



Pension
Review
Board

Retirement Benefits in the Public and Private Sectors – A Comparison of Trends, Regulatory Environments, and Related Issues

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Executive Summary

Retirement compensation in the United States evolved from disability replacement income plans offered to armed services personnel to employer sponsored defined benefit and defined contribution plans. Throughout much of the employer sponsored retirement plan history, defined benefit plans were the primary structure in both the private and public sectors. This trend has changed recently as retirement plan data show that in 1975, 73 percent of private sector workers were covered by defined benefit plans, while in 2005, only 36 percent were covered. By contrast, public sector worker participation in defined benefit plans remained relatively stable during the same time period, declining only moderately from 98 percent participation 1975, to 92 percent participation in 2005.

Proponents of public sector retirement plan redesign reference the trend towards increased defined contribution plan offerings in the private sector as evidence that a public sector transition is inevitable. However, this argument may oversimplify the complexities of the retirement compensation debate by comparing two dissimilar industries, public and private, and stating that influencing forces in one are the same as the other. Differences in revenue generation, regulatory environments, and workforce composition and compensation result in unique structural profiles for public and private sector entities.

This paper identifies factors influencing employer choice of retirement plans in the public and private sectors. It discusses the history of retirement benefits and the evolution of the public and private sector regulatory environments. It also identifies events affecting viability of defined benefit plans in the private sector, and discusses how recent events are shaping policy discussions for defined benefit plans in the public sector.

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Retirement Benefits in the Public and Private Sectors

Public and private sector retirement plans have evolved along divergent paths. In the United States, defined benefit plans have historically been the dominant retirement incentive in both the private and public sectors. Defined benefit plans, or pension-type plans, promise a specified monthly benefit for plan participants during retirement.¹ In 1975, 73 percent of private sector workers, and 98 percent of public sector workers were covered by defined benefit plans.²

Since the 1970's peak in employer sponsored private sector defined benefit retirement plans, total and relative participation has since declined. In 2005, only 36 percent of currently employed private sector workers participated in such defined benefit plans, while public sector participation remained high, at 92 percent. As defined benefit plan participation decreased in the private sector, defined contribution plan participation increased.³ In defined contribution plans, the employee or the employer, or both, contribute to the employee's individual account under the plan, with the employee ultimately receiving the balance plus accrued investment earnings.⁴

Percent of Workers with Employer Sponsored Defined Benefit Pension Coverage²

	1975	2005
State and Local	98%	92%
Private Sector	73%	36%

In the 30 years ending in 2005, new defined contribution retirement plan structures such as the 401(k) have become significantly more prevalent and popular in the private sector.⁵ During the same time period, public sector participation in defined benefit plans has remained relatively stable. However, the recent economic contraction of 2008 and 2009, and the corresponding reduced global growth, has placed downward pressure on the funded statuses of public sector plans, and has spurred new debate concerning the equity and sustainability of public sector defined benefit plans.

¹ United States Department of Labor, *Retirement Plans, Benefits & Savings – Types of Retirement Plan*, available at <http://www.dol.gov/dol/topic/retirement/typesofplans.htm> (accessed November 6, 2012).

² Alicia Munnell, Kelly Haverstick, and Mauricio Soto, *Issue Brief – Why Have Defined Benefit Plans Survived in the Public Sector?*, Center for State and Local Government Excellence (December 2007), available at <http://slge.org/publications/issue-brief-why-have-defined-benefit-plans-survived-in-the-public-sector> (accessed June 11, 2013); and

Investment Company Institute, *Research Perspective, 401(k) Plans: A 25-Year Retrospective* (November 2006), available at www.ici.org/pdf/per12-02.pdf (accessed October 29, 2012).

³ Employee Benefit Research Institute (EBRI), *Retirement Trends in the United States Over the Past Quarter-Century* (June 2007), p. 1; available at <http://www.ebri.org/research/?fa=retirement>

⁴ United States Department of Labor, *Retirement Plans, Benefits & Savings – Types of Retirement Plans*; available at <http://www.dol.gov/dol/topic/retirement/typesofplans.htm> (accessed November 6, 2012).

⁵ Investment Company Institute, *Research Perspective, 401(k) Plans: A 25-Year Retrospective*; available at www.ici.org/pdf/per12-02.pdf (accessed October 29, 2012).

Background and Trends

In the United States public sector, the earliest retirement plans were defined benefit plans established to provide replacement income to soldiers injured in battle during the American Revolutionary War.⁶ Through the nineteenth century, military plans in the United States evolved to include retirement benefits in addition to disability replacement income. Additionally, during the 19th century and early 20th century, non-military federal workers were granted pension-style retirement plans through Congress on a case-by-case basis. Congress ultimately offered comprehensive pension coverage to non-military federal workers through the passage of the Federal Employees Retirement Act of 1920.⁷ The 1920 Act created the first comprehensive pension system for U.S. civil service workers.⁸

During the mid to late-1800's, state and municipal governments established and offered pension retirement plans for public safety employees, including firefighters and police officers. Non-public safety employee retirement plans were offered at the beginning of the twentieth century, with local governmental entities establishing retirement plans for teachers and administrative personnel.⁹

In the private sector, the first employer-provided pension plan was a disability plan offered by the American Express Corporation in 1875.¹⁰ In the early 20th century, private sector pension plans were limited only to those in the railroad, public utilities, and financial industries.¹¹ Growth in private sector disability and pension plan coverage was initially slow. There were 12 total private pension plans in 1900, 117 private pension plans in 1916, and 200 by 1926.¹²

The modern era for retirement systems began in 1935, when Congress passed the Social Security Act, establishing two national social insurance programs to meet the risks of old age and unemployment.¹³ The Act includes a federal program of old-age benefits for retirees and a Federal-State system of unemployment insurance.¹⁴ Following the passage of the Social Security Act, the State of Texas created most of its statewide and large municipal retirement systems. The Teacher Retirement System

⁶ Clark, Robert; Craig, Lee; and Wilson, Jack. *A History of Public Sector Plans in the United States*, University of Pennsylvania Press. Philadelphia, p. 1.

⁷ Ibid, p. 5.

⁸ Clark, *Supra* note 7.

⁹ Clark, *Supra* note 7.

¹⁰ Clark, *Supra* note 7, p. 5.

¹¹ Clark, *Supra* note 7.

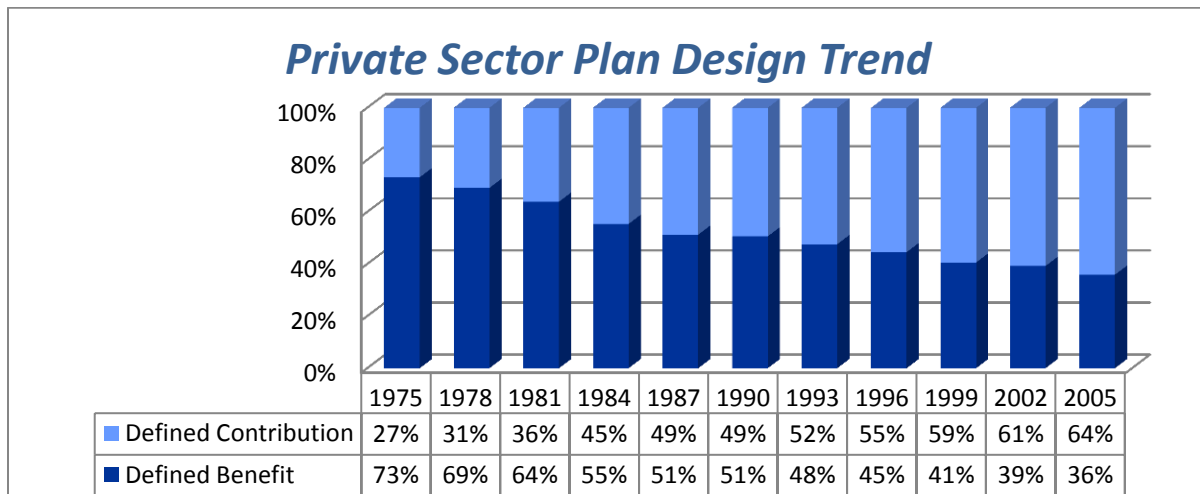
¹² Clark, *Supra* note 7, p. 5.

¹³ United States Social Security Administration, "The Social Security Act of 1935", available at <http://www.ssa.gov/history/35act.html> (accessed February, 18, 2013).

¹⁴ Social Security Administration, Office of Research, Evaluation and Statistics, "Social Security Programs in the United States", July 1997; available at <http://www.ssa.gov/policy/docs/progdesc/sspus/>.

of Texas (TRS), the State's largest system, was created in 1937, followed by the Employees Retirement System of Texas (ERS) in 1947, and the Texas Municipal Retirement System (TMRS) in 1948.

