Retirement and Benefits: New Realities in an Economic Downturn

By Valerie Martin Conley

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By any indicator—corporate debt, mortgage delinquencies, employment growth, or consumer spending, for example—the 2009 economy performed dismally.[1] Fortunately, we now see improvement: the pace of decline in the job market slowed in recent months, for instance. But even slow improvement comes with a price.

The Government Accountability Office (GAO) tracks the funds appropriated under the American Recovery and Reinvestment Act (ARRA), signed into law by President Obama on February 17, 2009. The act's good news: it targets 41 percent of the projected federal outlays to education and training in 2010.[2]

Despite this support, higher education suffered unprecedented shortfalls in state budgets. By November 2009, stated one report, "26 states have now seen budget shortfalls that total $16 billion." "Adding the initial and midyear budget shortfall together," the report continued, "the collective budget gaps in 48 states total $178 billion or 26 percent of state budgets—the largest gaps on record."[3] Forecasts for higher education, absent stopgap resources, predict more cuts that will result in hiring freezes, furloughs, layoffs, program elimination, and dismissal of tenured faculty members.

Nor have benefits, including retirement benefits, been immune. In Iowa, the governor asked for 10 percent reductions in current appropriations to state agencies, institutions, and boards. In turn, the Iowa Board of Regents requested the state's public universities and special schools to reduce their budgets by 10 percent. University presidents responded by proposing a temporary reduction in institutional payments to defined contribution retirement plans. After the Regents approved this proposal in October 2009, the University of Iowa announced:

> Effective with the payroll period beginning on Nov. 1, 2009, and ending with the payroll period ending on June 30, 2011, the University of Iowa will reduce retirement contributions to Defined Contribution Retirement Plans by 20 percent, from 10 percent to 8 percent. The temporary reduction, authorized by the Board of Regents, State of Iowa, is in response to Governor Chet Culver's order reducing current appropriations to state agencies, institutions, and boards by 10 percent.[4]

"Reducing the university's contribution to retirement accounts temporarily and possibly permanently," the president of the Iowa State University faculty senate told the Board of Regents, "has been almost universally condemned as bad policy."[5] Taking a long–term view, the senate president added, "Reducing retirement contributions will adversely affect the amount of money available to future faculty as they approach retirement age. The net result is that they will continue to work more years."[6] But other states joined Iowa in taking similar desperate measures.

The economic downturn prompted many observers to ask if higher education employees will delay retirement due to the decrease in the value of their retirement accounts. And, if so, when? Should institutions offer phased retirement programs, buy-outs, or both? Faculty members prefer phased retirement to buy-outs, and the state of the economy implies substantial buy-outs are needed to persuade faculty to accept them.[7]

