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Pension Funds Strained, States Look at 401(k) Plans

By STEVEN GREENHOUSE

Lawmakers and governors in many states, faced with huge shortfalls in employee pension funds, are turning to a strategy that a lot of private companies adopted years ago: moving workers away from guaranteed pension plans and toward **401(k)**-type retirement savings plans.

The efforts come as the governors of Wisconsin and Ohio, citing dire budget problems, are engaged in bitter showdowns with public-employee unions over wages, pensions and collective bargaining rights.

The new plans allow states to set a firm, upfront limit on the amount they will contribute and leave it up to the employee and the financial markets to make the money grow. In a traditional pension system, the employer promises a certain benefit, then must find a way to pay for it.

Like private employers, which in droves have terminated traditional pension plans, many government officials like the idea of shifting much of a pension plan's risk to the worker. And some workers prefer a **401(k)**-type system because it gives them more control over their retirement assets, including the ability to take the money with them when they change jobs.

Utah lawmakers voted last year to make a partial changeover to a **401(k)**-type plan, following in the footsteps of Alaska, Colorado, Georgia, Michigan, Ohio and several other states, which offer at least

some version of it.

In February, Kentucky's Senate approved a full switch to a 401(k)-type plan, although the bill faces uncertain prospects in the House. In Oklahoma and Kansas, legislative committees will be studying the issue intensively over the next few weeks. Gov. [Sam Brownback](#) of Kansas has made it clear he hopes the state Senate will embrace some form of a 401(k)-type plan. Texas is also considering a switch.

Utah decided to adopt a 401(k)-type plan after the stock market plunge in 2008 caused the shortfall in the state's pension plan to balloon to \$6.5 billion.

"We said, 'O.K., how do we prevent this from happening again?'" said Dan Liljenquist, a state senator who pushed for the changes. "How do we eliminate the bankruptcy risk for our pension fund?"

Under the new plan, Mr. Liljenquist said, the state's retirement contributions for new workers will be roughly half that for current employees, potentially saving \$5 million a year for every 1,000 new workers hired.

Still, these plans — similar to 401(k)'s, but named after [other sections](#) of the tax code — are not being embraced in states with the biggest pension problems like Illinois, California and New Jersey, which have shortfalls so immense that a switch would not solve their problem.

Unlike private companies, most states are constitutionally or contractually barred from changing the pension plans of current employees without their consent. So the new rules are generally voluntary or apply only to new employees.

In fact, switching workers to 401(k)-type plans can make the underfunding problem even worse. As contributions move to individual investment accounts, less money goes into the traditional plan to help finance pensions promised to other workers.

"There's no free lunch here," said Alicia H. Munnell, director of the Center for Retirement Research at [Boston College](#). "People say, 'We can reduce our costs here if we have a defined-contribution system.'"

Well, if you do this, you still haven't done anything about your unfunded liabilities.”

California's problems are so acute that just last week a government-appointed commission of experts urged the state to consider at least a partial switch to 401(k) plans; six years ago, an effort by [Arnold Schwarzenegger](#), then governor, to move new employees into such plans was blocked by local governments and public-employee unions.

The long-term benefits of restructuring pension systems are alluring to many public officials. The new governors of Florida and Kansas, [Rick Scott](#) and Mr. Brownback, and lawmakers in North Dakota, Oklahoma, Virginia and several other states are seriously discussing adopting 401(k)-type plans for state employees.

“Every state has to solve this problem or else there's going to be a very dire consequence,” said Mike Mazzei, a Republican state senator in Oklahoma who heads the Senate select committee on pensions and is backing an overhaul of a system that faces \$16 billion in unfunded obligations.

The push to switch to 401(k)-type plans comes overwhelmingly from Republicans, who see them as more individualistic and free market. Democrats generally oppose the change, partly because their union allies are eager to keep traditional plans.

Utah chose to take a hybrid approach to limit taxpayers' liability and keep money flowing into the old plan.

Starting July 1, new state workers will be able to choose either a traditional pension plan or a 401(k)-type plan, with the state contributing 10 percent of an employee's salary (12 percent for uniformed workers) to whichever plan a worker chooses. But there is an important twist: Utah will never pay more than 10 percent of a new employee's salary to the pension plan. If the plan becomes too underfunded, employees who have joined the plan will have to pay a percentage of their paycheck to help eliminate the shortfall.

The Utah plan is meant to give workers a choice, said Mr. Liljenquist, who became such an expert on

pension overhauls during Utah's debate that lawmakers in other states have sought him out for advice.

"Some state workers who will just work for the state a few years — take, say, bank examiners — I imagine 75 percent of them will choose defined-contribution plans," he said, referring to 401(k)-type plans. "And I think 90 percent of cops and firefighters and 75 percent of teachers will want a defined-benefit plan because they look at their government jobs as a single career."

Casey Parry, 32, a research consultant in the Utah human resources department, would prefer the 401(k) option. "It's hard when you're starting a job to make a decision whether to stay with an employer for 30 years," he said. "I prefer the security of having a defined-contribution plan that I know I can take with me. It's under my control. I can plan for it."

But Debra McBride, a [Medicaid](#) policy analyst who has worked for the state for 35 years, said she was happy with a traditional pension plan. "I imagine that anyone who went through the recession with a 401(k) and saw the stock market nosedive wished they had a pension plan instead of a 401(k)," she said.

Lawmakers considering changes are trying to balance competing needs. Georgia officials — fearing that many employees would retire with paltry amounts in their plans — stopped short of embracing a full-fledged 401(k) plan, setting up a hybrid plan different from Utah's. New employees join both a traditional pension plan, with a far less generous formula than the old formula, and a 401(k). The state contributes an automatic 1 percent of salary into the 401(k)-type plan and matches half of the next 4 percent that employees contribute.

"Georgia realized that having people solely in a 401(k), they have sole control and they might lose a lot of money in it," said Pamela L. Pharris, executive director of the Employees' Retirement System of Georgia, adding that such people eventually "might become dependent on the state."

The [National Association of State Retirement Administrators](#) has voiced support for traditional pension plans.

“Defined-contribution plans are a very unreliable vehicle for promoting retirement security,” said Keith Brainard, the association’s research director. “Many workers don’t know how to invest, many don’t contribute enough to their 401(k)s, and many cash out much of what’s in their 401(k) long before they retire, leaving them too little to live on when they retire.”

Mr. Brainard said it would be wiser for states to ask employees to contribute more toward underfunded plans than to switch to 401(k)-type plans. And in fact, some states have shored up their pension plans by requiring employees to pitch in more of their salary.

Despite the cautions, Bette Grande, a Republican state representative in North Dakota, vowed to continue pushing for 401(k)-type plans. Ms. Grande sponsored a bill to switch new employees entirely to such plans, but it was blocked by the House on Feb. 18. “I think it’s condescending to say that workers aren’t wise enough to manage their own investments,” said Ms. Grande, who said she would push to revive the bill. “I refuse to think I’m going to have a bunch of teachers on welfare.”



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