Defined benefit retirement plans were the most prevalent retirement incentive in both the private and public sectors through the 1970s. In 1975, 73 percent of private sector workers, and 98 percent of public sector workers were covered by defined benefit plans.¹⁵ In 2005, only 36 percent of private sector workers participated in defined benefit plans, while public sector participation remained high at 92 percent.¹⁶ As shown in the following table, the decrease in private sector defined benefit pension plan participation coincided with an increase in company-sponsored defined contribution plans.¹⁷



The private sector shift towards defined contribution plan structures in the 1970s relates to several events. First, the Employee Retirement Income Security Act of 1974 (ERISA) was passed, requiring private sector plan sponsor to pre-fund defined benefit retirement plans.¹⁸ Additionally, the Revenue Act of 1978 created an alternative for retirement planning that allowed employees to make pre-tax elective deferrals to employer-sponsored defined contribution plans.¹⁹ The costs of pre-funding

¹⁵ Alicia Munnell, Kelly Haverstick, and Mauricio Soto, "Why Have Defined Benefit Plans Survived in the Public Sector?". December 2007, Center for State and Local Government Excellence. Issue Brief; available at <http://slge.org/publications/issue-brief-why-have-defined-benefit-plans-survived-in-the-public-sector>; and

Investment Company Institute, Research Perspective, "401(k) Plans: A 25-Year Retrospective", November 2006; available at www.ici.org/pdf/per12-02.pdf (accessed October 29, 2012).

¹⁶ *Ibid.*

¹⁷ Employee Benefit Research Institute, Facts from EBRI, "Retirement Trends in the United States Over the Past Quarter-Century", June 2007, p. 1, available at <http://www.ebri.org/research/?fa=retirement>; and

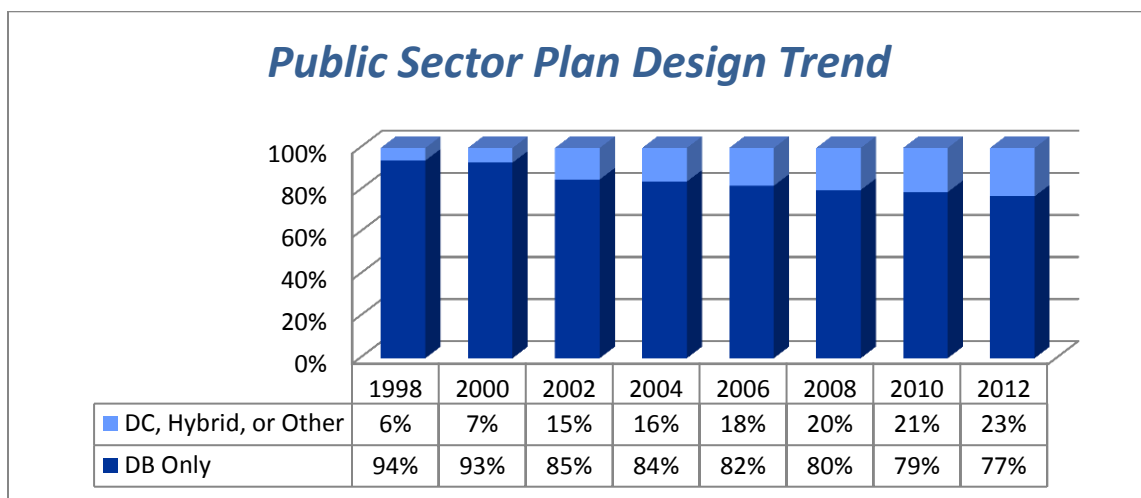
Employee Benefit Research Institute (EBRI) – "EBRI Databook on Employee Benefits, Chapter 10", Table 10.2a – "Total Participants", available at <http://www.ebri.org/publications/books/?fa=databook> (accessed November 5, 2012).

¹⁸ P.L. 93-406 – 29 U.S.C. §1001, et seq., ERISA is codified at §§1001 to 1453, title 29 of the United States Code (USC) and in §§ 401-415 of the Internal Revenue Code.

¹⁹ "History of 401(k) Plans: An Update", Employee Benefit Research Institute, February 2005, available at <http://www.ebri.org/pdf/publications/facts/0205fact.a.pdf>

defined benefit plans, and the advent of the 401(k) retirement plan alternative, led many employers to shift their employees into the 401(k) defined contribution plans. A defined contribution plan by its structure cannot have unfunded liabilities. The benefit to the employee in a defined contribution plan is simply the individual account balance in the plan which is comprised of contributions plus investment earnings.

Conversely, under a defined benefit plan, the retirement benefit is created through a benefit formula that is usually based on some combination of the employee's years of service and average salary. The plan is pre-funded by contributions, and supplemented with income from plan investments. If the contributions and investment returns are insufficient to pay retirement benefits owed, the plan sponsor is required to fund the difference. This obligation can place significant costs on plan sponsors, and has resulted in many plan closures in the private sector.



Unlike the private sector, public sector participation in defined benefit plans has remained stable over the same time period, however, as the preceding chart shows, public sector plan sponsors have been increasingly redesigning plans to include defined contribution plans, hybrid plans, and other alternative plan designs.²⁰ As policymakers evaluate retirement plans offered to public sector employees, it is important to understand the fundamental issues that have resulted in the different retirement plan trends observed in the public and private sectors. These issues include broad structural differences in revenue generation between private and public entities, differences in the costs of regulatory compliance, and compensation parity.

²⁰ National Conference of State Legislatures, *Tables Showing Which States Have Defined Benefit, Defined Contribution and Hybrid Plans for State Employees and Teachers*, January 2012.

Funding Consistency Effect on Retirement Plan Offering

Employer provided retirement plans may receive funding from the employers that sponsor the plan, the participating employees, or both. The ability to maintain a well-funded retirement system is dependent on the employer's generation of revenues, and the volatility of the revenue received can be a significant factor in determining the long-term viability of defined benefit style plans in the public and private sectors.

Revenues versus Taxes

Private sector revenue generation is dependent on a company's ability to sell its products or services. Companies in the private sector are susceptible to changing consumer preferences, industry and technology trends, and competition. This may result in volatile and unpredictable revenues and operating margins.

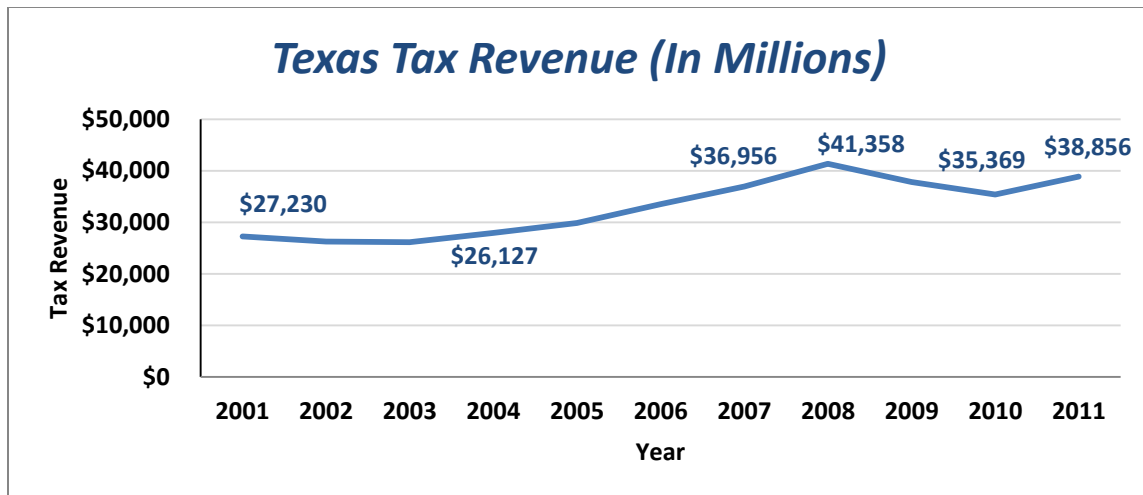
To demonstrate this point, in 2010 the Pension Benefit Guarantee Corporation (PBGC), the governmental organization created to provide insurance to private sector defined benefit plans, reported that the American Airlines pension plan was the largest private sector defined benefit program it supported.²¹ An analysis of American Airlines' revenue variation from 1995 to 2010 shows that the company's revenues fluctuated an average of 8 percent annually. Additionally, American Airlines generated negative operating income for seven of the fifteen years ended in 2010. In 2011, after years of reduced margins due to high competition and fuel costs, American Airlines filed for bankruptcy, and proceeded to freeze its defined benefit plans.

In contrast to the private sector, governmental entities receive funding from tax revenues, which are derived from broader, more diversified, economic bases. As a result of this broad diversification of industry, governmental tax revenues are less volatile and more predictable. From 1995 to 2010, Texas tax revenue exhibited 6 percent annual variation. This is nearly 25 percent less annual variation than American Airlines.

Despite the reduction in funding volatility for public sector entities, risk still exists. The following chart shows the tax revenues collected by the State of Texas from 2001 to 2011. As exhibited, tax revenues reached a high of \$41 billion in 2008. Subsequently, fewer property and sales taxes were collected, resulting in a drop in revenues in 2008 and 2009. This loss of income reduces the State's ability to fund governmental activities, including funding public employee pension plans.²²

²¹ Pension Benefit Guarantee Corporation – 2010 Pension Insurance Data Tables, Table S-5, *available at* <http://www.pbgc.gov/res/data-books.html> (accessed October 25, 2013).

²² Texas Comptroller of Public Accounts, "Texas Net Revenue by Source – Fiscal Years 1978 – 2010", *available at* http://www.window.state.tx.us/taxbud/revenue_hist.html; and Texas Comptroller of Public Accounts, "Revenue by Source for Fiscal Year 2011", *available at* <http://www.window.state.tx.us/taxbud/revenue.html>.



While governmental entities may receive reduced revenues in any given year, the magnitude of losses relative to budgets and the average annual variability of revenues is far less than that seen in the private sector. Additionally, governmental institutions exist to serve society over the long-term. As a result, governments are more likely to be able to endure short-term fluctuations in revenues.

