The Arnold Foundation's Favorite Actuary

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As reported in a recent "NCTR FYI," Josh McGee, the Vice President of Public Accountability for the Laura and John Arnold Foundation, directed some caustic comments at public pension actuaries during the National Conference of State Legislatures' Legislative Summit in Seattle earlier this month. During his debate with Diane Oakley, the Executive Director of the National Institute on Retirement Security (NIRS), McGee described actuaries who work with governmental plans as "not disinterested arbiters of truth" when it comes to the public pension studies that they produce. He called them members of "the cottage industry of consultants who rely on public DB plans for work," and told legislators that they should approach the work of such actuaries with a "healthy skepticism."

But that doesn't mean that the Arnolds dislike all actuaries. Indeed, they have their own favorite, who often provides them and their surrogate, the Pew Charitable Trusts, with actuarial analyses whenever the two partners come calling to "assist" state and local governments in "reforming" their pension plans.

That firm is called October Three, and it might interest NCTR members to know that it touts itself as "a leading force behind the reemergence of defined benefit plans across the country."

Honestly.

October Three, with corporate headquarters in Chicago, describes itself as "a full service actuarial, consulting and technology firm." It has registered the term "ReDefined Benefit Plan" (ReDB®) as a trademark. According to the firm, this is "an entirely new, design-based approach to retirement and to the management of both the employer's and the employee's financial risk, focusing on maximizing financial efficiency and employee value."

Essentially, the ReDB® is a cash balance plan with its interest credits based on market rates of return. October Three explains that these rates of return "can be tied to external indexes, such as mutual funds, or may be based on the pension trust's rates of return."

"Fundamental to ReDB® design is a careful management, and alignment, of the relationship between the interest credits granted to employees and the returns on the plan's assets," according to October Three. The result, they claim, is "steady, predictable costs, just like DC plans, without having to shift plan assets to a low-return, all bond portfolio." Interest credits can be varied among employees to reflect their different investment horizons, and employer guarantees and plan expenses can be financed by capping the interest credit and/or crediting something less than the full market rate of return on account balances.

It should perhaps therefore come as no great surprise that whenever the Pew/Arnold team "provide[s] selected states with customized technical assistance informed by tailored research," as Pew describes it, their "customized" assistance virtually always includes a recommendation—often using virtually identical language—that the state should close the existing defined benefit (DB) plan and replace it with a cash balance plan.

The National Public Pension Coalition (NPPC), comprised primarily of public sector unions, has been particularly critical of Pew's use of October Three. Instead of an experienced and impartial actuary, NPPC says that October Three "has very limited public sector clientele" and "specializes in selling a patented cash balance plan—and makes a profit for selling the plan." October Three is "hardly objective," NPPC warns, and the "biases that October Three [has] brought into their analysis should raise a number of red flags for legislators hoping to receive a well-researched pension proposal."

Pew has acknowledged its use of October Three, explaining in a 2012 letter responding to criticism of the Pew/Arnold activities in Kentucky that it "chose to retain the firm October Three because they do not represent public sector pension plans and thus would not face a conflict in any state where we might work," and that "the firm does design cash-balance plans for some of their other clients, but that is not unusual."

The Pew/Arnold team continues its efforts to "help policy makers consider implementing data-driven" pension policies, as Pew describes their efforts, having worked actively in Pennsylvania in connection with its recent pension reform legislation that would have replaced the state's current DB plan with a defined contribution/cash balance model, but was subsequently vetoed by the governor. According to press reports, Pew also recently appeared before the Joint Commission on Alabama Public Pensions to discuss reforms.

In that regard, it is well to note that Pew's partner, the Arnold Foundation, has given $78,000 to the Alabama Policy Institute to "support educational efforts related to public employee benefits reform in Alabama." In 2015, the Institute released a report entitled "Alabama's Public Pensions: Building a Stable Financial Foundation for the Years Ahead," that refers to previous pension reforms in Alabama as a "gauze bandage applied to a gaping wound." The Alabama Policy Institute report recommends that Alabama switch from its DB model to a cash balance plan, a move that also just happens to be strongly advocated by the Arnold Foundation.

"I am confident that Pew will be happy to have October Three help design such a plan for Alabama, as they did in Kentucky a few years ago," said Meredith Williams, NCTR's Executive Director. "But before they do, I hope Alabama legislators will heed the warning of some of their colleagues in Kentucky about their experience with Pew," he cautioned.

Williams was referring to a June 19, 2013, joint letter from ten Kentucky state legislators to their colleagues in other states warning how Pew had "duped enough [Kentucky] legislators into passing a bill that will cost taxpayers millions of dollars, will not reduce our state's unfunded liabilities, and will diminish retirement security." "Don't let Pew and Arnold convince you to pass this harmful reform that will have long-lasting consequences in your state," the letter stresses.

“I guess Josh would insist that October Three is a ‘disinterested arbiter of truth,’ but I think he might find some good folks in Kentucky who would disagree,” Williams pointed out.