

OPINION | FINANCE

# Wisconsin's Pension System Works for Everyone

State employees and taxpayers share the risks of financing retirement. The result is a pension fund that underpromises and overdelivers.

By [Justin Fox](#)

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That seems nice ... *Photographer: Justin Sullivan/Getty Images*

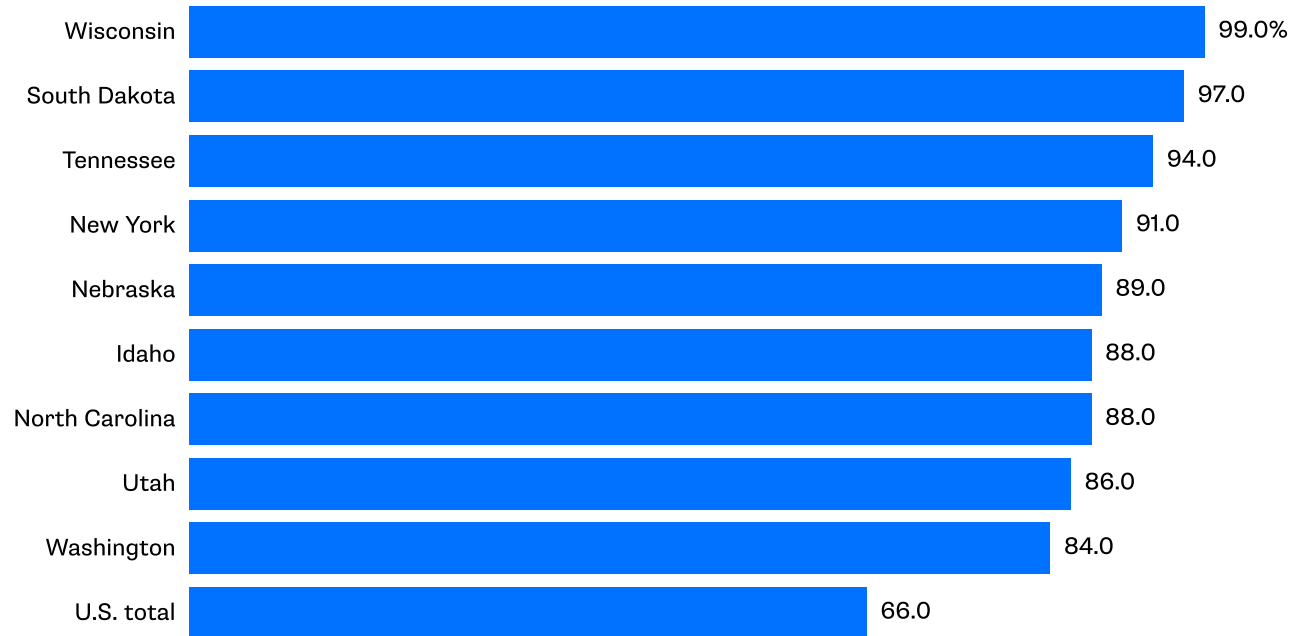
The latest Pew Charitable Trusts [report on the state pension funding gap](http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/04/the-state-pension-funding-gap-2016)

<http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/04/the-state-pension-funding-gap-2016>, which came out last month, has many words of warning for states that are “on an unsustainable course, coming up short on their investment targets and having failed to set aside enough money to fund the pension promises made to public employees.” New Jersey is in the worst shape of all, with pension fund assets that in 2016 added up to only 31 percent of liabilities. Colorado, Connecticut, Illinois and Kentucky all had funding ratios of less than 50 percent; 17 other states had assets less than two-thirds of liabilities.

Less attention is paid to the states that don't have looming pension crises. Maybe that's a mistake. Surely we could learn from, say, Wisconsin, the state with the best-funded retirement system. What does it do so differently?

### States That Aren't Facing a Pension Crisis

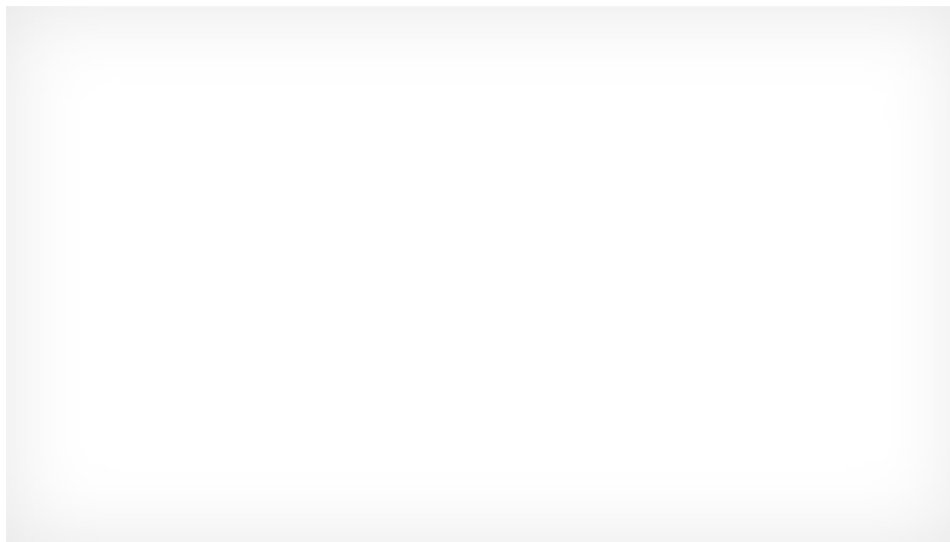
State pension fund assets as a percentage of liabilities, 2016