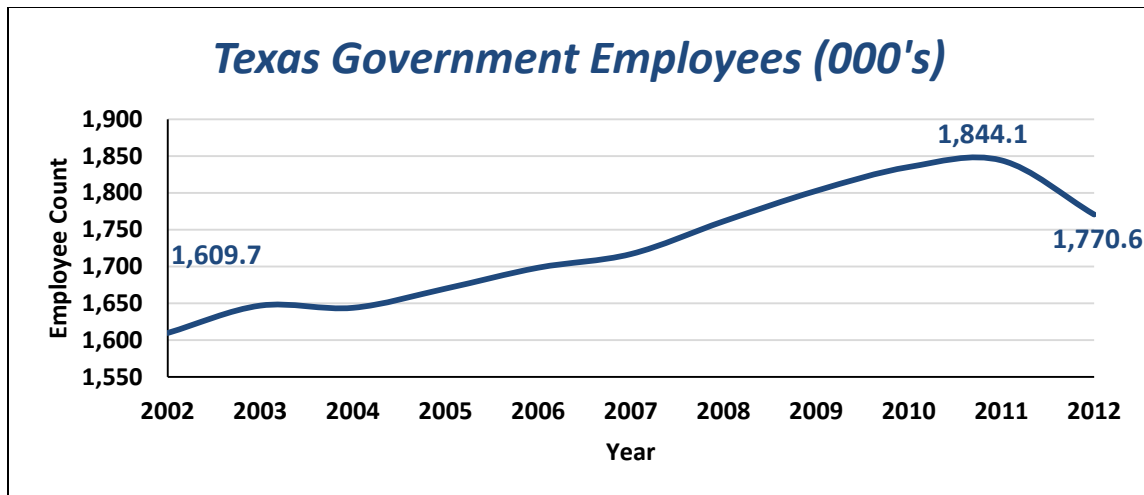
Employee Contributions

In the private sector, employees typically do not contribute to funding defined benefit retirement plans.²³ As a result, the funding of private sector plans is generally the responsibility of the sponsoring entity. This places increased pressure on private sector retirement plan sponsors to maintain the financial health of the plans.

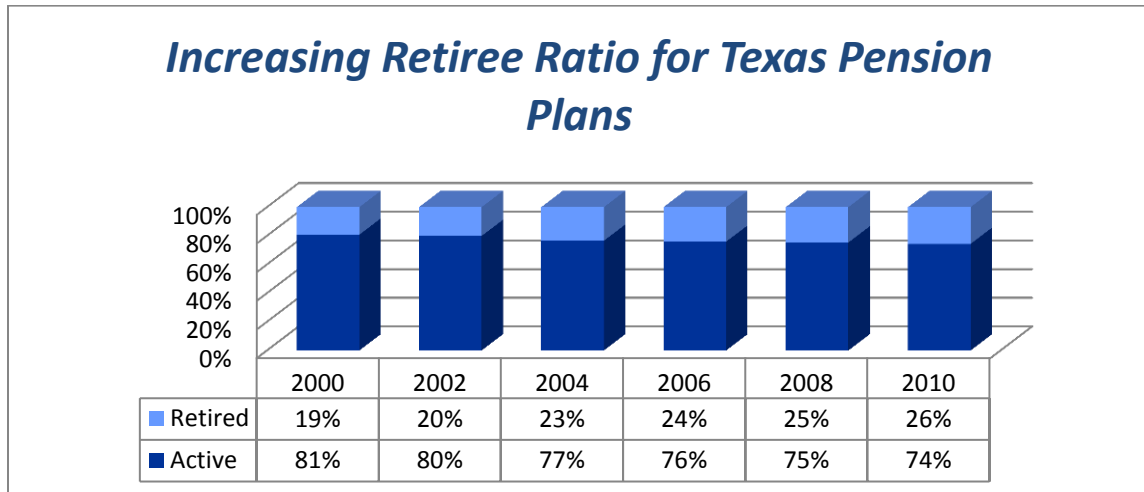
In the public sector, employers and employees contribute to defined benefit plans, resulting in shared funding responsibility. The following chart shows total Texas Government Employees from 2002 to 2012. Total public sector employees peaked in 2011 at 1.8 million before falling in 2012 to 1.77 million. A decrease in the total number of employees reduces the contributions a defined benefit plan receives.²⁴

²³ United States Bureau of Labor Statistics – Defined Benefit Plan definition, *available at* <http://www.bls.gov/bls/glossary.htm> (accessed March, 22, 2013).

²⁴ U.S. Department of Labor, Bureau of Labor Statistics at <http://www.bls.gov/data/#employment>. Queried “Employment, Hours, and Earnings – State and Metro Area”. “One-Screen Data Search”. 1. Texas 2. Statewide 3. Government 4. Government, State Government, State Government Educational Services, Local Government, Local Government Educational Services 5. All Employees 6. Seasonally Adjusted.



Additionally, active members as a percent of the total pension plan participants is a measurement of pension plan sustainability. This percentage declines as plans mature and plan members retire. The percentage can also decrease when fewer workers are hired to replace the retiring members. The chart below shows membership trends for Texas public employee pension plan participants. In 2000, retirees accounted for 19 percent of Texas public employee pension plan participants. This ratio increased to 26 percent in 2010 as public sector hiring decreased.²⁵



A reduction in the total participating workforce and a greater number of retirees as a percent of total pension plan membership places increased pressure on public sector pension plans. As more employees retire and fewer contributions are received, it may become necessary for sponsoring entities to cover the funding shortfall.

²⁵ PRB Data – Plan Data Run 11/26/2012.xls, can be requested from the agency.

Regulatory Environment and the Costs of Compliance

Retirement plans in the public sector operate under a regulatory framework that is largely separate from regulations governing private sector plans. For private sector plans, minimum standards for participation, vesting, and funding; and requirements of fiduciary standards, and reporting and disclosures are set forth in the Employee Retirement Income Security Act of 1974 (ERISA).²⁶ In the public sector, with certain Internal Revenue Code exceptions, these standards and requirements are largely left to the determination of the state and/or local plan sponsors and administrators.²⁷ The requirements under ERISA create a stricter and more onerous regulatory framework for private sector plans than public sector plans. Private sector plan sponsors complying with ERISA bear costs associated with the law's requirements of funding standards and minimum plan provisions, as well as administrative costs such as plan termination insurance.

ERISA's stricter regulatory standards for private sector defined benefit plans can be attributed to the inherent differences in the characteristics underlying public and private sector employers. Public sector employers are perpetual entities with broader and often more stable funding bases. In contrast, the life-span of private sector employers can be short-lived, which may create solvency issues for the fund.

Since the enactment of ERISA, the federal government has considered creating ERISA-style legislation for public sector plans on numerous occasions, but such legislation has never been enacted.²⁸ Prior to ERISA, both public and private sector plans were regulated by various Revenue Acts.²⁹ In the four decades following the enactment of ERISA, many states have voluntarily adopted laws and practices emulating a majority of ERISA requirements to regulate their public sector plans. Included in this regulatory progression is the changing financial reporting and accounting environment. Sections below will provide a brief history and overview of the regulatory framework of public and private sector plans.

Pre-ERISA Regulatory Environment

Private sector retirement plans were initially regulated only through the Internal Revenue Service, and regulation was limited primarily to guidelines on taxability of plan contributions and distributions, and qualification requirements for favorable tax treatment. In 1958, Congress passed the Welfare and

²⁶ P.L. 93-406 – 29 U.S.C. §1001, et seq., ERISA is codified at §§1001 to 1453, title 29 of the United States Code (USC) and in §§ 401-415 of the Internal Revenue Code.

²⁷ Title II of ERISA made conforming changes to the Internal Revenue Code relating to tax-qualification requirements and affects both public and private sector plans.

²⁸ See GovTrack that tracks the activities of the U.S. Congress available at <http://www.govtrack.us/congress/bills/111/hr6484>; <http://www.govtrack.us/congress/bills/112/hr567>; and <http://www.govtrack.us/congress/bills/113/hr1628>.

²⁹ See DOL, History of EBSA and ERISA available at <http://www.dol.gov/ebsa/aboutebsa/history.html>.

Pension Plans Disclosure Act (WPPDA), establishing the first reporting and disclosure requirements and granting the U.S. Department of Labor authority over some aspects of retirement benefit plans.³⁰

WPPDA was intended to limit fiduciary abuse and increase plan sponsor accountability, but stopped short of establishing explicit fiduciary standards. WPPDA was an important precursor to ERISA. The following table provides a background on pre-ERISA regulation for private sector defined benefit retirement plan sponsors.

Pre-ERISA Regulatory Environment for Pension Plans	
Regulation	Provisions
Internal Revenue Act of 1921	Established the tax exempt status of employer contributions to pensions and other deferred compensation plans; Clarified plan tax status; Exempted interest income of stock bonus of profit-sharing plans from current taxation. Distributions in excess of the amount initially contributed by the employee were still taxed.
Internal Revenue Act of 1926	Extended the exemption granted to stock bonus and profit-sharing plans to pension trusts.
Internal Revenue Act of 1928	Allowed employers to take tax deductions for reasonable amounts paid into a qualified trust in excess of the amounts required to fund current liabilities.
Internal Revenue Act of 1942	Tightened coverage standard qualification, limited allowable deductions, and allowed integration with Social Security.
Welfare and Pension Plans Disclosure Act of 1958	Established disclosure requirements to limit fiduciary abuse.
Amendments to WPPDA (1962)	Revised the 1958 act; shifted responsibility for protection of plan assets from participants to federal government to prevent fraud and poor administration.