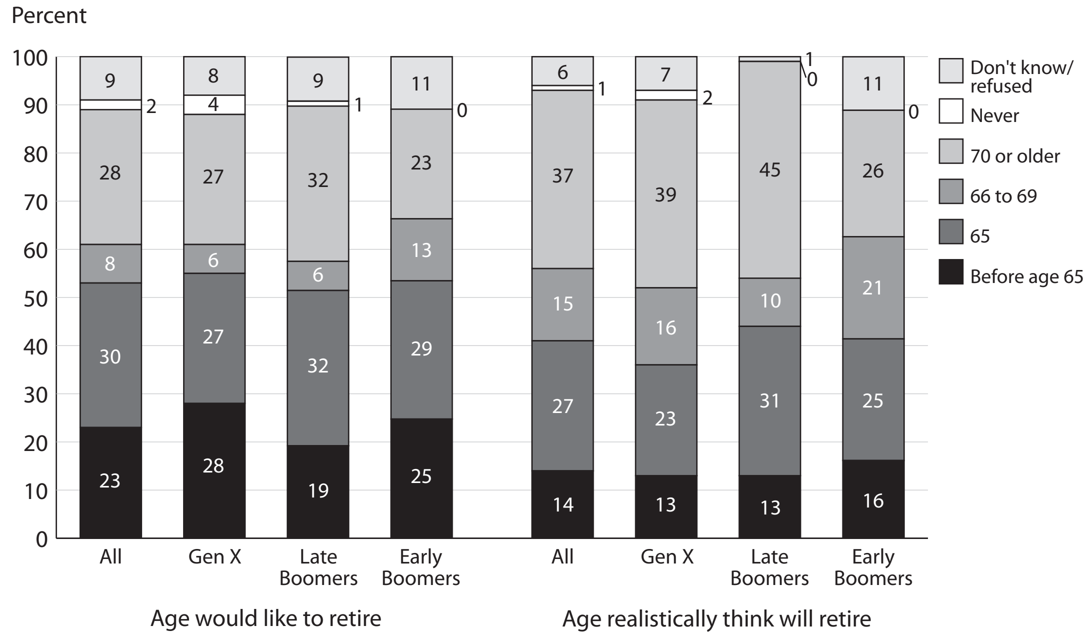
The 75-year old former president of Rhode Island College received a $75,850 incentive when he retired in June. He was not alone, though he reportedly received the largest incentive. Employees at Rhode Island College and the Community College of Rhode Island received 40 percent of their pay if they agreed to retire before July 2009. The incentive was $20,000 at the University of Rhode Island.[8] The aim of the retirement incentive program, explained a state spokesperson, was that the colleges could replace the older retirees with younger, lower paid faculty. But state officials only realized the full extent of the budget crisis after the older faculty members accepted the incentives. Now, the colleges may lack the funds to fill vacant positions. The 90 participating employees across Rhode Island's college and university system received $2.3 million in direct incentives. But the total cost came to $18.8 million, including unused sick and vacation time. Some retirees considered the availability of a subsidized health package a more attractive incentive than cash.[9]

One size does not fit all. A 2007 survey shows significant differences by age. Older faculty expressed less enthusiasm for phased retirement programs than younger faculty: 74 percent of younger faculty, but only 56 percent of early baby boomers said they were very or somewhat likely to participate in a phased retirement program. Full-time faculty members aged 29 to 61 in four-year institutions—the survey's target population—reported a gap between their desired and anticipated retirement ages. Nearly one-quarter (23 percent) of surveyed faculty wished to retire before age 65, but only 14 percent anticipated doing so; 28 percent would like to retire at age 70 or older, but 37 percent think they will (Figure 1).

One should not conclude that shortfalls exist in retirement planning and saving, cautions the TIAA-CREF report. But, the report adds, "30% of all faculty report that they realistically expect to retire later than they would like."[10]

The current economic climate heightens the challenges for faculty and staff. Here are key

Figure 1. Prospective Retirement Ages



Source: TIAA-CREF Institute, *Faculty Generations Survey* (2007).

findings from a report on the impact of the economic downturn on retirement decisions and on institutional responses to postponed retirements resulting from wealth declines. The report surveyed TIAA-CREF participants age 50 and older during 2008 and 2009.

