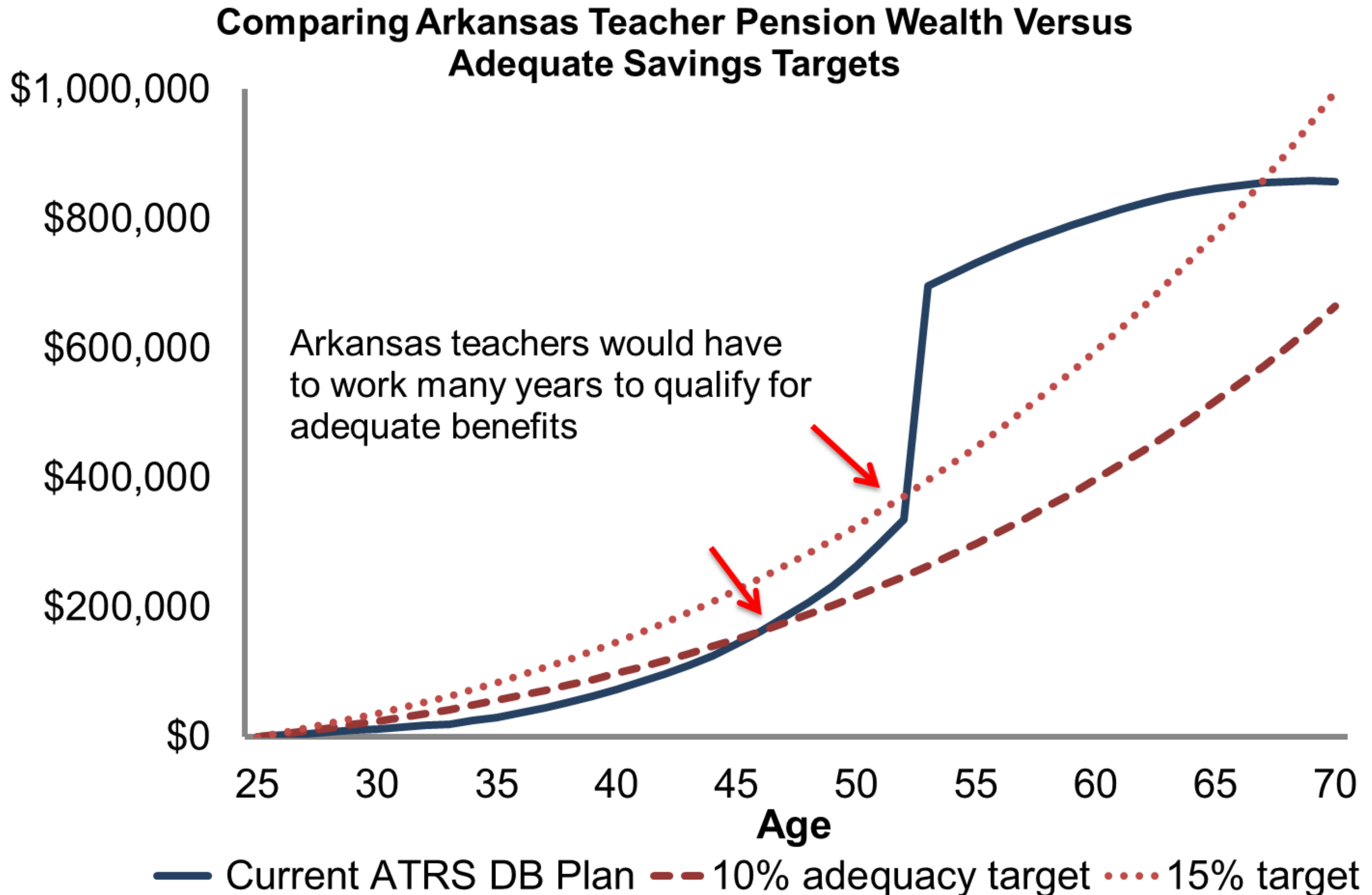


At first glance, Arkansas' teacher retirement benefit does appear adequate.