Studebaker Shut Down

A major catalyst leading to the enactment of ERISA was the Studebaker-Packard Corporation shut down. In 1963, the Studebaker-Packard Corporation, a major car manufacturer, closed its operations and subsequently did not have enough money in the pension fund to pay out all of the members of the plan. At the time, the provisions of the plan established that a plan member did not have a “legally enforceable right to a pension until he qualified to retire under the terms of the plan. If he quit or lost his job before he became eligible to retire, he forfeited his pension credit”.³¹ All retirees and employees over age 60 at the time of plan closure received their expected pension benefit in full, but younger employees received either a significantly-decreased lump-sum payout, or in many cases no payment at all.³²

³⁰ P.L. 85-836, 72 Stat. 997 (Aug. 29, 1958).

³¹ Wooten, James. “‘The Most Glorious Story of the Failure in the Business’: The Studebaker-Packard Corporation and the Origins of ERISA.” Buffalo Law Review, Vol. 49, p. 694.

³² *Ibid*, p. 684.

ERISA was enacted primarily to protect employees from losing earned benefits in events like the Studebaker shut down, and to provide stronger assurance that retirement benefit promises would be upheld.³³

ERISA

In 1974, Congress passed the Employee Retirement Income Security Act (ERISA) to curb improper practices and mismanagement of private sector employee benefit plans and to protect the interest of participants and beneficiaries.³⁴ ERISA regulates all types of private-sector employee benefit plans, including retirement pension plans.³⁵ Governmental retirement plans generally are not subject to a majority of the provisions of ERISA.³⁶ However, some of the ERISA requirements codified in the Internal Revenue Code (IRC) do affect governmental retirement plans.³⁷

ERISA created a federal regulatory framework to address deficiencies in private pension plans, including inadequate vesting provisions, funding requirements, forfeiture of earned retirement benefits, lack of uniform fiduciary requirements, and inadequate disclosure and communication requirements.³⁸ The goal of ERISA was to set uniform standards for administration of private pension plans, and to encourage private sector employers to establish pension plans and increase the number of

ERISA and the IRS

Provisions of ERISA are codified in both the United States Code (USC §§1001 to 1453, title 29) and the Internal Revenue Code (IRC §§ 401-415).

Pension-related provisions in IRC Sections 401, 402, 404, 410, 411, 414, 415, 417, and 430 include requirements relating to minimum participation, vesting, benefit accrual, and funding standards that are substantially the same as the standards in Title I of ERISA.

For private sector plans, the IRC also contains non-discrimination requirements intended to prevent discrimination against non-highly compensated employees.

Plans must conform to provisions within the Internal Revenue Code to qualify for favorable tax treatment.

³³ Statement by President Gerald R. Ford Upon Signing the Employee Retirement Income Security Act of 1974, September 2, 1974; *available at* <http://www.pbpc.gov/about/who-we-are/pg/president-ford-signing-erisa-of-1974.html>, (accessed December 14, 2012).

³⁴ P.L. 93-406 – 29 U.S.C. §1001, et seq., ERISA is codified at §§1001 to 1453, title 29 of the United States Code (USC) and in §§ 401-415 of the Internal Revenue Code.

³⁵ An employee benefit plan may mean an employee welfare benefit plan or an employee pension benefit plan. See ERISA § 3(3), 29 U.S.C. §1002(3).

³⁶ Section 4(b)(1) of ERISA provides that Title I of ERISA does not apply to an employee benefit plan that is a governmental plan.

³⁷ Title II of ERISA made conforming changes to the Internal Revenue Code relating to tax-qualification requirements and affects both public and private sector plans.

³⁸ See Senate Labor Committee Interim Report No. 92-634 at p. 112 published in 1972, can be requested from the agency.

participants receiving private retirement benefits.³⁹ Congress sought to achieve this goal by granting federal tax deductions and deferrals to certain types of private sector, and public sector plans.

To be qualified for favorable tax treatment under the IRC, both the public and private sector plans had to meet requirements pertaining to benefits and distribution.

To this end, ERISA established and codified several funding and administrative practices that have since become standard practice for both the private and public sectors. The most significant requirements include increased funding standards, plan termination insurance, and minimum plan provisions (See **Appendix A** for a comparison of these requirements in the public and private sectors).⁴⁰

Funding Standards

ERISA introduced a requirement of pre-funding. Prior to ERISA, many plans operated on a pay-as-you-go basis. ERISA requires that current obligations (i.e. normal cost) should be funded in the year in which they occur, and past-service obligations should be amortized over a 30-year period. Other stricter amortization periods were also specified under ERISA.

Plan Termination Insurance

ERISA created an insurance program to provide retirement benefit protection to private sector plan participants. The Pension Benefit Guaranty Corporation was created to ensure that plan participants receive promised benefits, up to a statutory limit, should a plan terminate with a lack of sufficient assets to pay promised benefits. The insurance program is funded by premiums paid to the PBGC by all private sector defined benefit plans.

Minimum Plan Provisions

ERISA introduced certain eligibility, participation and vesting rules to increase benefit eligibility for plan participants. Also, under the Internal Revenue Code (IRC), plans had to meet certain nondiscrimination rules demonstrating that the plan was for the broad segment of the employer's workforce and did not favor highly compensated employees only.

Additionally, ERISA codified and standardized requirements pertaining to reporting and disclosure and fiduciary standards.

Reporting and Disclosures

ERISA contains extensive reporting and disclosure requirements that serve a dual purpose. First, the requirements support funding and fiduciary standards with meaningful reporting and disclosure of accounting, investing, and actuarial data. Second, the standards provide plan participants access to information about the financial status of their plan and information on their entitlement to plan benefits. ERISA's reporting and disclosure standards were similar to the

³⁹ House Report No. 93-533, October 2, 1973, prepared by Committee on Education and Labor, can be requested from the agency.

⁴⁰ Senate Report No. 98 – 221, August 1984, Special Committee on Aging, can be requested from the agency.

standards adopted under the Welfare and Pension Plans Disclosure Act of 1959 (WPPDA).⁴¹ Detailed reporting and disclosure provisions are included in **Appendix B**.

Fiduciary Standards

ERISA clearly established plan trustees as the responsible fiduciaries of the pension plans who will be charged with ensuring that the plan meets its pension promises; trustees are required to act in the sole interest of the fund's participants and beneficiaries. Detailed fiduciary standards provisions are included in **Appendix C**.

In the decades following passage of ERISA, federal legislation has been enacted to modify ERISA and pension-related provisions of the Internal Revenue Code, and to expand and clarify national criteria for establishing and administering qualified retirement plans. A listing of significant post-ERISA legislation and related provisions for public and private retirement systems are included in **Appendices D and E**.

Pension Protection Act of 2006

The most significant post-ERISA pension legislation is the Pension Protection Act of 2006 (PPA). The primary intent of the PPA was to increase pension plan funding levels in order to protect employee retirement benefits and minimize the exposure of the federally supported PBGC. Under the PPA, the regulatory framework and funding requirements for private sector plans were significantly tightened. Salient changes instituted by the PPA include an increased funding target, shortened amortization periods, modified interest rate determination method for measuring pension liabilities, restricted use of asset smoothing methods, and benefit restrictions for underfunded plans.

Some researchers argue that the new funding rules of PPA have created a volatile and unpredictable pension funding environment for the private sector plans.⁴² Under the new provisions, plans must have a target funded ratio of 100 percent and any unfunded liability incurred must be amortized over a maximum 7-year period instead of the 30-year maximum previously required under ERISA. Also, PPA restricts the use of asset smoothing by private sector plans potentially leading to a higher volatility in calculating the value of plan assets.⁴³

Additionally, PPA requires that instead of a single interest rate used to measure pension liabilities, private sector plans use a discount rate based on the 24-month average of the certain investment-grade corporate bond rates.⁴⁴ The PPA specified three interest rates (i.e. segment rates) dependent upon when benefits are expected to be paid to participants of different ages. This new discount rate

⁴¹ P.L. 85-836, 72 Stat. 997 (Aug. 29, 1958). Also, see History of EBSA and ERISA available at <http://www.dol.gov/ebsa/aboutebsa/history.html>.

⁴² Munnell, A.H., and Sotelo, M. 2007, *Why are Companies Freezing Their Pensions?*, can be requested from the agency.

⁴³ *The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act* (PRA 2010), Pub. L. No. 111-192 provided a temporary relief to the private sector plans with regard to the 7-year amortization period, allowing for a 15-year amortization period to be used for a two year period.

⁴⁴ Internal Revenue Service determines the segment rates. Current rates available at <http://www.irs.gov/Retirement-Plans/Funding-Yield-Curve-Segment-Rates> (Accessed 7/8/13)

provision effectively reduces the plan sponsor's flexibility in setting its contribution rate to the retirement plan.

The PPA also creates new penalties for plans deemed to be "at risk" – generally defined as plans under 80 percent funded using common actuarial assumptions, and under 70 percent funded using more conservative assumptions. Sponsors of "at-risk" plans must pay additional contributions, and are restricted from enacting any benefit increases until funded status improves to acceptable levels. More significantly underfunded plans, with a funded ratio of less than 60 percent, are required to freeze future benefit accruals for all participants until their funded ratio rises above 60 percent.

