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Pension Crisis: Could Buyouts Be a Solution?

State and local governments are trying unconventional ways to fund their pension liabilities, such as offering lump-sum cash payments to employees.

When it comes to chipping away at pension liabilities, there aren't a lot of options. In some places, lawmakers can freeze cost-of-living increases to pension payments or move back retirement dates for existing employees. But that's not legal everywhere. So the majority of pension reforms in the past decade have targeted new employees and focused on controlling the growth of future liabilities.

But some places are getting more creative.

In Philadelphia, where the municipal pension plan is less than half-funded, Controller Alan Butkovitz is pushing a buyout of sorts aimed at the city's most expensive workers. In exchange for taking an upfront cash payment based on their estimated lifetime benefits, the employee or retiree would accept a reduced level of pension benefits going forward. The benefits would be equivalent to what newer Philadelphia public employees are receiving now.

"We've settled on benefits right now that everyone agrees are reasonable and humane," said Butkovitz. "Their survival and living standard is protected. If you're going to give them a lump sum of money, behaviorally, people prefer that approach."

The buyouts would be offered to 31,000 city retirees and 2,500 active employees who are members of Plan 67, the city's oldest and most generous pension plan in which employees can receive up to 100 percent of their final salary in retirement. Plan 67 is responsible for $5 billion of the city's roughly $6 billion in unfunded liabilities.

If every eligible plan member takes the buyout, it would reduce Philadelphia's unfunded liability by $1 billion, according to an independent audit. And, the idea goes, those who opt for the lump-sum payment could use it as an opportunity to pay off debt or a mortgage, or start a new business.

Philadelphia isn't the only place where hamstrung officials are considering unconventional solutions for their pension plans.

In Illinois, where courts have ruled against any changes to retirees' payments, lawmakers have contemplated lump-sum payouts to reduce their unfunded pension liability. The state's public employees plan is currently 34 percent funded.

In Connecticut, Gov. Dannel Malloy is pushing a plan that would split its troubled state employees' pension fund into two, as a way of isolating the unfunded liability.

Experts say the main difficulty with these approaches is that they tend to be more complicated than they are effective. The proposal in Connecticut doesn't reduce the actual amount the government owes its retirees — it merely pays for the more expensive pension benefits directly out of the state's annual budget so the liabilities are not on the pension fund's balance sheets.

“The split is a helpful accounting exercise, but it really comes down to: Are you really putting in today what you need for the future?” said Greg Mennis, director of The Pew Charitable Trusts’ public-sector retirement systems project.

Connecticut, he added, has a history of not paying its pension bills, which is why the system is so underfunded. S&P Global Ratings said last year that the split could worsen the state’s unfunded liabilities and warned it could downgrade Connecticut if it moved ahead with Malloy’s proposal.

“There are no panaceas,” said Mennis.

Pension buyouts have worked in the corporate sector where employees have taken a lump-sum payment at a slight haircut. But they haven’t been done in the public sector, thanks to the different accounting rules for public pensions that make their liabilities appear lower than comparable corporate-sector plans, said Josh B. McGee, senior fellow at the Manhattan Institute and vice president of public accountability at the Laura and John Arnold Foundation.

That can mask what a government would actually owe an employee who wants to cash out today. Indeed, an initial analysis of Bukovitz’s original idea of a straight pension buyout proved to be too expensive for the city.

The optics are also a challenge, said McGee. “Politically, you’re saying you’re going to cash out and give someone a lump sum. The public perception of that is not that great.”

As for what’s next, Butkovitz said the pension board this month is discussing a number of issues it would like to address via a member survey, including the minimum threshold for participation, the age range of people opting in and whether those who take a lump-sum payment would also agree to financial management classes.

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