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NIRS Fact Check
DPS Employee Compensation: the Role of Pension Benefits
March 31, 2008

In the interest of promoting the highest standards of research in the area of retirement security, as part of its mission, the National Institute on Retirement Security routinely reviews emerging work in the field. On March 17, 2008, the Donnell-Kay and Piton Foundations released a report on the Denver Public Schools Retirement System. In our review of this report, we uncovered a number of factual errors, the most significant of which we describe herein.

Error # 1: "Pension plans such as DPS' only work because - like Social Security - younger workers are paying for the pension benefits of retiring workers." Page 4
This statement is incorrect. Pensions are pre-funded, meaning that the employer and the employee set aside money in the pension fund each year, as work is performed by the employee. These funds are invested and grow over time. The accumulated assets are then used to pay benefits in retirement. Nationally, investment earnings account for about three-quarters of the funds available to pay for retirement benefits in state and local pension plans. In contrast, Social Security is a pay-as-you-go system where contributions from the current generation of workers pay benefits for the current generation of retirees.

Moreover, the report fails to acknowledge a key area where the issue of Social Security *is* relevant for Denver Public School (DPS) system employees. DPS employees (similar to about half of public school teachers nationwide) are NOT covered by Social Security. This is a significant error of omission in the report. The fact is that the Denver Public Schools Retirement System (DPSRS) plan must do the job of two plans - Social Security *and* an employer-sponsored pension plan.

Error #2: "…These pension benefits are not portable." Page 5.
It is incorrect to claim a "lack of portability" in defined benefit plans generally or with DPSRS specifically. There is nothing inherent in the nature of a pension or a 401(k) plan that dictates portability. Rather, the degree of portability varies with the specific plan design. In fact, the ability in DPSRS to purchase service credit is designed to facilitate the attraction of mid-career professionals into the system. Teachers joining the system mid-career can purchase up to ten years' service credit in the system. Up to five years may be for private sector service. In addition, the system gives up to ten years' worth of credit toward eligibility for benefits for prior public teaching service, at no cost to the teacher. And those who leave before vesting are eligible for a refund of their contributions to the system, which they may roll over to an Individual Retirement Account. Of course, it is highly unlikely that individuals who leave DPS after a few years for a job in the private sector will have similar opportunities to purchase service credit or to receive eligibility credits with a private sector employer. This may be unfortunate, but it is not within the control of DPS nor DPSRS.

Error #3: "In addition to this 8% match, the District is currently paying an additional 19% of the salaries of employees…" Page 5
The report seriously overstates the size of DPS contributions to the DPSRS. DPS is not contributing 19% of pay on top of another 8% contribution as the report appears to claim. According to the latest Comprehensive Annual Financial Report for DPSRS, the employer contribution rate is 12.83%, effective July 1, 2007. That is, the actual employer contribution rate is less than half of what the report claims it to be.

Error # 4: "…the average life expectancy today of a teacher retiring at age 55 with 30 years of experience is over 85 years of age." Page 9
According to the Social Security Administration, life expectancy at age 55 is 79 for men and 82 ½ for women. That is, beneficiaries will receive benefits for a much shorter period of time than the report implies. For a teacher retiring at age 55, the expected length of retirement is about 25 years instead of the over 30 years implied in the report.

Error #5: "This pension structure is thus very damaging to the effort to retain the District's most valuable senior employees." Page 11
The report appears to assume that simply because employees become eligible for a retirement benefit, they automatically take it. However, this assumption is simply not borne out by the facts. According to the plan's most recent Comprehensive Annual Financial Report, just 1 in 4 teachers who are eligible for early retirement at age 50 typically take it. In fact, at any early-retirement age, eligible teachers are more likely to stay on the job than they are to leave. Moreover, just 13% of all retirees in the DPSRS were early retirees. A large body of research has shown that retirement decisions are driven by many factors – one's health status, other sources of retirement income, Social Security receipt, spousal and family considerations, the satisfaction one gets from a job, and many more – not just the incentives that are offered by a specific plan design. However, this body of research is not referenced anywhere in the report.

Error #6: "For employers, defined benefit plans are also much more costly than defined contribution plans." Page 14
This statement is incorrect. Because of the potential policy implications, this is perhaps the most potentially harmful error in the report. In fact, for any given level of retirement benefits, the evidence shows that pension plans are far more cost effective than 401(k) plans. Thus, the report's policy proposal to switch from pension to 401(k) plans for Denver's teaching workforce would have to either, dramatically increase the cost of retirement benefits to taxpayers or dramatically reduce the level of benefits offered to teachers. The report does not address the preferable course of action – increasing taxes or cutting benefits. Although the report avoids engaging this point, policy makers would not have that luxury if they chose to follow the report's policy recommendation.

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