In addition to the tightened funding requirements, PPA also requires additional reporting and disclosure. Beginning in 2008, all single-employer plans are required to file a Plan Funding Notice disclosing the plan's funding target attainment percentage, a summary of assets, funding target and credit balances for the most recent three-year period. This Notice must be made available to all participants, beneficiaries and labor organizations, and is filed with the PBGC. PPA also imposes additional PBGC reporting requirements on plans that are under 80 percent funded.

Impact of ERISA in the Public Sector

Governmental retirement plans are exempt from the majority of ERISA provisions, including all requirements related to reporting and disclosure, funding, vesting and plan termination insurance (ERISA Titles I and IV). State and local retirement plans are instead governed by standards set in state constitutional and statutory law, local ordinances, relevant case law, common law relating to trusts, and individual plan design documents.⁴⁵

At the time of ERISA's passage, the Act included a provision requiring Congress to conduct a study on public employee retirement systems.⁴⁶ *The Pension Task Force Report on Public Employee Retirement Systems* was published in 1978 by the House Committee on Education and Labor, four years after ERISA's adoption. The report was critical of state and local pension management.

In response to the report, the Public Employee Retirement Income Security Act (PERISA) was introduced in Congress to impose ERISA-style reporting, disclosure and funding requirements on public sector retirement plans. However, the legislation was not enacted. Subsequent Congresses have seen similar proposals, including the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA) in 1984, and the Public Employee Pension Transparency Act (PEPTA) introduced in 2010, 2011, and 2013, but none has been enacted to date.⁴⁷

⁴⁵ Calhoun, Carol V., Cynthia L. Moore & Keith Brainard, *Governmental Plans Answer Book, Second Edition*, Aspen Publishers, 2007. p. 1-11.

⁴⁶ U.S. Congress, House Committee on Education and Labor, *Pension Task Force Report on Public Employee Retirement Systems*, 95th Congress, 2nd Session, March 15, 1978, can be requested from the agency.

⁴⁷ See GovTrack that tracks the activities of the U.S. Congress *available at* <http://www.govtrack.us/congress/bills/111/hr6484>; <http://www.govtrack.us/congress/bills/112/hr567>; and <http://www.govtrack.us/congress/bills/113/hr1628>.

ERISA standards have indirectly influenced many state and local public sector plan requirements related to pre-funding of plans, investment practices, reporting and disclosure requirements and fiduciary duties.⁴⁸ Out of a desire to avoid additional federal regulation and maintain local control of governmental retirement plans, many states have codified requirements that address the same issues posed by ERISA.

In Texas, the Pension Review Board (PRB) was established in 1979 as an oversight body for public sector retirement plans. The powers and duties of the PRB are enumerated in Texas Government Code, Chapter 801. The oversight role played by the PRB in monitoring Texas public retirement systems models the oversight responsibilities of the Department of Labor for private sector plans as created by ERISA. The Texas regulatory framework applicable to Texas state and local governmental plans also embody many of the ERISA standards relating to reporting, disclosure, fiduciary responsibilities and asset administration. By codifying these ERISA standards in statutes applicable to Texas public retirement systems, Texas has created ERISA-type requirements for Texas governmental plans. Appendices A through C include a comparison of significant regulatory differences between private sector and Texas public pension plans.

ERISA and the IRS, continued

Governmental plans are subject to some provisions of the Internal Revenue Code, including those related to tax qualification, compensation limitation for benefit accruals, minimum required distributions, and pre-ERISA vesting requirements.

Governmental plans are not subject to nondiscrimination, minimum coverage or minimum participation rules.

Detailed analyses of the relationship between the Internal Revenue Code, ERISA and governmental plans can be found in Chapter 1 of the *Governmental Plans Answer Book, Second Edition* (Calhoun, Moore & Brainard 2007).

State and Local Laws

Governmental plans operate in a different regulatory environment from private sector plans. Private sector plans must conform to a uniform set of requirements, in ERISA, for funding standards, vesting, and minimum plan provisions. Public sector plans must conform to the provisions and requirements in the individual plan's governing statute as created by the state or local plan sponsor. The lack of a uniform national standard for plan provisions allows public sector plan sponsors to tailor plans to meet their membership needs, and to potentially offer members the ability to customize their plans.

One of the fundamental differences between governmental plans and private sector plans is the level of involvement in the political process required to make plan modifications.⁴⁹ Private sector plan sponsors may establish, modify and even close their plans as long as they do so in accordance with ERISA requirements. Public sector plan sponsors are not required to adhere to a majority of ERISA

⁴⁸ Employee Benefit Research Institute, *Fundamentals of Employee Benefit Programs, Part Five – Public Sector*, 2005, p. 20.

⁴⁹ Employee Benefits Research Institute, *supra* note 37; p. 3.

provisions, but may not have latitude to add or change the structure of a plan if not authorized by statute.

Texas Constitution

In Texas, all statewide retirement systems and many local plans are established in state statute, and generally require legislation to enact plan modifications.⁵⁰ Statewide retirement systems, including the Employees Retirement System (ERS), the Texas Teacher Retirement System (TRS), the Texas County and District Retirement System (TCDRS) and the Texas Municipal Retirement System (TMRS), are established under the authority of Texas Constitution Article XVI, Section 67.

Section 67 also requires the legislature to grant authority for cities and counties to create retirement benefit plans for their officers and employees. This section impacts the administration of Texas public retirement plans by requiring that benefits be financed based on sound actuarial principles; that assets held in trust for member benefits not be diverted; that boards of trustees be established to administer plans; and that the boards of trustees exercise ordinary prudence and discretion in the discharge of their fiduciary duties. Article XVI, Section 66 of the Texas Constitution prohibits certain non-statewide retirement systems from making plan modifications that reduce or impair accrued benefits of vested employees.

Texas Statutes

For some retirement systems in Texas, state statutes govern most aspects of plan design and administration, and any plan changes must be made through legislation unless the governing statute of the plan expressly grants authority for changes to be made locally.⁵¹ For governmental entities that establish plans under Vernon's Civil Statutes, board composition and fiduciary duty, plan membership, creditable service, retirement and disability benefits, and employee and employer contribution rates are often specified in state law; while entities that establish plans under Government Code 810 may determine plan governance and provisions locally. Similarly, in the case of plans established by city ordinance, plan changes may be made locally without involving the legislature, provided changes do not violate any applicable constitutional protections.

Local Governance

While a few Texas local retirement systems are codified in state statute, many other systems are allowed to make changes locally without legislative involvement. Because authorization for local changes is made on an individual basis in each plan's statute, wide variation exists. Some plan statutes do not allow for any changes to be made at the local level, while others grant authority for most elements of plan design, funding and benefits to be changed at the local level. The governing statutes

⁵⁰ Statewide retirement systems in Texas have rule-making authority to modify plan provisions that would risk the system's plan qualification status under Section 401(a) of the Internal Revenue Code; and rule-making authority to clarify plan provisions as necessary.

⁵¹ *Ibid*

of certain plans that are allowed to make structural changes locally may require these plans to receive approval from an actuary before adopting these changes.⁵²

Accounting Standards in the Public and Private Sectors

Retirement plan financial reporting requirements are different in the public and private sectors. In the private sector, accounting standards for pension plans are governed by the Financial Accounting Standards Board (FASB). Current financial reporting standards for private sector pension plan sponsors began when FASB issued Financial Accounting Statement (FAS) 87 – Employers’ Accounting for Pensions, which became effective in 1987.⁵³ In 2006, FASB reorganized the body of accounting standards, and FAS 87 was codified under Accounting Standards Codification (ASC) 715. Under FAS 87 and ASC 715, pension plan sponsors must apply strict liability cost measurement standards and market-based asset valuation methodologies in preparing and presenting financial statements.

In the public sector, the Governmental Accounting Standards Boards (GASB) oversees reporting standards for governmental entities. In 2012, GASB issued Statement No. 67, Financial Reporting for Pension Plans, which replaced GASB Statement No. 25, and Statement 68, Accounting and Financial Reporting for Pensions, which replaced GASB Statement No. 27. GASB enacted these changes to tighten reporting requirements for pension liabilities for public sector entities (See **Appendix F** for a comparison of accounting standards for the public and private sectors).

The changes recently enacted by GASB should increase the parity between governmental financial reporting standards and private sector reporting standards. For more than two decades, the private sector has been required to report the present value of pension plan liabilities using lower discount rates than the public sector, causing higher liability balances and reported expenses. However, accounting standard differences only specify different reporting requirements, not funding policy differences. It is the strict funding provisions under ERISA, and more recently the PPA that have placed direct additional pressure on private sector plan sponsors. Conversely, the public sector is allowed greater flexibility in setting funding policy. Appropriate funding policy for public sector plans is currently set by governmental retirement plan sponsors. This methodology will continue under the new GASB standards.

While accounting standards have not had a direct impact on the choice in retirement plans that employers offer, the accounting information presented and the use of that information may indirectly affect retirement benefit offerings. In the private sector, emphasis on earnings in each reporting period increases pressure on management to minimize operating expenses. Strict accounting standards for pension liabilities results in significant fixed costs for companies, which may negatively

⁵² Section 7 (b) of the Texas Local Fire Fighters’ Retirement Act (Article 6243e, Vernon’s Texas Civil Statutes) requires an approval from the board selected actuary before the trustees can adopt or change a benefit or requirement for payment of benefits.

