

Survivor is an individual designated by a *plan participant* to receive death benefits, if the *plan participant* dies while still on the job, or *survivor benefits*, if the *plan participant* dies while in retirement status. The survivor is sometimes called the beneficiary.

Survivor Benefits are paid to an individual designated by the *plan participant*. The survivor receives benefits upon the death of the *plan participant* who is in retirement status. They differ from death benefits, which are paid to a survivor upon the death of a *plan participant* who is still on the job.

Transfer of retirement funds occurs when one retirement plan is willing to accept assets from another retirement plan.

Vesting occurs when an employee acquires an irrevocable right to his/her accrued benefits under a pension plan, even if he/she leaves employment prior to eligibility for an immediate retirement benefit. A vested benefit may be paid as a lump sum or, frequently, is paid as a deferred annuity upon retirement.

FREQUENTLY ASKED QUESTIONS

Q. How can DB plan sponsors respond to the needs of employees seeking greater portability and flexibility?

First, they can maximize portability by allowing purchases of prior service credit, sometimes known as “buying back prior service.” Such purchases allow plan participants to buy back service credit for work with a previous employer that was not long enough to result in a pension benefit. Second, they can enhance the benefit of short service employees, which affords greater flexibility. Some defined benefit plans index the future retirement benefit of an individual who has terminated service before retirement eligibility. This indexing is, in effect, a COLA that increases the value of an individual’s benefit between the time of termination of service and retirement eligibility. In other plans, a plan participant who terminates before retirement eligibility receives a matching contribution if he/she withdraws his/her benefit or a larger match if he/she waits until retirement eligibility.

Q. Will converting to a DC plan improve the unfunded liability of a DB plan?

Converting to a DC plan does just the opposite. It actually worsens the unfunded liability of an existing DB plan. This is because fewer individuals will be participating in the DB plan. Thus, contributions into the DB plan from employers and employees will decrease. The smaller amount of contributions may actually require an increase in contributions at a later time to ensure all promised benefits are paid. In addition, some pension funding methods use the ongoing flow of new, younger members to help finance the cost of the plan’s promised benefits. For plans that rely on those methods, redirecting future employees from a DB to a DC plan can raise the cost of the DB plan.

Q. Do DB plans have value for younger, short-service employees?

Yes. An employee need not spend his/her entire career with the same employer to benefit from a DB plan. A DB plan affords a guaranteed retirement payment for vested participants. (In most education retirement systems, vesting takes place in five or fewer years.) A DB plan can provide a retirement benefit that is greater than the benefit from a well-invested DC plan, depending on the age of the participant when beginning and terminating employment. Moreover, the DB plan usually offers features such as disability benefits and death benefits (payable to the survivor of an individual who dies while still on the job). These features are not usually available in a DC plan.

Q. What would it take for a DC plan to provide the same benefit value as a DB plan?

One of the biggest problems encountered by defined benefit plans is the difficulty in communicating the benefit in terms that can be readily understood and accepted by participants. Lacking understanding results in failure to appreciate the plan's value.

DC plans provide for contributions allocated each year to each participant, while DB plans typically state a benefit promise in terms of an annual benefit commencing at normal retirement age. Whereas DB plans base an individual's guaranteed retirement benefit on a formula, the ultimate retirement benefit for a DC plan participant will depend on how much money has been contributed to the account and the investment earnings on those contributions after fees.

To compare apples to apples, let's look at an example of a payout for a career employee under a traditional DB plan that provides for an annuity benefit based on final average pay (e.g., 2.5 percent of highest average pay times years of service). Assume his/her annuity begins at \$50,000 per year and has a 3 percent cost-of-living adjustment, an annual rate of return of 4 percent, and a 25-year payout.

The amount a DC plan participant would need to fund the same annual benefit is \$1,071,500. If the payout lasted 40 years, the amount needed would be \$1,602,766. Few DC plan participants, even those who contribute to their accounts during their entire careers, are able to amass such large sums to produce a comparable yearly benefit.

The effect of the difference in benefit values is that a DC participant may need to work longer than he/she expected in order to achieve adequate retirement savings.

Q. Why are DC plans more prevalent in the private sector?

DC plan proponents frequently draw parallels between public-sector and private-sector pension coverage. They say that the private sector is converting from DB to DC plans and, by analogy, the public sector should, too. A closer look at the private sector data reveals that large private sector employers are retaining their DB plans. The majority of DB plan terminations in the private sector occurred among plans with two to nine participants. Most DB plans in the public sector are similar in size to the DB plans in the private sector that are being retained. There's another factor that DC plan proponents should examine: Where the number of DC plans did increase in the private sector, the growth was not attributable solely to DB plan terminations. The number of new DC plans was three times the number of DB plan terminations. The data suggests that because the growth of DC plans exceeded the decline of DB plans, private-sector employers that have never before offered any pension plans are now doing so through DC plans.

Q. How do the annual administrative and investment expenses for DB plans compare to the total expenses for DC plans providing the same benefit?

Costs of DC plans are usually higher than DB plans. According to the U.S. Department of Labor, 401(k) expenses, a common type of DC plan in the private sector, ranged between 0.99 and 1.40 percent. A review of 12 of the nation's largest DB plans revealed an average expense ratio of 0.25 percent. Why the difference? DB plans have the ability to lessen their expenses through economies of scale related to their large size, negotiating beneficial investment management fees, and, in some cases, by investing some assets using internal staff rather than external managers. Moreover, DB plans do not provide the costly individual services required of DC plans, such as updating participant accounts on a regular basis.