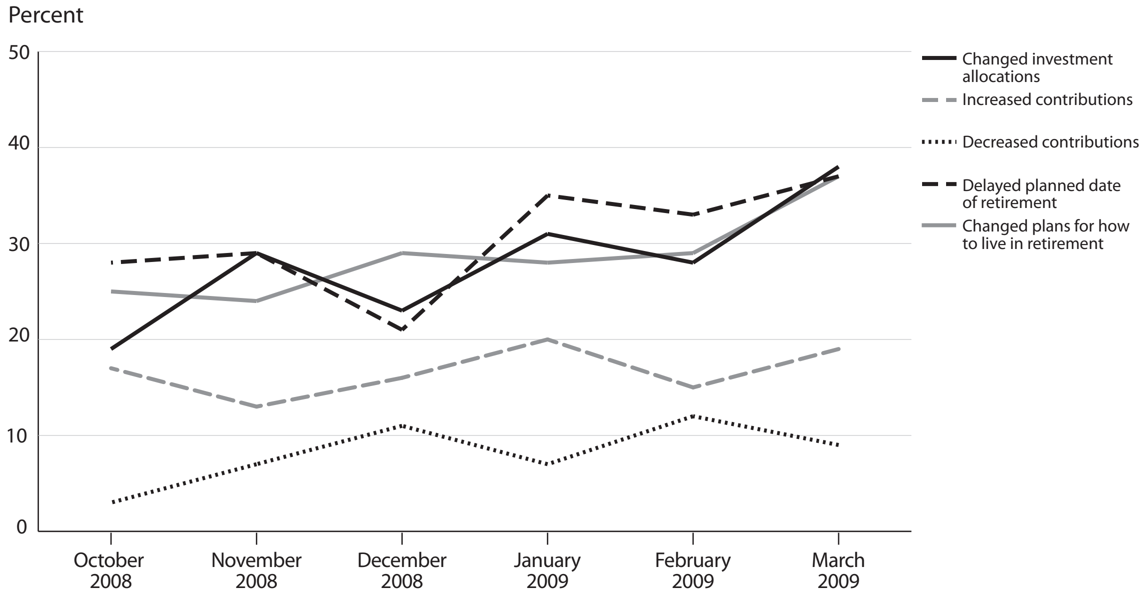
- During the first three months of 2009, about one-third of the respondents delayed their planned retirement date.
- By March 2009, 37 percent of participants said they changed how they planned to live in retirement.
- Many participants changed their investment allocations: 19 percent increased, and nine percent decreased their contributions.

Figure 2 shows how TIAA-CREF participants age 50 and older changed their retirement saving and planning between October 2008 and March 2009.

The trend continued. "One-half (52%) of those surveyed [during an April–May 2009 follow-up] had made adjustments in their retirement savings during the past year in response to developments in the economy and financial markets."[11] Two–thirds expressed concern "about outliving their savings" (65 percent) and "about choosing the best way to draw income from their savings" (67 percent).[12] We may again discern differences by age. "Those closest to retirement age ["relatively old (age 65 to 70)"] are most likely to view asset protection as their primary objective." But "among near–retirees in the age 50 to 64 cohort, growing savings is relatively more common as the primary objective."[13]

Higher education employees, this evidence suggests, are evaluating *and* adjusting their asset allocation strategies. Sixty-one percent of the adjusters increased their savings. Approximately one-quarter (27 percent) of those surveyed (N = 1002) said their expected retirement age increased due to financial market and economic developments. "The typical (median) increase in expected retirement age among these individuals is three years."[14] Administrators were more likely than faculty

Figure 2. Changes in Retirement Saving and Planning Among TIAA–CREF Participants Age 50 and Older



Source: TIAA–CREF Institute, *Participants Age 50 and Older Survey* (October 2008–March 2009).

or staff to report they planned to work longer. Forty-two percent of administrators, but only 23 percent of faculty and 22 percent of staff, said their expected retirement age had increased.

Many respondents adjusted their expectations, but "only 4% reported that their employer had changed the amount it contributes to the individual's retirement account in the past year."[15] The Iowa story suggests the percentage may increase as colleges and universities continue to look for cost savings. Collective bargaining contract negotiators must therefore understand the compensation and benefits trade-offs for retired employees, near-retirees, and younger faculty and education support professionals (ESPs) who will work for many years before becoming eligible to receive retirement benefits.

A 2009 symposium addressed savings adequacy, equity risk and return, retirement incentive programs, retirement pattern management, and financial planning. Among the highlights: First, replacement rate targets can be set too high. The preferred alternative is a lifecycle model that "assumes, given resources and preferences, that a household maximizes its lifetime well being by smoothing the discounted marginal utility of consumption across periods of time."[16] Second, evidence suggests that long-term equity returns currently appears average, but economists debate optimal asset allocations and reward-to-risk ratios.