- Overall contributions are sufficient—employees contribute 6% and employers contribute 6.44% toward retirement.
- Arkansas teachers do participate in Social Security.
- Replacement rates for full-career teachers are good.

➢ However, Arkansas' benefit structure delivers benefits unevenly, leaving many teachers with inadequate savings.

Arkansas teachers must stay for long stretches of time in order to qualify for adequate benefits.



Are there other models that could provide a higher share of Arkansas teachers with adequate retirement benefits?

- I looked at two comparisons, a defined contribution plan offered by the University of Arkansas and the T-DROP cash balance plan currently offered only to early retirees.
- My goal was to analyze the *structure* of how assets accumulate under each plan.

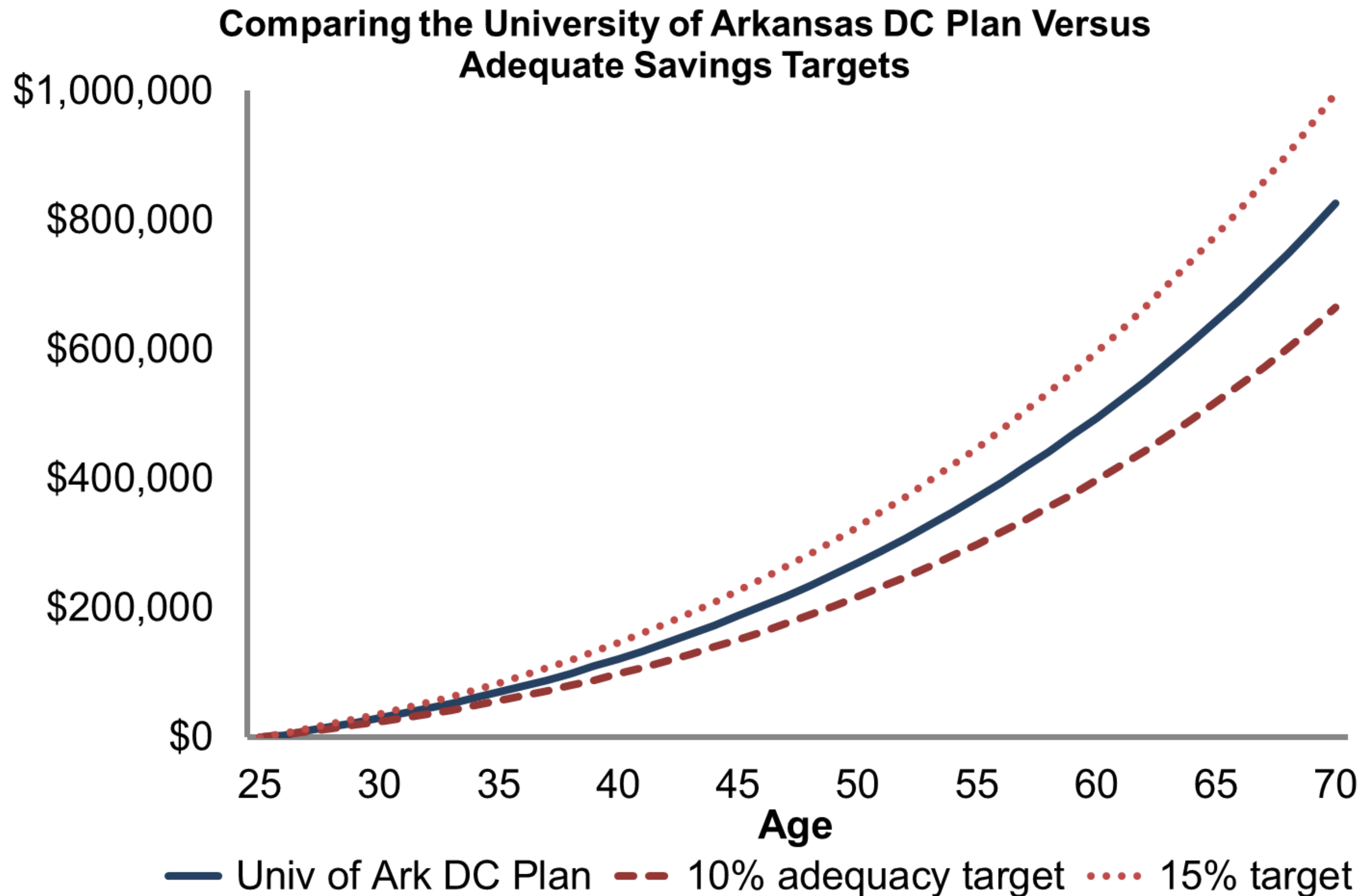
How the University of Arkansas defined contribution (DC) plan works.