Source: Pew Charitable Trusts

Wisconsin did not become the best-funded retirement system in the nation by asking a lot of state taxpayers. Only the District of Columbia, South Dakota and Wyoming spend less on pensions as a share of overall state and local government spending than Wisconsin does, [according to the National Association of State Retirement Administrators](https://www.nasra.org/files/Issue%20Briefs/NASRACostsBrief.pdf) <<https://www.nasra.org/files/Issue%20Briefs/NASRACostsBrief.pdf>> .

Wisconsin also doesn't exactly skimp on pension benefits. The average state and local pension benefit in Wisconsin in 2016 was \$24,897, [according to the Census Bureau](https://www.census.gov/programs-surveys/aspp.html) <<https://www.census.gov/programs-surveys/aspp.html>> , which ranked it 19th among the 50 states and District of Columbia. To see if differences in the cost of living might be skewing the ranking, I also divided the pension benefit by the state's per capita income. Wisconsin came in 19th again.



Somebody must be paying for all this, and to some extent Wisconsin state and local workers are, with the employee share of pension contributions, 47.5 percent in 2016, higher than in all but two other states. [1](#) But the dollar contribution per plan participant in Wisconsin isn't exorbitant, again ranking 19th among the states in 2016. Those state and local workers do not seem to be getting a bad deal, in other words. [2](#)

What enables Wisconsin to deliver pretty good pensions at quite low cost is a retirement plan that occupies a middle ground between the defined-benefit (DB) pension plans that were once predominant in the U.S. and the defined-contribution (DC) 401(k)s that have supplanted them in the private sector. I wrote a column last week about the [rise of a middle-way pension approach](https://www.bloomberg.com/view/articles/2018-05-03/targeting-a-better-way-to-save-for-retirement) [variously dubbed collective defined contribution](https://www.bloomberg.com/view/articles/2018-05-03/targeting-a-better-way-to-save-for-retirement) [target benefit](http://www.bbc.com/news/business-27665364) [and defined ambition](https://en.wikipedia.org/wiki/Target_benefit_plan) [and credited the Dutch with originating it in the past decade or so](https://www.pwc.co.uk/finance/pensions/defined-ambition-the-future-of-pensions.html). A reader then pointed out that this was pretty much how Wisconsin had been running its pensions since the late 1970s.

Credit for the innovation goes to a couple of state bureaucrats who were confronted with a difficult puzzle. The Wisconsin Legislature had decreed in 1975 that most state and local retirement systems be combined for efficiency's sake into a single organization. These systems followed a number of different benefit formulas, with some closer to DC than DB, and the secretary and deputy secretary of the Wisconsin Department of Employee Trust Funds had to figure out how to make them all fit together. "Whether it was his idea or my idea or it came from both of our brains — I don't think I know of any other place that did it like that," recalled Gary Gates, the deputy at the time and the secretary for two decades to follow, in a [Milwaukee Journal Sentinel profile](https://projects.jsonline.com/news/2016/9/26/wisconsins-fully-funded-pension-system-is-one-of-a-kind.html) [two years ago](https://projects.jsonline.com/news/2016/9/26/wisconsins-fully-funded-pension-system-is-one-of-a-kind.html).

Their new idea was to offer participants a relatively modest pension with no cost-of-living adjustments [3](#) but supplement it with post-retirement "annuity adjustments" [that are ratcheted up or down depending on investment](http://etf.wi.gov/faq/annuity_adjustments.htm)

performance, which is measured over rolling five-year periods to keep the adjustments from being too abrupt. Contributions to the plan are also adjusted [http://etf.wi.gov/employers/wrs\\_contribution\\_rates.htm](http://etf.wi.gov/employers/wrs_contribution_rates.htm) based on investment returns and changes in life expectancy, with most employees and government agencies contributing 6.7 percent of pay each in 2018 [http://etf.wi.gov/news/ht\\_20170627.htm](http://etf.wi.gov/news/ht_20170627.htm) . And plan participants can choose to put half their contributions into a [non-guaranteed plan](http://etf.wi.gov/news/variable_fund_faq.pdf) [http://etf.wi.gov/news/variable\\_fund\\_faq.pdf](http://etf.wi.gov/news/variable_fund_faq.pdf) that aims for even higher investment returns.

