Savings Fund Shenanigans in Detroit?

January 8, 2014

MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

If benefits are to be cut, cut them fairly.

Public employees in Detroit are looking at the prospect of substantial cuts in their pension benefits – not cuts to future benefits but actual reductions in the amount that retirees are currently receiving and current workers have earned to date. As a rule, I hate to see such cuts. People have accepted jobs on the assumption of a given wage and pension benefit. They did the work. Now is the time for the government to fulfill its obligation.

But if a retirement system has an unduly generous component, then it seems fine to go after that money. And it has been suggested that Detroit has just such a component – the Annuity Savings Fund, which emergency manager Kevyn Orr recently proposed closing. This plan has provided some – but by no means all – Detroit public employees with excessive returns. So if benefits have to be cut, it would seem desirable to claw back these unjustified gains before slashing the pension benefit of the average worker.

Detroit has two pension systems: The General Retirement System (GRS) and The Police and Fire Retirement System (PFRS). In addition, some employees participate in the Annuity Savings Fund, a defined contribution plan. Members of Detroit GRS and PFRS do not contribute to their defined benefit

pension – a very unusual arrangement in the public sector. Any contributions that are made go to the Annuity Savings Fund. Participants in GRS can contribute 0 percent, 3 percent, 5 percent, or 7 percent to the Annuity Savings Fund; the average contribution rate appears to be 5.9 percent. Participants in PFRS face a mandatory contribution rate of 5 percent. The contributions to the Annuity Savings Fund are commingled with the defined benefit plan assets although the benefits from the plan are distinct.

The questionable part of this story rests on the annual rate of return credited to the Annuity Savings Fund or the interest rates used to annuitize. Information about the fund is very difficult for the public to obtain. But from a Bloomberg News article and conversations with experts, it appears that participants in the GRS plan receive a return on Annuity Savings Fund contributions that is equal to the *higher of* the actual return or the assumed return used by the defined benefit system – roughly 8 percent. If true, that arrangement means that participants in 2009 received about 8 percent even though the pension fund lost 22 percent. Then when the market bounced back in 2011, they received the 19 percent return earned by the fund.

The situation with PFRS appears to be more reasonable. The Annuity Savings Fund is credited annually with the actual return earned by the fund, with a floor of zero percent.

The Detroit situation raises three issues. First, in order to figure out whether these allegations are true, it is necessary to review the plan documents. But at present it is virtually impossible to get a hold of these documents. Some descriptive information is available for the plans, but it includes no information on the rate of return credited to the accounts of GRS

participants. Such information ought to be easily accessible both to officials dealing with the bankruptcy and to the public.

Second, and more importantly, if some members of the GRS have received the returns described above, their Annuity Savings Fund benefits should be at the top of the list for cuts. As an economist, I have no idea whether such an approach is possible under applicable laws. But one outlandish component should not be used to justify across-the-board cuts in the regular pension benefits. Finally, if such an outrageous arrangement does exist, somebody is to blame. It is not the employees. If Boston College offered a plan where the return was the higher of 8 percent or the actual return, I would contribute as much as possible. If this is really the way that Detroit's Annuity Savings Fund works, who signed off on the financial viability of offering such returns?