

RESEARCH FINDINGS: STUDIES AND ARTICLES ON DEFINED BENEFIT PLANS VS. DEFINED CONTRIBUTION PLANS

The studies, reports and articles that follow address issues pertaining to converting defined benefit pension plans to defined contribution plans. The sources include organizations opposed to conversions, states considering changing their retirement systems, academic researchers and investment firms.

A Report to the House of Representatives: 77th Texas Legislature

Date: November 28, 2000

Source: Texas House Committee on Pensions and Investments

<http://www.house.state.tx.us/committees/reports/76interim/peninvest.pdf>

Relevant Findings:

The committee was charged with evaluating the pros and cons of defined contribution plans that do not guarantee members any specific level of benefits upon retirement. The committee considered and compared plans adopted in other jurisdictions with Texas' state plans in regard to their ability to provide security to retirees and cost and fairness to diverse employee groups. The report analyzed which type of plan better meets the needs of the state and the employee. The report includes the following findings:

1. Under a DB plan, about 80 percent of the accrued dollars are spent on retirement benefits, compared to only 50 percent of DC plan dollars. The remainder funds loans, terminations, and early retirements. (p. 33)
2. Offering employees the ability to choose between DB plans and DC plans will drive up the total cost of the entire system. (p. 32)
3. DB plans allow the state flexibility in adjusting benefits during times of inflation and eroding buying power. DC plans do not. (p. 33)
4. For the refunds of TRS member accounts issued in FY1999 and FY2000, only 18 percent to 19 percent of those withdrawing their retirement funds rolled them into another retirement vehicle. (p. 32)

Benefit Review Study of the Nebraska Retirement Systems

Date: August 2000

Source: Buck Consultants

<http://www.state.ne.us/home/pers/PDF/benefitstudy.pdf>

Relevant Findings:

Nebraska operates both DB plans and DC plans. This report presents the results of a review of the benefits of the Nebraska Retirement System.

1. Nebraska DB plans rank at median or above median with regard to the initial Normal Retirement benefit. (p. 10)
2. Nebraska DC plans rank below median with regard to the initial Normal Retirement benefit. (p. 45)

Defined Contribution Plan Survey: Insight Into Participant Investment Knowledge & Behavior

Date: April 2001

Source: John Hancock Financial Services

<http://www.jhancockstructures.com/gsf/survey2002.pdf>

Relevant Findings:

1. Most participants of DC plans do not utilize the training and tools necessary to become knowledgeable individual investors. (p. 21)
2. Only one-half of participants in a DC plan have a targeted asset mix, and only one-third have the discipline to rebalance the mix periodically. (p. 22)
3. The boom of the 1990s gave DC plan investors too much confidence, enacting a "let it ride" mentality that has hurt many investors now. (p. 22)

MetLife Retirement Income IQ Test

Date: June 2003

Source: MetLife Mature Market Institute

<http://www.asec.org/toolsh.htm>

Relevant Findings:

There are widespread misconceptions among Americans about how much time they will spend in retirement and how much income they will actually need once they stop working. Unlike the retirement calculators offered by a number of investment companies that focus on saving for retirement, the MetLife on-line calculator is designed to help individuals adequately prepare for living in retirement by helping them calculate the monthly income their retirement savings will provide. A survey commissioned in early 2003 found the following:

1. Only 32% of pre-retirees are actively calculating how much is required to live comfortably in retirement.
2. Survey respondents underestimated both income needed during retirement as well as life expectancy and longevity risk (i.e. the likelihood of outliving their assets).

Mind the Gap! Why DC Plans Underperform DB Plans, and How to Fix Them

Date: April 2000

Source: Barclay's Global Investors

http://www.brookshamilton.com/pdf/Mind_The_Gap.pdf

Relevant Findings:

This paper addresses the disadvantages that DC plan participants face relative to DB participants and offers suggestions for closing the performance gap.