This means Wisconsin government employees and retirees are more exposed to investment risks than participants in traditional defined-benefit pensions. On the other hand, they appear to be far less exposed to the risk of a state financial crisis than, say, their peers across the border in Illinois. And unlike participants in a 401(k) plan, they share their risks — including the risk of outliving their retirement savings, a big issue with DC plans — with hundreds of thousands of other workers and retirees, and leave investment decisions in the very capable hands of the State of Wisconsin Investment Board.

The SWIB is the [eighth-largest public pension fund](http://www.pionline.com/article/20180205/INTERACTIVE/180209925/funded-status-of-the-largest-us-public-pension-funds) <http://www.pionline.com/article/20180205/INTERACTIVE/180209925/funded-status-of-the-largest-us-public-pension-funds> in the country, with \$117 billion in assets under management at the end of last year. It has a great reputation <https://www.swib.state.wi.us/single-post/2017/12/04/SWIB-Wins-Pair-of-Allocators-Choice-Awards> and generally great investment returns [https://docs.wixstatic.com/ugd/69fc6d\\_1a99062b92a045cdb4672e03e5db6ad4.pdf](https://docs.wixstatic.com/ugd/69fc6d_1a99062b92a045cdb4672e03e5db6ad4.pdf) . That reputation and those returns may to some extent be products of the hybrid structure of the retirement system, which gives both taxpayers and state workers reason to keep a close eye on the SWIB. As David Villa, SWIB's chief investment officer, [described in a 2015 essay](https://www.the300club.org/wp-content/uploads/2015/12/T3255_300_Club_Paper_V3.pdf) [https://www.the300club.org/wp-content/uploads/2015/12/T3255\\_300\\_Club\\_Paper\\_V3.pdf](https://www.the300club.org/wp-content/uploads/2015/12/T3255_300_Club_Paper_V3.pdf) :

*In a hybrid plan, employees care far more than they would in a DB structure about irrational governance because they share a preponderance of the risk and are therefore less likely to ask their agents to lobby for things that will hurt them in the long-term.*

*The hybrid plan also mitigates assumption errors. If the assumptions for the rate of return are optimistic, the plan will likely suffer value destruction. Employees' and employers' views of that destruction varies markedly across plans. For the DC plan, the employer is indifferent as they have no skin in the game, while*

*in a DB structure they should oppose the optimism as they carry the full burden of the value destruction. Employees naturally face the opposite situation. In a hybrid plan both employees and employers are incentivized to eliminate optimism as both suffer when value is destroyed.*

*As a result of the better alignment of interests in a hybrid plan, a virtuous cycle of governance is created, which means the outcomes in terms of benefits to employees (and costs for employers) are less volatile, making it the preferable structure.*

There's been some pressure

[https://www.nasra.org/files/Topical%20Reports/Plan%20Design/Defined\\_Contribution\\_Plans\\_An\\_Update.pdf](https://www.nasra.org/files/Topical%20Reports/Plan%20Design/Defined_Contribution_Plans_An_Update.pdf)

on states in recent years to shift from pensions to DC plans. In 2011, newly elected governor Scott Walker and the Republican majority in the Wisconsin Legislature passed a law ordering state officials to look into moving that direction. In 2012, the heads of the three state agencies charged with this task — two of them Walker appointees — turned in a report [https://www.nasra.org/files/State-Specific/Wisconsin/WI\\_conversion\\_study\\_1207.pdf](https://www.nasra.org/files/State-Specific/Wisconsin/WI_conversion_study_1207.pdf) that effectively answered, *Why on earth would we ever want to do that?* And really, why would they?

*This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners.*

1. *Wyoming and South Dakota, in case you were wondering.*
2. *I used data from the Census Bureau's Annual <https://www.census.gov/programs-surveys/aspp.html> Survey of Public Pensions <https://www.census.gov/programs-surveys/aspp.html> for both of these calculations.*
3. *Currently calculated as years of service times 1.6 percent times the average of the highest three years of salary, with a reduction for early retirement. There's an alternative formula that adds up the contributions you and your employer have made over the years and the return on that investment, and calculates a monthly benefit from that. Whichever is highest when you retire is the guaranteed benefit.*

To contact the author of this story:

Justin Fox at [justinfox@bloomberg.net](mailto:justinfox@bloomberg.net)

To contact the editor responsible for this story:

Brooke Sample at [bsample1@bloomberg.net](mailto:bsample1@bloomberg.net)