- Employees must contribute at least 3 percent of salary, but can contribute up to federal maximum.
- The employer contributes at least 5 percent, and will match employee contributions up to 10 percent.
- Employer contributions “vest” after 2 years.
- Contributions are invested in TIAA or Fidelity accounts, at the employee’s discretion.
- Accounts are fully portable and are owned by the employee.

Comparing the University of Arkansas defined contribution (DC) plan to the adequate savings targets.

- To compare the University of Arkansas DC plan to the same adequacy targets, I assumed:
  - Employees contribute 6 percent of salary.
  - The employer matches the 6 percent.
  - Employer contributions vest after 2 years.
  - The employee earns annual returns of 6.5 percent (4 percent real).

Under these assumptions, the Univ. of Ark. DC plan would ensure nearly all employees reach a minimal savings target.



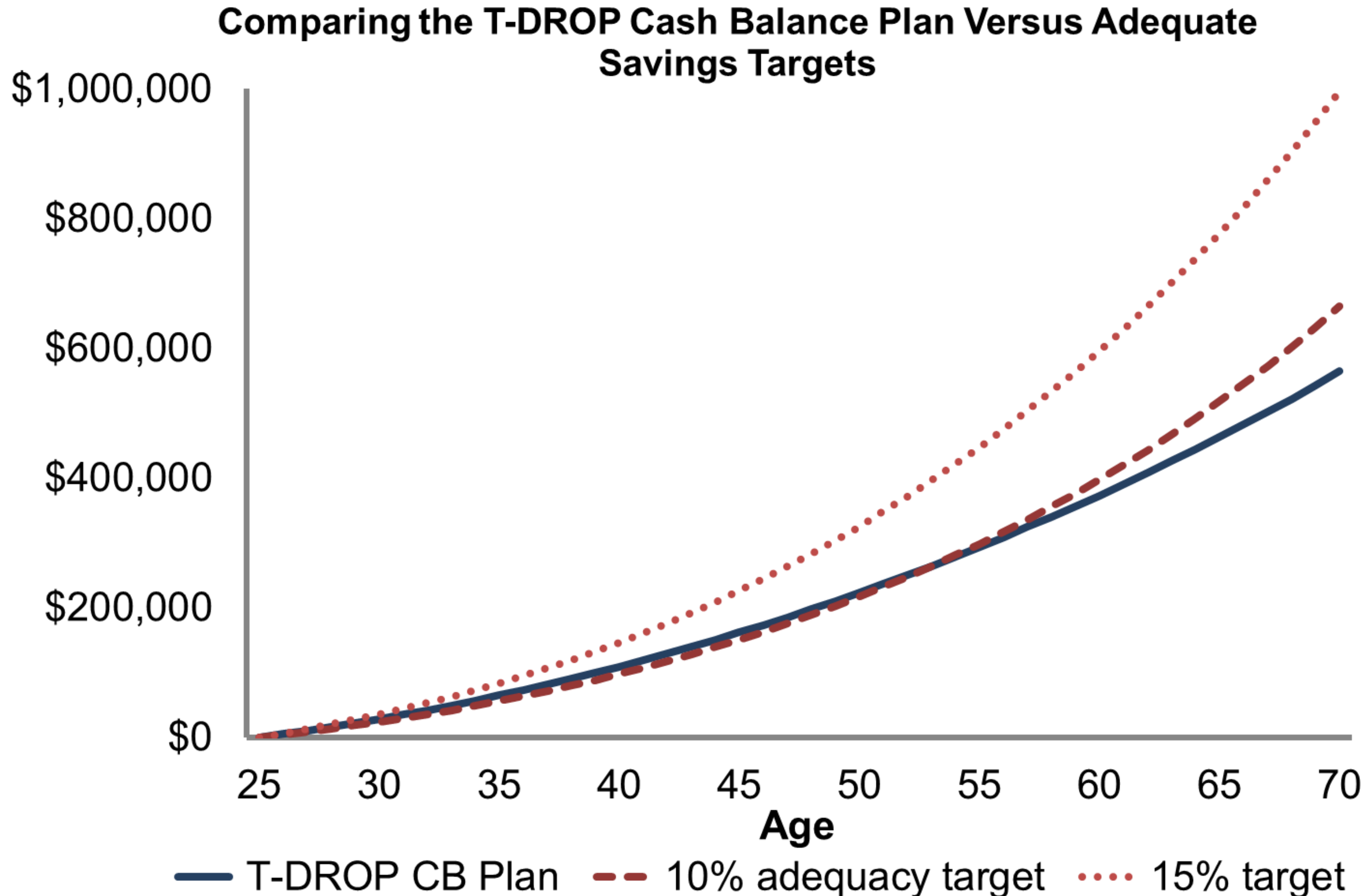
How the T-DROP cash balance plan works.

