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January 12, 2016

**VIA EMAIL & HAND DELIVERY**

Members of the Jacksonville City Council  
117 West Duval Street, Suite 425  
Jacksonville, FL 32202

Dear Members of the Council,

I very much appreciate Mayor Curry's innovative approach to funding the Police and Fire Pension Plan's unfunded liability. The Mayor is right to say that the unfunded liability is preventing this community from moving forward with our priorities, and we need a dedicated funding source for the debt. In moving forward, however, we don't need to make the same mistakes that put us into the current difficult situation: adopting short-term political approaches that ignore the future negative impact. The current funding plan is positive, but including a 401(k)-type pension design requirement is certain to cause a host of new problems.

As a member of the former Jacksonville Retirement Reform Task Force, I appreciate that Mayor Curry and his team followed through with developing the type of dedicated funding plan the Task Force urged. For years, our city created new benefits that we could not afford. Doing so was politically easy because it gave good benefits to the public safety officers who deserved them, without seeming to add costs to the budget. Some did speak up and warned of the future consequences of doing what was politically expedient, but those warnings were not heeded. I believe that the same types of long-term harm will result from adopting a 401(k) plan, and I urge you to consider the consequences of changing the pension design as requested by the Mayor.

**The Costs of Turnover**

Traditional, defined-benefit plans provide benefits at the back end of a public servant's career, but if the employee leaves early, he or she forfeits all or most of the benefit. 401(k) plans permit the employee to leave with the full value of the retirement benefit, so employees are not incentivized to build long-term careers. The argument for 401(k)-type plans in government is essentially that the private sector has adopted them, so they must be good enough for public employees. The difference between private sector employment and public sector (especially public safety) is that turnover has become routine in the public sector and doesn't severely

impact business operations.<sup>1</sup> Turnover in the public sector, however, is expensive and destructive.

Former Sheriff Rutherford explained to the Task Force that public safety training has become so sophisticated that Jacksonville now invests over \$100,000 to train a single police officer. The Task Force considered the effects and costs of turnover in its comprehensive analysis of pension design. The Task Force considered 401(k)-type plans, traditional defined benefit plans, and hybrid plans (a mix between the other two designs.)<sup>2</sup> The Task Force quickly ruled out a 401(k) plan, based on the concern that Jacksonville employees, unlike private sector employees, do not receive Social Security benefits, and concluded some sort of guaranteed retirement benefit should be provided. The Task Force then conducted a detailed analysis, and specifically found that continuation of defined benefit plan would best maintain competitiveness and reduce turnover.<sup>3</sup>

In making its analysis, the Task Force, specifically considered the greater turnover that 401(k) and 401(k)-hybrid plans create. The Task Force compared the turnover that Texas experiences with its 401(k)-hybrid plan, finding it to be approximately 20% greater than the State of Florida experiences for its police officers in the current, Florida Retirement System defined benefit plan.<sup>4</sup> Turnover concerns are a natural consequence of these types of plans.<sup>5</sup>

In an article published recently, reporter AG Gancarski pointed to the problems that the City of Palm Beach has experienced after adopting a 401(k)-hybrid plan.<sup>6</sup> Apparently, more than 60% of the Palm Beach police department has been on the job less than three years, the only

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<sup>1</sup> Adoption of a 401(k) plan will increase turnover. The academic literature, as well as the experiences of various public employers support this fact. Allen, S.G., Clark, R.L., and McDermed, A. 1993. Pensions, bonding, and lifetime jobs. *Journal of Human Resources*. 28(3): 463—481; Even, W. E., and MacPherson, D. 1996. Employer Size and Labor Turnover: The Role of Pensions, *Industrial and Labor Relations Review*, 49(1): 707-728; Nyce, Steven. 2007. "Behavioral effects of employer-sponsored retirement plans." *Journal of Pension Economics and Finance*. 6(3): 251-285.