⁵³ FAS 87, Employees’ Accounting for Pensions, *available at* <http://www.fasb.org/cs/BlobServer?blobkey=id&blobwhere=1175820920574&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs>.

affect company earnings and force management to decide between providing a defined benefit retirement for the company's employees, and increasing periodic earnings. In the public sector, less emphasis is placed on earnings analysis in determining the success of programs.

Social Security

Social Security insurance funding has been required in the private sector since passage of the Social Security Act of 1935.⁵⁴ In the public sector, Social Security coverage was not offered until 1951. From 1951 to 1991 federal law allowed governmental entities the option to participate in the program through voluntary agreements. In 1991, federal law changed to require that state and local governments that do not participate in Social Security must provide a retirement plan that qualifies as either a:⁵⁵

- A defined benefit retirement system that provides a retirement benefit to the employee that is comparable to the benefit provided by the Social Security part of FICA,⁵⁶ or
- A defined contribution plan that provides for an allocation to the employee's account of at least 7.5 percent of the employee's compensation during any period under consideration. (Contributions from both the employer and the employee may be used to make up the 7.5 percent)⁵⁷

For more than five decades the private sector was required to fund Social Security benefits, while participation by public sector entities was voluntary. Compulsory payment of Social Security program costs by private sector companies increased their operating expenditures, resulting in reduced ability to fund additional benefits, including employee retirement plans.

Additionally, the Internal Revenue Service reports that the majority of uncovered local government public employees are police officers, firefighters and teachers.⁵⁸ The Pension Review Board surveyed the 89 active actuarially funded public pension plans in Texas in 2011 to determine how many provided Social Security benefits to their members. Of the plans surveyed, 79 plans with 2,216,797 members responded. Of the total respondents, 41 plans with 1,423,390 members (64 percent of members) did not participate in Social Security.⁵⁹

⁵⁴ Internal Revenue Service, Publication 15 – Main Content, Section 9, “Social Security and Medicare Taxes”, available at <http://www.irs.gov/publications/p15/ar02.html> (accessed June 11, 2013). Note: The requirements listed are minimum provisions and do not provide a comprehensive listing of Non-Social Security qualification.

⁵⁵ 26 CFR 31.3121(B)(&)-2 – Service by Employees Who Are Not Members of a Public Retirement System.

⁵⁶ Internal Revenue Service, Federal-State Reference Guide. Publication 963 (Rev. 11-2011). Pages 80-81, available at www.irs.gov/pub/irs-pdf/p963.pdf (accessed May 15, 2012).

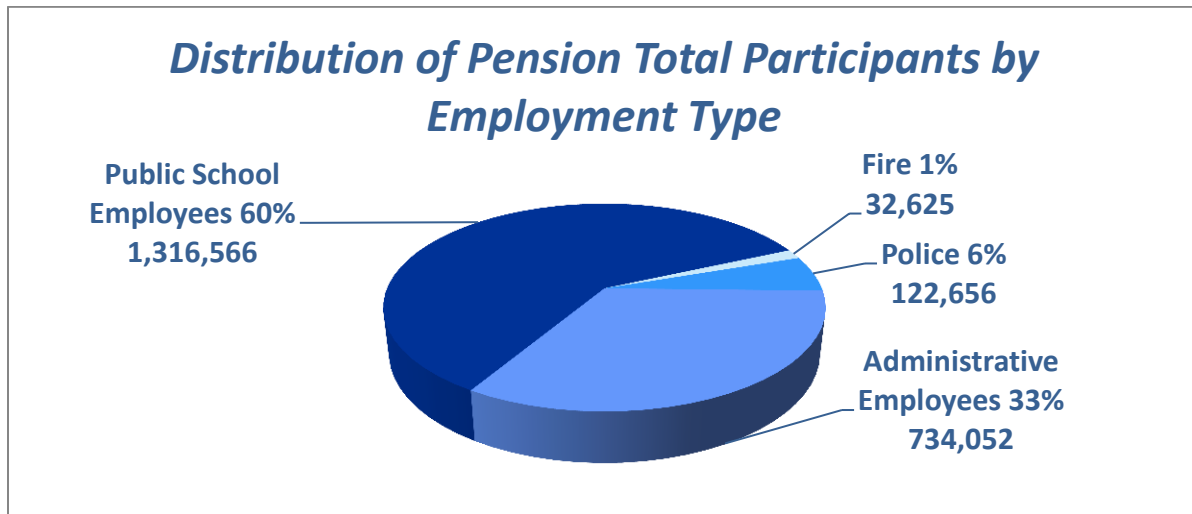
⁵⁷ *Ibid.*

⁵⁸ Internal Revenue Service, Publication 963 (Rev. 11-2011), Catalog Number 21843B, Department of the Treasury, available at [Service www.irs.gov](http://www.irs.gov).

⁵⁹ PRB Survey Data – *Social Security Survey Results 2011 for Actuarially Funded Plans.xls*, can be requested from the agency.

Workforce Compensation

Analysis of public and private sector retirement plan differences should include a comparison of total compensation since the value benefits may provide affect compensation parity comparisons between the two sectors. To illustrate this point, this section presents an analysis of wages and benefits for Texas educational and administrative employees. As the following chart shows, these employment categories comprise approximately 93 percent of the Texas pension-participating public employee workforce.⁶⁰



Educational Personnel

In Texas educational personnel comprises the largest proportion of public sector employees, at approximately 60 percent of the public sector workforce; and consists of teachers and faculty members employed by local Independent school districts. Most of these employees participate in the Teacher Retirement System of Texas (TRS). A comparison of teacher salaries to workers in the private sector with similar educational attainment was performed in the Economic Policy Institute (EPI) 2010 report, "The Teaching Penalty".⁶¹ A summary of the EPI's analysis is presented in the following table.

Comparison of Texas Public Teacher and Public Employee Wages by Educational Attainment ⁶²			
Education Level	Teacher Salary	Private Sector Salary	Teacher Discount
Bachelor's Degree	\$45,344	\$63,700	-29%
Master's Degree	\$52,104	\$78,936	-34%
Weighted Average	\$46,904	\$67,236	-30%

⁶⁰ Pension Review Board Data compiled from the most recent retirement plan annual financial reports received as of December 1, 2012.

⁶¹ The Economic Policy Institute, "The Teaching Penalty, An Update Through 2010" (March 30, 2011); available at <http://www.epi.org/page/-/old/issuebriefs/IssueBrief298.pdf>.

⁶² Ibid

This analysis finds that teachers are paid approximately 30 percent less than their private sector counterparts with similar educational attainment. While this analysis does not provide information on the type of work performed by private sector employees included for comparison, reviewing educational attainment-adjusted compensation, as reported in the Economic Policy Institute, would suggest that Texas teachers receive lower salaries than similarly educated employees in the private sector.

Administrative Personnel

Administrative personnel comprise the second largest segment of Texas public employees, accounting for 33 percent of the total public employee workforce. The Texas State Auditor's 2012 report, "State Employee Benefits as a Percent of Total Compensation," states that the average classified full-time Texas state employee earned total compensation of \$58,808 in fiscal year 2011. This compensation consists of \$39,804 in salary (approximately 67.7 percent of the total), and \$19,004 in benefits (approximately 32.3 percent of the total).⁶³ This wage falls short of the \$42,161 reported by the Bureau of Labor Statistics (BLS) for the average private sector employee in the United States, regardless of education level, or the \$67,236 reported by the EPI for the average private sector employee in Texas with a bachelor's degree.⁶⁴ A comparison of salaries included in these reports is presented in the following table.

Comparison of Texas Public Teacher and Public Employee Wages by Educational Attainment⁶⁵	
Category	Salary
Average Texas State Employee (SAO Report)	\$39,804
Average United States Private Sector Employee (BLS)	\$42,161
Average Texas Private Sector Employee with a Bachelor's Degree (EPI)	\$67,236

Compensation Summary

Salary data for the public and private sectors suggest that governmental employees are paid less than their private sector counterparts. Private sector employers have other forms of compensation that may be provided, including stock options and bonuses, not available to public sector employees. Furthermore, participation in Social Security for private sector employees is mandatory, while public sector employees may not participate in Social Security as previously noted. Responsibly constructed defined benefit retirement plan compensation may offset this discrepancy, and improve total compensation parity between the two sectors.

⁶³ Texas State Auditor's Office, "State Employee Benefits as a Percentage of Total Compensation". February 2012; available at <http://www.sao.state.tx.us/reports/main/09-704.pdf>.

⁶⁴ The Economic Policy Institute, *supra* note 47; and

Bureau of Labor Statistics U.S. Department of Labor, "Employer Costs for Employee Compensation – June 2012", available at <http://www.bls.gov/news.release/pdf/ecec.pdf>.

⁶⁵ The Economic Policy Institute, *supra* note 47.

Conclusions on Retirement Plans in the Public and Private Sectors

Private sector employees are generally at greater risk of having their pension plan terminated than public sector employees.⁶⁶ This is due in part to the private sector's greater susceptibility to revenue stream stressors, including competition and economic volatility. The additional risks are also the result of higher costs of compliance associated with stricter funding requirements, payment of plan insurance, and adherence to minimum plan provision requirements.