- Employees do not contribute.
- The employer contribution is determined as a function of the employee's years of service.
- Contributions "vest" immediately.
- Contributions grow at a pre-determined rate (currently 3 percent), but ATRS can increase that rate during years with strong investment returns.
- Employees can choose a lump-sum distribution or monthly annuities based on the balance.

Comparing the T-DROP plan to the adequate savings targets.

- To compare the T-DROP plan to the same adequacy targets, I assumed:
  - Employees contribute 6 percent of salary.
  - The employer matches the 6 percent.
  - Employer contributions vest immediately.
  - The employee earns annual returns of 4.9 percent nominal (the current 5-year average).

The T-DROP plan would protect most teachers, but lower investment returns hurt its long-term accumulation.



These examples show that Arkansas could achieve better results for workers by changing the *structure* of their plan.

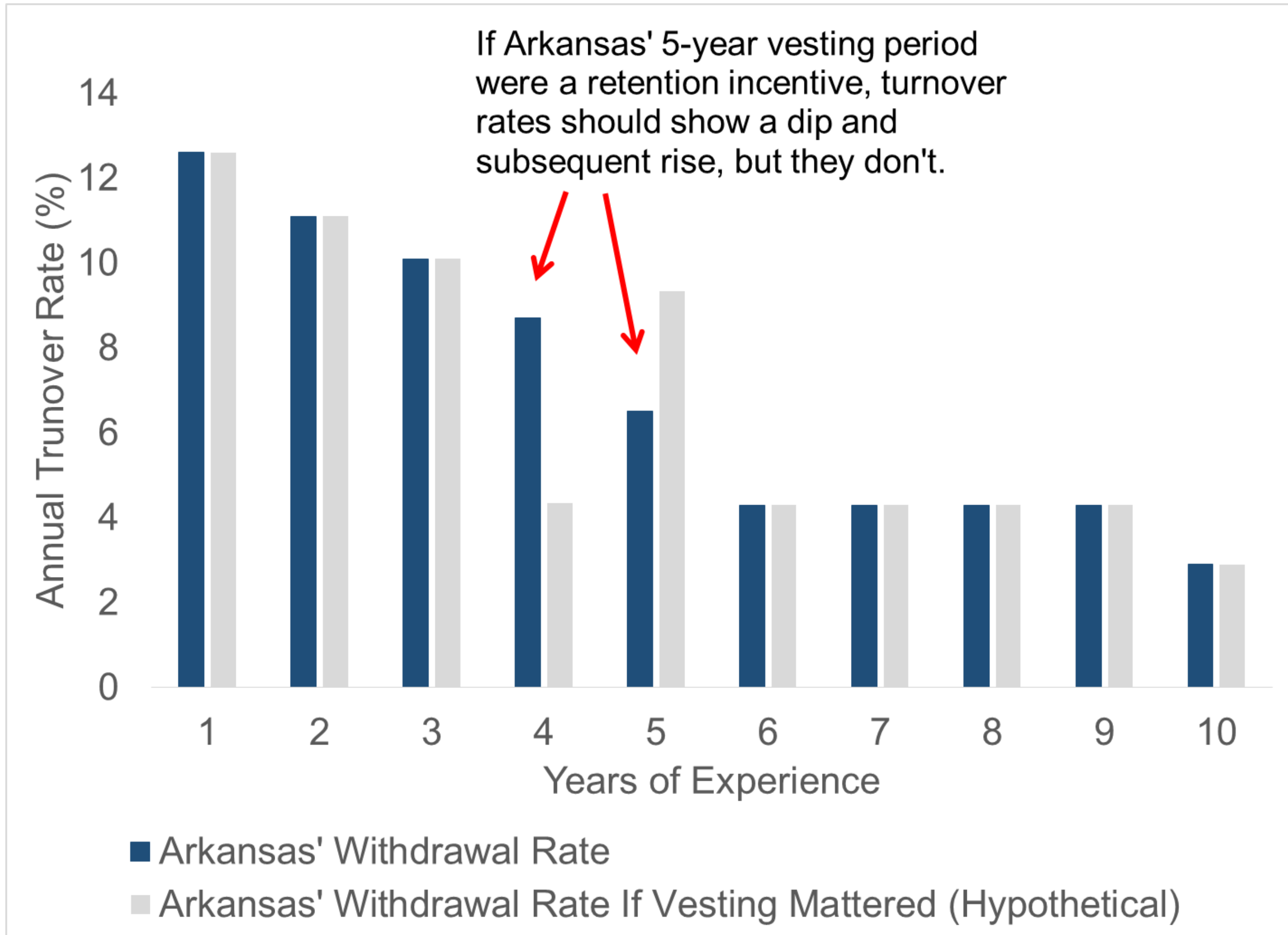
- Both the University of Arkansas DC plan and the T-DROP cash balance plans have steadier accrual patterns. As a result, they do a better job of covering all workers.
- Either plan could be tailored to suit the needs of Arkansas' teacher workforce, and the state could "nudge" teachers to make smart decisions (e.g. make adequate contributions, keep fees low).
- Either plan could allow workers to convert lump sum accounts into monthly annuities.
- Neither option would accumulate additional unfunded liabilities, and the state could continue to pay down its existing debts.

Would changes to the pension plan affect the state’s ability to attract and retain a high-quality workforce?