<sup>2</sup> See Jacksonville Retirement Reform Task Force Report, March 19, 2014, pp. 32-39.  
<http://www.coj.net/retirement-reform/docs/retirement-reform-task-force-final-report.aspx>

<sup>3</sup> The defined benefit plan for new employees is significantly less expensive than the plan that existed for employees prior to the recent revisions. The new plan calls for 5.1% of payroll to be contributed by the City and 9.9% contribution by employees, compared to a 25.1% contribution by the City and 6.8% contribution by the employees previously. Table 1 at p. 35 and Table 3 at p. 26. (Under each plan 4% of payroll is paid by State "chapter" funds).

<sup>4</sup> Task Force report, at 32-33.

<sup>5</sup> The Nevada consultant report cited below, states the turnover concern on page 18, as follows:

*DC plans are portable and provide a greater benefit to employees who leave the system before retirement age. Therefore, requiring new employees to be covered by a DC plan would reduce retention, possibly resulting in shortages of workers. Higher turnover rates result in increased training costs and lower levels of productivity. In addition, employees covered by the DC plan may seek employment with employers who provide a DB plan. Providing greater benefits to employees who terminate before retirement may not be the best use of retirement funding.*

<sup>6</sup> <http://floridapolitics.com/archives/198117-pension-plan-pushback-begins-against-lenny-curry>

veteran officers are those who elected the DROP program under the old system, and the city council is considering withdrawing the new program to address the problems.<sup>7</sup>

Turnover will be costly. Jacksonville has been dealing with personnel cost issues for the best part of the last decade, and relatively few new police and firefighters have been hired within that time. At the same time, the recent pension struggles have encouraged many more veteran employees to elect DROP status. Within the next several years, we will be faced with a very new public safety workforce, and adopting a pension plan that encourages turnover will only exacerbate the problem.

The City will have to try to keep some of its veteran employees. The prospect of public safety departments filled with rookies will result in costly band-aids to try to fix the problem. Retention bonuses, higher salaries, and greater employer pension contributions will be necessary to try to stem the exodus of trained public safety officers.<sup>8</sup>

### **The Current Plan is Actually Cheaper than a 401(k) Plan**

Assuming a 7% rate of return, the Task Force found that the current plan costs 2.8% less, in terms of payroll costs, than the 401k-hybrid would cost.<sup>9</sup> In reality, the administrative costs for a 401(k) plan are greater than for a defined benefit plan.<sup>10</sup>

### **Other Factors Favoring the Current Plan**

Other reasons support the current pension design. Traditional pensions, in fact, serve as a deterrent to misconduct: employees who commit certain offenses forfeit their pensions. Paying employees a good portion of their compensation after the end of their employment is a means of ensuring honest and professional service: just as contractors are not paid until the end of the job as a means of ensuring sufficient work, we traditionally pay our police and firefighters at the end of their careers as a means of discouraging abuse of the substantial power that the members of the public place in them.

Public safety employment uses a rank structure, which is best served when experienced and tested employees reach supervisor status. Creating long-term employment is necessary to

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<sup>7</sup> See <http://www.palmbeachdailynews.com/news/news/local-govt-politics/council-may-consider-scaling-back-pension-cuts/npXzt/>

<sup>8</sup> For a description of the types of costs that will likely be created by efforts to stem turnover, see Weller, Christian E., "What Does the Literature Tell Us About the Possible Effect of Changing Retirement Benefits on Public Employee Effectiveness?" Political Economy Research Institute, University of Massachusetts Amherst, 2011. <http://50.87.169.168/Documents/EPRN/Possible-Effect-of-Changing-Retirement-Benefits-on-Public-Employee-Effectiveness.pdf>

<sup>9</sup> Page 35, at Table 1. The financial projections used by the Task Force predicted that a 7% rate of return could be predicted with a 50% level of certainty. If a lower rate of return was used (a 5.4% rate of return that would be predicted with a 75% level of certainty), the cost for the traditional plan is 2.5% greater. See Table 2.