To illustrate the risks associated with private sector defined benefit retirement systems, the following table summarizes Pension Benefit Guarantee Corporation data, including the number of plans, total participants, terminations, and claims from 1975 through 2009.⁶⁷

PBGC Single-Employer Program Pension Plan Terminations ⁶⁸					
Fiscal Year	Total Plans At Period Beginning	Total Participants (in '000)	Standard Terminations	Distress/ Involuntary Terminations	Total Claims (in '000)
1975-1979	Not Available	Not Available	28,572	586	\$252,206
1980-1984	95,439	27,518	29,236	622	743,655
1985-1989	112,208	29,809	48,519	537	1,701,719
1990-1994	91,899	31,633	36,340	694	2,841,949
1995-1999	53,589	32,634	15,620	443	782,617
2000-2004	35,373	34,108	6,969	706	14,759,470
2005-2009	29,605	34,232	6,916	507	22,737,120

The total number of participants in private sector defined benefit plans steadily increased each five-year period from 1980 to 2000. From 2000 to 2009, total participation remained relatively constant. From 1985 to 2005, the total number of private sector single employer defined benefit plans decreased from 112,208 to 29,605. Relative consistency in total participation coupled with the simultaneous decrease in number of total plans indicates that private sector defined benefit plans have consolidated. Concurrent with the broad consolidation of pension plans in the private sector, PBGC data show significant claims payments for involuntary or distress terminations in each of the five year periods presented. The amount of these termination claims has grown exponentially over the three decades presented, from \$252 million in the 1975-1979 time period, to more than \$22 billion in the 2005-2009 time period.

⁶⁶ Employee Benefits Research Institute, *Regulation of Public Sector Pension Plans*, p. 3, can be requested from the agency.

⁶⁷ 2011 Pension Benefit Guarantee (PBGC) Annual Report, can be requested from the agency.

⁶⁸ Pension Benefit Guarantee Corporation – “2010 Pension Insurance Data Tables.pdf” Tables S-3, S-4, S-7, S-30; available at <http://www.pbgc.gov/res/data-books.html>.

In the public sector, plan terminations are rare, however terminations can still occur. In Texas no entity has terminated a plan through bankruptcy; however a few local entities have closed their retirement plans to new hires while continuing to fund the accrued benefits owed to the existing plan participants.

Effects of Structural Compliance and Compensation Differences

The financial risks associated with funding defined benefit plans are a concern for both public and private sector employers, however, private sector employers face more difficulties. Less revenue predictability results in greater risk for private sector defined benefit plan sponsors. Additionally, requirements under ERISA and provisions outlined in Pension Protection Act mandating a strict plan funding requirement target of 100 percent; payment of plan termination insurance premiums; and adherence to minimum plan provision requirements increase regulatory costs of compliance on plan sponsors in the private sector.

Public sector plan sponsors incur risk when creating sustainable defined benefit funding structures. However, comparison of the structural differences between these entities and their private sector counterparts finds that they are generally better able to support defined benefit retirement plans due to greater revenue predictability and greater flexibility in the regulatory environment. Any review of retirement plan structures and compensation alternatives should consider the relatively greater ability for public sector entities to support defined benefit retirement systems.

Appendices

Appendix A - Comparison of Significant Regulatory Differences	
Funding Standards	
PRIVATE PENSION PLANS	TEXAS PUBLIC PENSION PLANS
<p>Federal law: Employee Retirement Security Act (ERISA) §§ 302-308; IRC, 26 U.S.C. § 412, § 430, § 431, and § 432.</p> <p>To ensure payment of promised benefits, ERISA created rules targeting the full funding of benefits over a closed period. These rules were substantially modified and made more stringent by the Pension Protection Act of 2006 (PPA), targeting full funding over a seven year period. Private sector defined benefit plans must adhere to strict requirements relating to amortization periods, asset valuation methods, and discount rates.</p>	<p>Funding standards for Texas public retirement plans are set in the plan's governing statute, plan documents and/or is set by the retirement system's sponsoring entity.</p>
Plan Termination	
PRIVATE PENSION PLANS	TEXAS PUBLIC PENSION PLANS
<p>Federal law: Employee Retirement Security Act (ERISA) § 204(g); 29 U.S.C. § 1054(g)</p> <p>Anti-cutback Rule. ERISA prohibits plan amendments that eliminate or reduce benefits already accrued by plan participants who have met certain plan requirements. However, the anti-cutback rule only prohibits retroactive amendments and allows prospective changes to the plan that may eliminate, freeze or reduce benefits.</p> <p>Pension Benefit Guaranty Corporation (PBGC). The PBGC, an independent agency of the Federal government, guarantees pension benefits up to a certain amount set by law for defined benefit plans.</p>	<p>State law: Texas Constitution, Art. XVI, § 67 and retirement system's respective governing statute under Texas Government Code or Vernon's Texas Civil Statutes</p> <p>In Texas, the State Constitution protects the vested accrued benefits of participants of certain local retirement systems. The constitution protects against the reduction or impairment of benefits that current and former employees would be eligible for without accumulating additional service, and prohibits the reduction or impairment of retiree benefits. Public retirement systems not protected by the Texas Constitution may have similar protections under their respective governing statutes.</p>
Minimum Plan Provisions	
PRIVATE PENSION PLANS	TEXAS PUBLIC PENSION PLANS
<p>Federal law: Employee Retirement Security Act (ERISA) §§ 201-210; IRC, 26 U.S.C. § 410, § 411</p> <p>ERISA contains certain participation, benefit accrual, minimum vesting and spousal survivor protection requirements. These standards are also codified in the IRC. The requirements protect employee's right to fairly participate in an employer sponsored plan, avoid age discrimination, and receive vested benefits. As compared to the public sector, these minimum plan provisions are stringent and restrictive in nature.</p>	<p>Plan participation, benefit accrual and vesting standards for Texas retirement plans can be set by the governing statute of the respective retirement plan or is incorporated in the system's plan document as approved by the governing body and/or the sponsoring entity of the system. The Internal Revenue Code also contains certain pre-ERISA vesting requirements and maximum benefit limitations that apply to public pension plans.</p>

Appendix B - Reporting and Disclosure

Private Pension Plans	Texas Public Pension Plans
<p>Federal law: Employee Retirement Security Act (ERISA) §§ 101-111; 29 U.S.C., Part 4, §§ 1021–1031</p>	<p>State law: Tex. Gov’t Code, Chapter 802, §§ 802.101–802.107</p> <p>Note: Per Tex. Gov’t Code, Section 802.002 (a), some Texas statewide retirement systems are exempt from certain reporting and disclosure requirements of Chapter 802 of the Gov’t Code.</p>
<p>1. Summary Plan Description. ERISA requires plan administrators to provide participants and beneficiaries a document, written in plain, non-technical language that summarizes plan participation requirements, benefits, vesting requirements, and methods available for appealing claim denials. (29 U.S.C. § 1022).</p>	<p>1. Information to Member or Annuitant. A retirement system must provide to its members a summary of benefits, procedures for claiming or choosing the benefits and information on contributions, withdrawal of contributions, eligibility for benefits requirements, including any right to terminate employment and retain eligibility Tex. Gov’t Code, § 802.106(a).</p>
<p>2. Summary of Plan Modifications. Any material modifications to a plan not resulting in issuance of a new Summary Plan Description must be communicated to participants in a Summary of Plan Modifications within 210 days of the end of the plan year in which the change was adopted. (29 U.S.C. § 1024(b)(1)).</p>	<p>2. Plan Modifications. A retirement system is required to distribute to each active member and retiree a summary of any significant change that is made in statutes or ordinances governing the system and that affects contributions, benefits, or eligibility (Tex. Gov’t Code, § 802.106(b)).</p>
<p>3. Benefit Statements. ERISA requires plan administrators to provide benefit statements to DB plan participants and beneficiaries once every three years, and upon request. Benefit statements must discuss accrued benefits, amount of non-forfeitable benefits, and date on which accrued benefits become fully vested. (29 U.S.C. § 1025(a)(1)(B)).</p>	<p>3. Benefit Statements. A retirement system is required to provide annually to each active plan participant a statement of the amounts of member’s accumulated contributions and total accumulated service credit on which benefits may be based (Tex. Gov’t Code, § 802.106(c)).</p>
<p>4. Annual Funding Notice. Plan administrators must provide funding notices to PBGC, plan participants and beneficiaries and labor organizations, if involved. The notice should include information about plan’s funding policy, assets, liabilities, membership and benefits guaranteed by the PBGC (29 U.S.C. § 1021(f)).</p>	<p>4. Financial Condition Notice. A retirement system is required to provide to plan participants a summary of the financial condition of the retirement system, if the actuary of the system determines that the financing arrangement of the system is inadequate. Tex. Gov’t Code, § 802.106(d)</p>
<p>5. Annual Reports. Most plans are required to file an Annual Report (Form 5500) with the Department of Labor (DOL) providing information on the plan's operation, funding, assets and investments. Filing of Form 5500 satisfies the annual reporting requirements for the IRS as well. Form 5500 may require certain plans to conduct an audit. The annual report must include plan’s financial and actuarial statements. This document is not required to be distributed to participants, but copies are made available upon request. (29 U.S.C. § 1023).</p>	<p>5. Annual Reports. Board of trustees of the retirement systems are required to conduct actuarial valuations of the systems at least once every three years and annual audits of the systems in accordance with generally accepted accounting standards. The trustees are also required to publish an annual financial report and file actuarial valuations and the annual financial reports with the PRB (Tex. Gov’t Code, § 802.101 and § 802.103).</p>