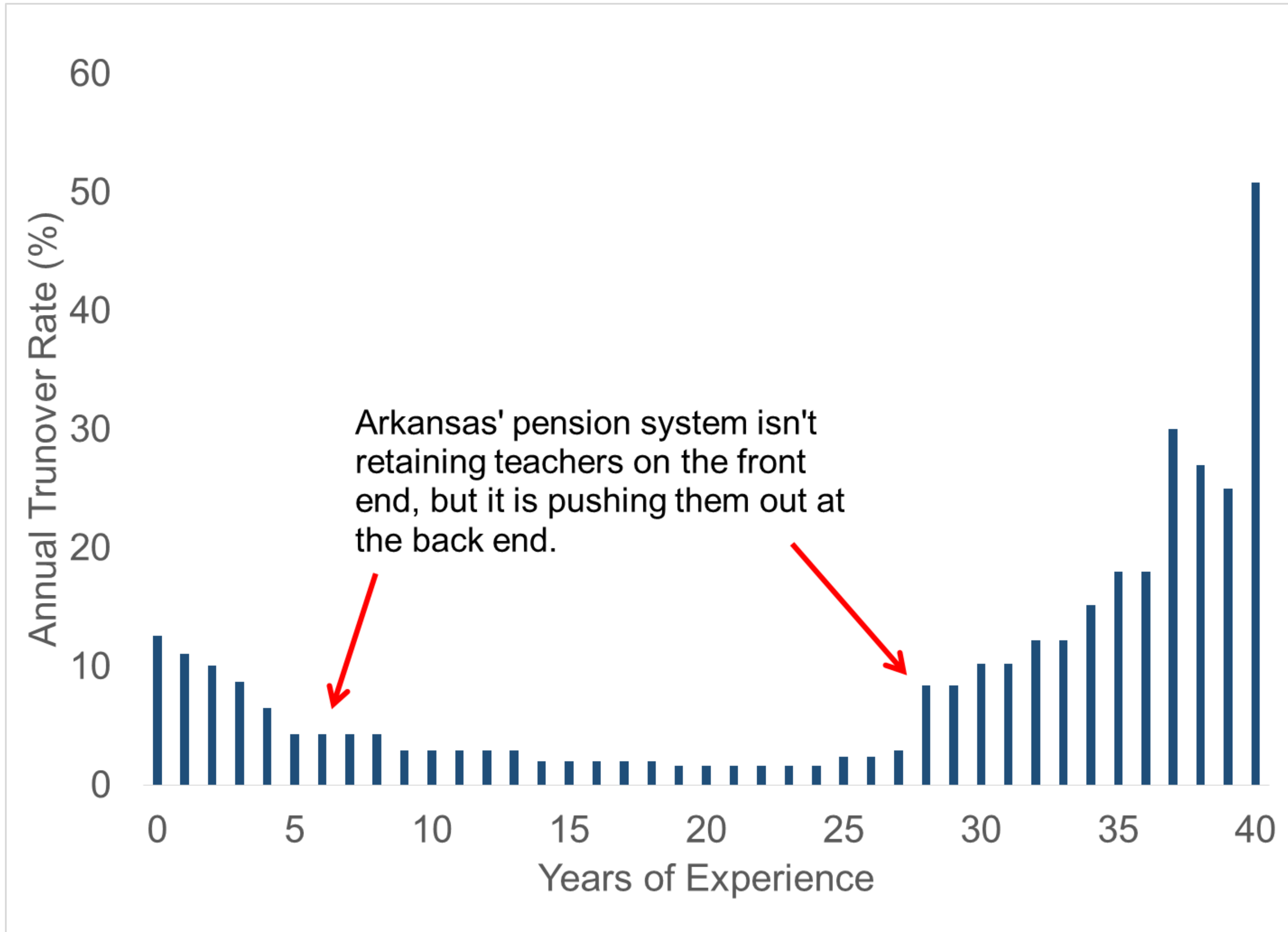
Workers, especially young and mid-career teachers, do not change their behavior based on retirement issues.

- A recent study found that increases in employee contribution rates had no effect on teacher recruitment.
- No state assumes that teachers change their behavior in order to qualify for a pension.
- Late-career teachers do stick around to maximize their benefits, but this applies to only a fraction of workers.
- Pensions also exert a late-career "push out" effect that encourages veteran teachers to leave the profession.
- On net, enrolling new workers in a new plan (especially a good one) is not likely to significantly alter overall teacher quality.