<sup>10</sup> Administrative and investment cost for defined benefit plans to be .43 percent of assets, and defined contribution plans to be .95 percent of assets. Texas Pension Review Board. 2012. *A Review of Defined-benefit, Defined-contribution, and Alternative Retirement Plans*.

<http://www.prb.state.tx.us/files/reports/areviewofdbdand.pdf>

make the upper ranks hard-earned prizes that are filled by experienced and accomplished professionals. Further, the wisdom that accompanies age helps to create a competent and capable command structure. Creating a short-term public safety system by eliminating the defined benefit plan runs counter to these important goals for public safety agencies.<sup>11</sup>

## Conclusion

It is not difficult to foresee that abandoning the defined benefit plan will create higher compensation costs. A 401(k) plan will not keep officers on the job for long, and eventually the City will be forced to increase pay to stem the turnover.<sup>12</sup>

The concerns that I and others have expressed are not merely theories. They represent some very real long-term concerns that this City should closely examine before rushing into the adoption of a 401(k)-type plan. The Jacksonville Retirement Reform Task Force spent hundreds of hours, along with substantial consultant time in meeting 17 times over a 9 month period. The Task Force's decision to reject a 401(k) plan is consistent with the reluctance of other public employers to adopt similar plans. In Nevada, for instance, the state hired the HR Consulting Firm the Segal Group, which concluded in its report:

An unmistakable feature of DC plans is that many risks are shifted to the employee. This could result in workforce recruitment and retention issues that would not be felt for several years. While many employers find the stable cost structure of a DC plan attractive, the closure of the DB plan to new members would make the cost of the DB plan increase significantly as a percent of DB member payroll. A DC plan may seem ideal for a sponsor that desires a retirement plan with a stable cost, however, the retirement benefits for a DC member are unknown. As a result, a DC plan may not provide employees with adequate retirement benefits. Although the idea of a DC plan seems straightforward, the administration of a mandatory, statewide, multiple-employer DC plan that will grow to over one hundred thousand participants creates a number of administrative challenges. A number of other issues, including the possible impact of a DC on public safety would also need to be considered.

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<sup>11</sup> Professor Weller identifies other costs as well. The abstract to the above referenced article states:

*Proposals exist to change public employees' retirement benefits from defined benefit (DB) pensions. This could increase employee turnover and raise initial compensation. More experienced employees are replaced with less experienced ones, reducing effectiveness. But, new hires' effectiveness could increase with higher compensation. We simulate the net impact of these offsetting effects and find that there is a 60% to 70% chance that effectiveness will fall relative to the effectiveness that would have prevailed without benefit changes. There could be substantial transition costs, which could increase to 0.8% of payroll in the third decade after the switch for a typical DB pension.*

<sup>12</sup> In addition to Palm Beach, other public employers have found that the switch to 401(k) systems doesn't work. West Virginia abandoned its defined contribution plan for its teachers, after realizing that the costs of the 401(k) plan was higher than for the defined benefit plan. <http://www.wsj.com/articles/SB121744530152197819> .

If these issues are not fully resolved prior to the implementation of a DC plan, they will surely arise later. These are the issues that have presented challenges to other public sector retirement systems that sponsor DC plans. If it is not agreed upon in advance that the characteristics of a DC plan are in the best interest of taxpayers, public employees and employers, and the State of Nevada, the State will face pressure soon after adopting a DC plan to revert to a DB plan.<sup>13</sup>

The Nevada report is a good synopsis of the pros and cons of the two systems. While the Segal Group provides the advantages and disadvantages of each plan, it concludes with the above warnings about some very important factors that could easily cause substantial problems for the state and cause it to switch back to a traditional pension plan.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'Tad', with a horizontal line extending to the right.

Tad Delegal

TAD/md

cc: Mayor Lenny Curry

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<sup>13</sup> Public Employees' Retirement System of the State of Nevada, Analysis and Comparison Of Defined Benefit And Defined Contribution Retirement Plans, The Segal Group, 2010.  
<https://www.nvpers.org/public/executiveOfficer/2010-DB-DC%20Study%20By%20Segal.pdf>