Understanding and communicating investment risk, one participant explained, requires evaluating the success of investment strategies relative to goals and targets. "Some behavioral economists," he noted, "postulate the existence of both a 'security level' of wealth below which investors do not wish to fall and an 'aspiration level' that they aspire to achieve, and 'rational' individuals will invest accordingly."[17] "Investors are not necessarily rational," he acknowledged, but allocation decision-making—including expected returns and risk—is complex, even for well-educated individuals. This complexity "argues that people do seem to understand the idea of investment risk and to care about it, but they need an environment that makes the risk they face more salient to the outcome they will achieve."[18] Individuals, he concluded, need the "right information presented the right way" to make the best choices.[19]

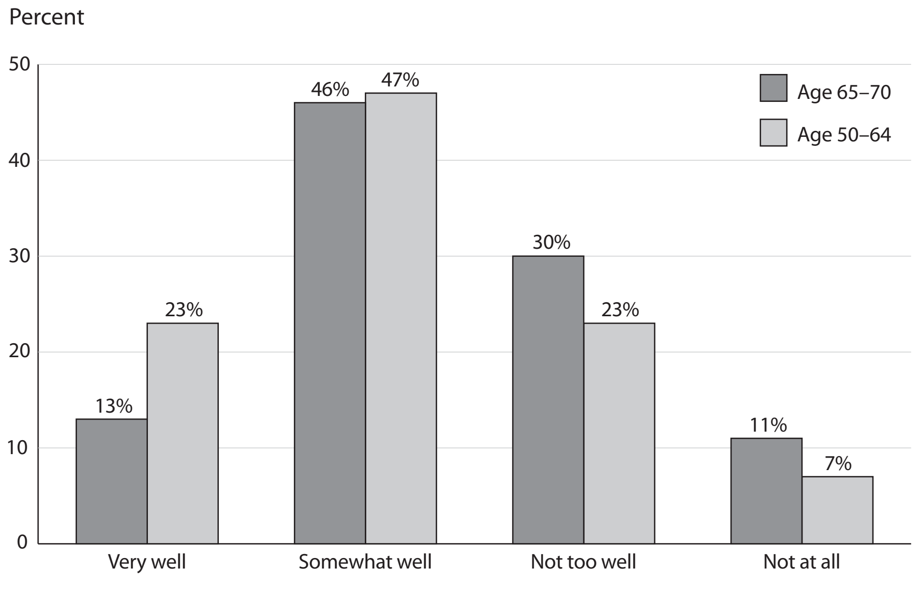
Research supports this argument. "Forty percent of near-retirees," notes one study, "report that they do not have a good understanding of the various options available for converting retirement savings into retirement income."[20] Figure 3 shows the reported level of understanding among higher education employees by age (50–70) for drawing retirement income from savings.

Figure 4 shows the reported level of understanding for drawing retirement income from savings, by higher education employee group.

The shift from defined benefit to defined contribution or to defined benefit/contribution plans, heightens the need to increase understanding—especially of annuities and of public sector defined contribution pension plans. In one survey, about one-third (31 percent) of respondents who did not intend to annuitize said they did not understand the process. Eleven percent said they needed more information and time to think about it and "9% fear that the payments will not continue to be made over time."[21]