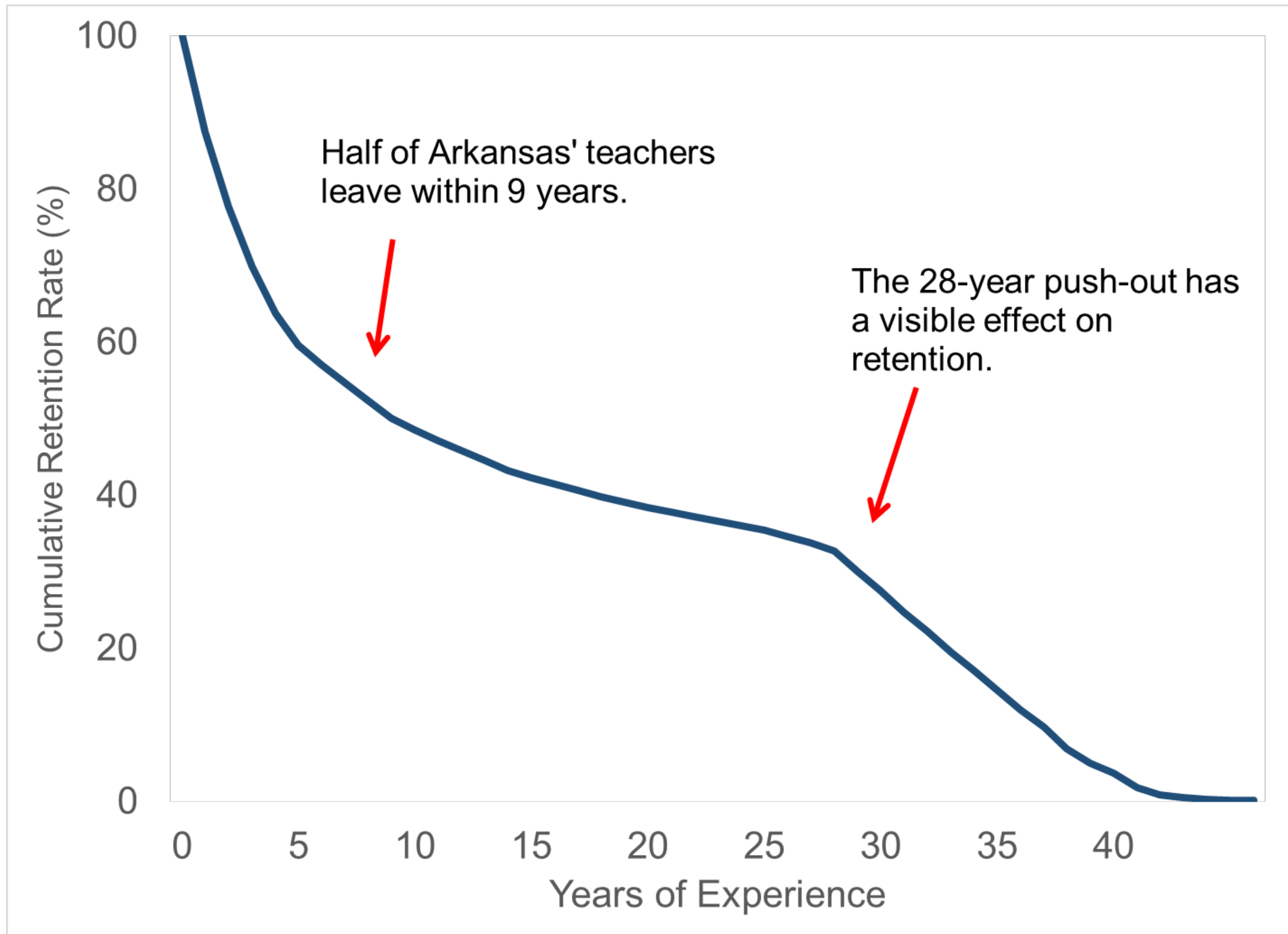
If Arkansas teachers valued a pension, they should change their behavior to qualify for one (at 5 years). But they don't.



In contrast, Arkansas' pension plan starts to push out veteran teachers starting at 28 years of experience.



On a cumulative basis, half of Arkansas' teachers leave within 9 years, and less than 4 percent make it 40 years.



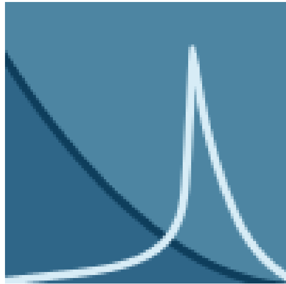
Key lessons for Arkansas

- Retirement plans should be designed for workers, not employers. Arkansas' main goal should be providing a path to a secure retirement to all workers, no matter how long they choose to stay.

- Given existing turnover patterns, most teachers would be better off in a more portable plan.

- There are multiple options for Arkansas to provide a simple, low-cost, financially sustainable retirement plan for all teachers.

For more information, visit:



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