Appendix C - Fiduciary Responsibility

Private Pension Plans	Texas Public Pension Plans
<p>Federal law: Employee Retirement Security Act (ERISA) §§ 401-414; 29 U.S.C., Part 4, §§ 1101–1114</p>	<p>State law: Texas Constitution, Art. XVI, § 67; Texas Government Code, Chapter 802 § 802.203 and retirement system’s respective governing statute under Texas Government Code or Vernon’s Texas Civil Statutes</p>
<p>1. Exclusive Benefit Rule. The fiduciary must act (1) solely in the interest of participants and beneficiaries and (2) exclusively to provide benefits to participants and beneficiaries and to defray reasonable plan administrative costs (29 U.S.C.A. § 1104(a)(1)(A)).</p>	<p>1. Exclusive Benefit Rule. The governing body shall discharge its duties solely in the interest of participants and beneficiaries for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the system. Tex. Gov’t Code, § 802.203. The Exclusive Benefit Rule is also contained in Texas Constitution, Art. XVI, § 67 and respective statutes of various Texas Public retirement systems.</p>
<p>2. Prudent Man Rule. Fiduciaries must act with the care, skill, prudence, and diligence, under the circumstances prevailing at the time, that a prudent man acting in a like capacity and familiar with such matters would use in conducting an enterprise of a like character with like aims (29 U.S.C.A. § 1104(a)(1)(B)).</p>	<p>2. Prudent Person Standard. A board shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds. Texas Constitution, Art. XVI, § 67(a)(3).</p>
<p>3. Diversification Rule. Fiduciaries must diversify plan investments to minimize the risk of large losses, unless, under the particular circumstances, it is clearly not prudent to do so (29 U.S.C.A. § 1104(a)(1)(C)).</p>	<p>3. Diversification Rule. The governing body shall diversify the investments of the system to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Tex. Gov’t Code, § 802.203(a)(3).</p>
<p>4. Acting in Accordance with Plan Documents Rule. Fiduciaries must act in accordance with the documents and instruments governing the plan to the extent that those documents and instruments are consistent with ERISA provisions (29 U.S.C.A. § 1104(a)(1)(D)).</p>	<p>4. Plan Documents. The governing body shall discharge its duties in accordance with the documents and instruments governing the system. Tex. Gov’t Code, § 802.203(a)(4).</p>
<p>Internal Revenue Code (IRC) § 401(a)(2) – no part of plan assets may be used for purposes other than for exclusive benefit of employees and beneficiaries, known as “exclusive benefit rule”).</p> <p>In addition to these rules a fiduciary must meet common law fiduciary standards of care.</p>	<p>5. Internal Revenue Code (IRC) § 401(a)(2) – no part of plan assets may be used for purposes other than for the exclusive benefit of employees and beneficiaries (known as “exclusive benefit rule”).</p> <p>Duty of Care. The governing body shall discharge its duties with the care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise with a like character and like aims. Tex. Gov’t Code, § 802.203(a)(2). Duty of Care standard is also contained in Texas Constitution, Art. XVI, § 67 and respective statutes of various Texas Public retirement systems.</p>

Appendix D - Private Sector Pensions Regulatory Timeline		
Year Adopted	Regulation	Key Provisions
1921	Revenue Act of 1921	Employees were allowed to make pre-tax contributions to the pension trust and taxed only when they received distributions.
1926	Revenue Act of 1926	Allowed employers to deduct pension contributions from corporate income and allowed plan's trust fund's to grow tax free.
1935	Social Security Act of 1935	Enacted Social Security benefits.
1938	Revenue Act of 1938	Established the 'non-diversion' rule for qualified plans.
1942	Revenue Act of 1942	Tightened participation requirements and introduced disclosure requirements.
1958	Welfare and Pension Plans Disclosure Act of 1948 (WPPDA)	DOL became involved in regulation of employee benefits. Previously the IRS was the only entity involved. Established filing requirements.
1974	Employee Retirement Income Security Act (ERISA)	Created federal regulation for private sector pension plans.
1978	Revenue Act of 1978	Allowed for qualified deferred compensation (sec. 401(k)) plans.
1984	Retirement Equity Act of 1984	Mandated automatic spousal survivor benefits; reduced the maximum age requirement for the purposes of enrollment and vesting in pension plans; and created spousal rights to pension benefits through qualified domestic relations orders (QDROs) in the event of divorce.
1986	Tax Reform Act of 1986 (TRA)	Distributed administration responsibilities under ERISA, giving administration of fiduciary, reporting and disclosure requirements to the Employee Benefit Security Administration (EBSA); and administration of vesting, funding and participation requirements to the IRS.
1987	Omnibus Budget Reconciliation Act of 1987	Amended funding rules governing underfunded and overfunded plans and changes PBGC premium levels and structure. Imposed a limit on maximum tax deductible contributions based on the plan's current liability (150% full funding limit).
1989	Omnibus Budget Reconciliation Act of 1989	Created mandatory Labor Department Civil penalties for violations of fiduciary responsibility. Granted regulatory authority to Treasury to create new nondiscrimination rules.
1994	Social Security Administrative Reform Act of 1994	Established Social Security Administration as an independent federal agency.

Appendix D - Private Sector Pensions Regulatory Timeline, Continued

Year Adopted	Regulation	Key Provisions
1997	Taxpayer Relief Act of 1997	Created provisions affecting private sector retirement plans, including 10% limit on investment in employer securities to certain 401(k) plans, increased the 150% full funding limit and changed 403(b) annuity rules.
2001	Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)	Increased participant elective deferrals to defined contribution plans. Allowed catch-up contributions for employees age 50 and over. Increased benefits and contribution limits under qualified plans. Increased the compensation limit and changed the compensation definition for deduction purposes
2004	Pension Funding Equity Act of 2004	Created a new pension interest benchmark through 2005 as a blended corporate bond rate.
2006	Pension Protection Act of 2006 (PPA)	Completely replaced and tightened rules governing how companies fund their defined benefit pension plans by specifying segment rates for minimum funding and disclosure requirements. Made significant changes in defined contribution rules to encourage automatic enrollments.
2008	Worker, Retiree, and Employee Recovery Act of 2008	Made technical changes to PPA of 2006
2010	Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010	Provided relief for pension plan funding through 2011.
2012	Pension Relief Act of 2012 (MAP-21)	Passed in 2012 as part of a highway funding bill, MAP-21 temporarily (through about 2016) lowers minimum pension funding requirements by installing a floor on the interest rates (called segment rates) used to calculate the minimum funding requirement. Additionally, MAP-21 increases PBGC fixed and variable premiums, starting in 2013.

Appendix E - Public Sector Pensions Regulatory Timeline		
Year Adopted	Regulation	Key Provisions
1921	Revenue Act of 1921	Employees were allowed to make pre-tax contributions to the pension trust and taxed only when they received distributions.
1926	Revenue Act of 1926	Allowed employers to deduct pension contributions from corporate income and allowed plan's trust fund's to grow tax free.
1974	Employee Retirement Income Security Act (ERISA)	Title II & III contain provisions affecting public sector plans
1978	Revenue Act of 1978	Allowed for qualified deferred compensation (sec. 401(k)) plans.
1986	Tax Reform Act of 1986	Distributed responsibilities under ERISA Title I, giving administration of fiduciary, reporting & disclosure requirements to the EBSA and administration of vesting, funding & participation requirements to the IRS; responsibility was previously overlapping . Responsibility to administer certain ERISA provisions undertaken by IRS does affect public sector plans.
2001	Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)	Increased participant elective deferrals to defined contribution plans. Allowed catch-up contributions for employees age 50 and over. Increased benefits and contribution limits under qualified plans. Increased the compensation limit and changed the compensation definition for deduction purposes.
2006	Pension Protection Act of 2006 (PPA)	Clarified certain minimum distribution rules for governmental plans. Exempted all governmental plans from nondiscrimination rules. Waived the 10% early withdrawal penalty for distributions made from governmental defined benefit plans to a public safety employee. Allowed certain rollovers from qualified retirement plans to defined contribution plans. Amended interest credit rules for plans with hypothetical accounts.

Appendix F - Accounting Standards in the Public and Private Sectors		
Accounting Treatment	Public Sector (GASB 68)	Private Sector (FAS 87 (ASC 715))
Balance Sheet Impact	Net Pension Liability recognized on plan sponsor's balance sheet as a liability	Plan's funded status (i.e., unfunded PBO) shown on balance sheet in liability and equity (AOCI) sections
Market Value of Assets	Used to Calculate the Net Pension Liability	Used to Calculate the Plan's Funded Status
Required Actuarial Valuation Method	Entry Age Normal Cost Percentage of Payroll	Projected Unit Credit
Required Discount Rate	Single interest rate: Expected return on assets, blended with high quality municipal bond rate based on when the fund is expected to be exhausted	Single interest rate that must relate to the market rate of interest available on high-quality debt
Other assumptions	Must be individually reasonable	Must be individually reasonable
Pension Expense	Sum of: Normal cost; Interest on the NPL; Amortization of gains and losses and assumption changes; Full cost of plan amendments adopted in the current year.	Sum of: Service cost; Interest on the PBO; Amortization of gains and losses, assumption changes and plan amendments; Minus expected return on plan assets.