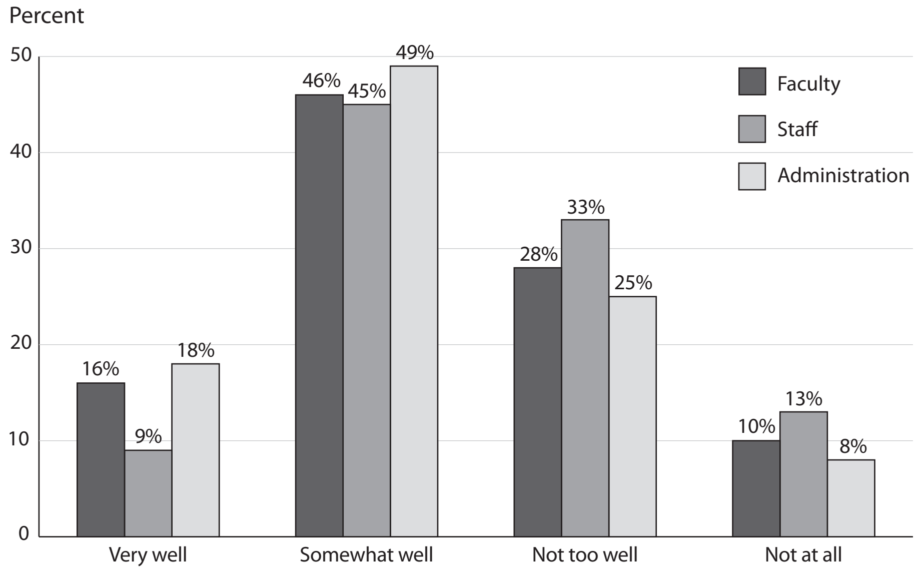
Professional advice helps. "Near retirees who have consulted with a financial advisor feel that they have a much better understanding of their options for converting savings to income in retirement."[22] Collective bargaining contract negotiators should know of the availability of an annuity payout option, "rare among private sector 401(k) plans," but "generally available in defined contribution plans sponsored by colleges and universities." Negotiators should also know the best practice characteristics of these plans.[23]

Figure 3. Generating Retirement Income from Retirement Savings by Age: Level of Understanding



Source: TIAA–CREF Institute, *Participants Age 50 and Older Survey* (April and May 2009).

Figure 4. Generating Retirement Income from Retirement Savings by Employee Group: Level of Understanding



Source: TIAA–CREF Institute, *Participants Age 50 and Older Survey* (April and May 2009).

DEFINED CONTRIBUTION PENSION PLANS

A recent report outlines six principles for effective "core"—the primary source of retirement benefits—defined contribution plans:

1. Retirement plans should focus on providing adequate and secure income throughout retirement.
2. Retirement income adequacy and security is a shared employer/employee/government responsibility.
3. It is important for all individuals to have access to a well-designed employer–sponsored retirement program.
4. Effective retirement programs require an appropriate investment offering that is designed to achieve the objectives of the plan.
5. Effective retirement programs require a broad range of integrated participant services.
6. Retirement programs are more effective with competent fiduciary mechanisms.[24]

The report summarizes best practice benchmarks in seven categories: 1) eligibility and participation, 2) vesting, 3) total contributions (employer and employee), 4) investments, 5) distributions, 6) administrative structure and fees, and 7) other participant services. Among the best practices cited are mandatory enrollment and participation, 100 percent vesting after one year, total contributions (employer and employee) of at least 12 percent of pay if covered by Social Security and of 18–20 percent if not covered. The report also recommends extensive investment education, and retirement and life planning services.[25]

The authors then detail preferred characteristics of "defined contribution pension plans:"

- Increasing retirement savings by adding such plan design features as mandatory participation, automatic enrollment, and auto-save arrangements.
- Adopting investment structures that help to avoid some of the major sources of investment risk for participants, and that are more appropriate to providing adequate retirement income as the primary objective.

These structures may include:

(a) Reducing the number of investment funds available to a rational set of high-quality, reasonable-cost, easily understood and useable funds.

(b) Providing participants with simplified "one- or no-decision" investment services such as target-date lifestyle funds, target allocation funds, and qualified managed accounts. These funds can decrease the risk that participants will make poor investment allocation decisions.

(c) Providing participants investment advice to and through retirement that incorporates a broader range of financial inputs for sound retirement financial planning.

- Addressing longevity, inflation, and annuitization rate risk by incorporating retirement income products, features, and services that manage these risks more effectively, including:

(a) Mandatory annuitization of at least a portion of one's retirement account balance.

(b) Availability of variable life annuities and inflation-adjusted fixed annuities.

(c) Rethinking the use of accumulation period guaranteed fixed annuities as a means of replacing a portion of the benefit now typically secured by defined benefit arrangements.[26]

RETIREMENT INCENTIVE PROGRAMS

Retirement decision-making has become more complex as retirement incentive programs have evolved. The best programs have clear, transparent goals, allow sufficient time to design and implement the program, and involve faculty, staff, and union representation.[27] Program designers must consider short- and long-term consequences associated with the incentive. The University of Michigan established committees on retirement *and* on health benefits when redesigning its early retirement program. To gain more certainty over the timing of the retirement decision, Hofstra University offers faculty members a five percent increase in base salary or a one course reduction in teaching load in exchange for an irrevocable declaration to retire in five years.[28]

Researchers identified key questions to consider when designing a retirement incentive: What type of incentive will be offered? Will the incentive be financial, non-financial, or both? How will the incentive be distributed? Who will be eligible? How much will it cost? Will there be tax liabilities? Will the incentive provide for retiree health care benefits? Are there benchmarks or comparative data available to assess program effectiveness?[29]

Answering these questions requires reliable data. Best practices include an integrated process for identifying primary human resource concerns from the perspective of faculty, staff, and administrators, and a holistic human resources approach that incorporates life planning into financial planning.

CRITICAL MASS

Higher education is a significant employer in the U.S. In Fall 2008, Title IV institutions and administrative offices[30] employed about 3.7 million people—2.4 million full-time and 1.3 million part-time.[31] Most employees work in public institutions. We possess detailed information regarding primary function and occupational activity. About one-half (47 percent) of the full-time professional employees (excluding medical schools) in degree-granting institutions had faculty status; the other 53 percent did not. Postsecondary institutions in the U.S. spent approximately $43 billion on salaries and $11.6 billion for benefits.[32]

Table 1 shows the average expenditure per faculty member covered for retirement, by union status and type of institution. Average expenditures for unionized faculty members were $5,048. There was no difference in the average expenditure for faculty by type of institution.

PAYING MORE FOR LESS

The lead negotiator on a bargaining team sums up the new realities for benefits and retirement

Table 1. Average Expenditure Per Faculty Member Covered for Retirement, by Union Status and Type of Institution: 2004

	Average Expenditure per Faculty Member Covered for Retirement		
	Not Represented by a Union	Represented by a Union	Total
Total	$ 4,826.20	$ 5,048.40	$ 4,893.90
Four-year	5,057.50	5,053.30	5,056.50
Two-year	4,177.30	5,042.80	4,556.30

Source: U.S. Department of Education, National Center for Education Statistics, *2004 National Study of Postsecondary Faculty* (NSOPF:04).

in this economic downturn, "The bottom line is that they are paying more and more for less and less coverage."[33] We still do not know the full impact of this economic crisis on retirement benefits and pensions. But budget deficits and decisions to delay retirement have increased tension between colleges and their employees.

Differences in K–12, postsecondary, and higher education environments add more complexity. The median retirement age for public school teachers is 58.[34] By contrast, the median expected retirement age for postsecondary faculty and instructional staff is 65.[35] Surveyed employees in four-year institutions reported higher expected retirement ages—up to 75—than their two-year college colleagues (Figure 5).

What are the future prospects for adequate pensions and benefits? Together, recent institutional responses and research on individual attitudes and behavior foretell the effects of the economic downturn on retirement and benefits policies. Employees must learn more about asset allocation, tax issues, liabilities, and annuitization. They must also understand the long-term consequences associated with policies like those in Iowa and Rhode Island.

Collective bargaining negotiators must take the lead. As more higher education institutions shift away from defined benefit plans, negotiators must understand the characteristics of other types of pension plans and the extent to which each plan meets the needs of individual employees.[36]

Negotiations that focus on the most desirable combination of plan characteristics, acknowledge shared responsibility, recognize risk, and emphasize education and life planning are most likely to succeed.

NOTES

1 Russell Associates, 2009.

2 U.S. Government Accountability Office, 2009.

3 Stripling, November 2, 1009. The Center on Budget and Policy Priorities provided the data.

4 "President Mason Gives Budget Update…."

5 Van der Valk, 2009.

6 Ibid.

7 Yakoboski, April 2009, 3.

8 Jordan, 2008.

9 Gregg, 2008. The article did not report the cost of this benefit.

10 Yakoboski, 2007, 9.

11 Yakoboski, September 2009, 2.

12 Yakoboski, October 2009, 1–2.

13 Yakoboski, September 2009, 4.

14 Ibid.

15 Ibid. This result should be interpreted with caution given the small conditional sample size.

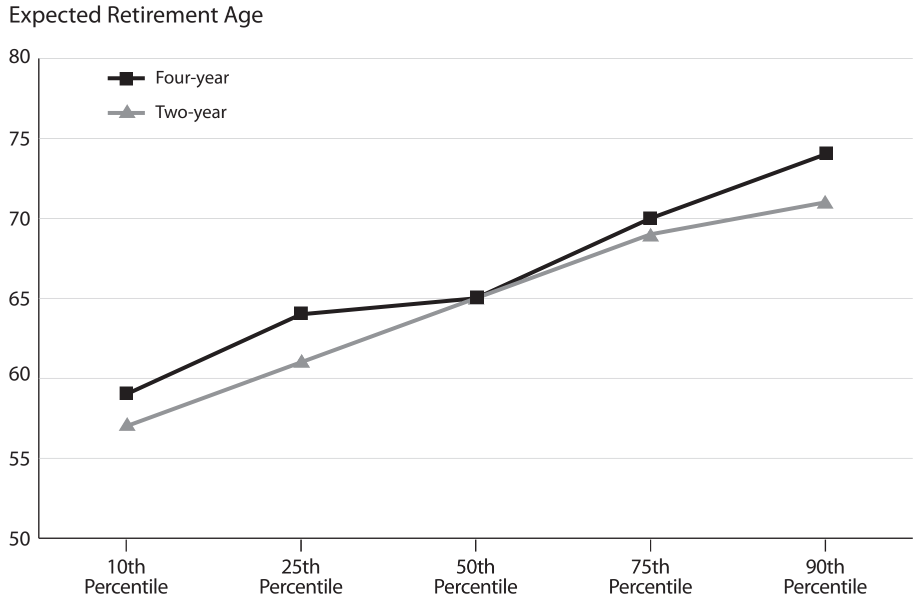
16 Yakoboski, June 2009, 3.

17 Ibid., 5. The participant was Tom Rietz, University of Iowa.

18 Ibid.

19 Ibid.

Figure 5. Percentile Distribution of Expected Retirement Age for Faculty and Instructional Staff, by Type of Institution: 2004



Source: U.S. Department of Education, National Center for Education Statistics, 2004 National Study of Postsecondary Faculty (NSOPF:04).

[20] Yakoboski, October, 2009, 3.

[21] Ibid., 5.

[22] Ibid., 7.

[23] Ibid.

[24] Crane, Heller, and Yakoboski, 2008, 7–11.

[25] Ibid., 24.

[26] Ibid.

[27] Chronister and Kepple, 1987.

[28] Yakoboski, June 2009, 7.

[29] Chronister and Kepple, 1987.

[30] The U.S. Department of Education's National Center for Education Statistics (NCES) collects information from postsecondary institutions in the U.S. (50 states, District of Columbia, and other jurisdictions) through the Integrated Postsecondary Education Data System (IPEDS). Participation in IPEDS is required for all institutions that participate in Title IV federal student financial aid programs, such as Pell Grants or Stafford Loans, as legislated by the Higher Education Opportunity Act (HEOA).

[31] Knapp, Kelly-Reid, and Ginder, 2010.

[32] Ibid.

[33] Stripling, November 23, 2009. The article quoted Naomi Zauderer, negotiator for the City University of New York Research Foundation staff.

[34] Podgursky and Ehlert, 2007.

[35] NSOPF, 2004.

[36] Two good resources are National Education Association, 2006, and Crane, Heller, and Yakoboski, 2008.

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