1. The returns achieved by DC plan participants have lagged institutional investors' returns by 2% annually. (p. 1)
2. DC plan investors generally take inappropriate amounts of risk -- either too high or too low. (p. 6)
3. Most DC participants lack the time, interest, or knowledge to become professional-quality experts in investment strategy. (p. 19)

Myths & Misperceptions of Defined Benefit and Defined Contribution Plans

Date: November, 2002, Updated May 2003

Source: National Association of State Retirement Administrators (NASRA)
<http://www.nasra.org/resources/myths%20and%20misperceptions.pdf>

Relevant Findings:

NASRA issued this white paper to address some of the more popular misunderstandings and misrepresentations about DB and DC plans in the ongoing debate about the retirement benefits that are provided to public employees.

1. A majority of terminating employees with a DC plan cash out their assets instead of rolling them over, which defeats the purpose of having a retirement plan to guarantee a level of retirement income that reflects the employee's salary and tenure. (p. 5)
2. DB assets are invested on the basis of a long time horizon, enabling the plan to withstand investment market volatility better than a DC plan's short investment horizon. (p. 8)
3. A legislature wishing to reduce retirement benefits can do so more easily under a DC plan than with a DB plan. (p. 12)

Plan Design: A Review of Current Public Pension Issues

Date: January 2000

Source: Kansas Public Employees Retirement System
<http://www.nasra.org/resources/Kansas%20study.pdf>

Relevant Findings:

During its 2000 session, the Kansas Legislature considered a number of proposals to change the benefit structure of the Kansas Public Employees Retirement System, wholly or in part, from a DB plan to a DC plan. This report contains a detailed analysis of those issues, sets forth several recommendations for legislative consideration, and conveys the following observations:

1. A wholesale shift to a DC format will create additional costs in the form of safety nets and/or entitlements. (p. 5)
2. Benefits = Contributions + Investment Earnings – Expenses This is an equation that is always and everywhere true and cannot be avoided by changing plan designs. (p. 2)

Resource Book: Preservation of Defined Benefit Plans, 3rd ed.

Date: 1998, updated in 2001.

Source: National Council on Teacher Retirement
<http://www.nctr.org/content/pdf/dbpresrv.pdf>

Relevant findings:

This publication describes the success of defined benefit plans in providing retirement security for public school teachers and other public employees in the United States. It also includes attachments detailing the latest innovations made by several state legislatures to enhance the value of defined benefit plans to their participants.

1. Defined benefit plans provide a more comprehensive retirement program than defined contribution plans do. (p.6)
2. Defined contribution plans adopted to cut costs may not produce expected savings. (p. 12)

Retirement in Balance: The Crucial Role of Defined Benefit Plans in Achieving Retirement Security in the United States

Date: May 2003

Source: AFL-CIO Center for Working Capital
<http://www.centerforworkingcapital.org/resources/other.html>

Relevant findings:

This report examines the history of worker-friendly pension plans, differences between types of defined benefit plans and trends in plan prevalence and benefits design in both private and public sector pension funds. Its findings regarding the structural advantages of defined benefit plans include:

1. The investment risks associated with defined benefit plans are borne by employers, who are responsible for covering shortfalls in plan assets and are better able to manage risk.
2. Employers pre-fund retirement promises so that workers can collect their benefits when it comes time to retire.
3. A government-backed insurance program covers private sector defined benefit plans, while defined benefit plans for public employees are backed by the state and local governments that offer them.
4. Professionals handle investment decision-making, contributing to long-term fund performance that beats defined contribution plans.
5. Defined benefit plans must offer annuities as a benefit option and typically include protections for widows and widowers, and they can provide annuities more efficiently than defined contribution plans that require participants to purchase annuities in the retail market.

Selected Issues Related to Governmental Defined Benefit & Defined Contribution Pension Plans

Date: December 2002

Source: Pennsylvania Public Employee Retirement Commission
(717) 783-6100

Relevant Findings:

This study examines the level of contributions under a DC plan that are necessary to provide a benefit at retirement that is the same as the benefit determined under a DB plan. The following findings are excerpted from the report:

1. A DC Plan would cost the State of Pennsylvania between 3-24 percent more of payroll to fund than a DB plan would. (p. 13)
2. Establishment of a DC Plan “will increase the potential liability of the Pennsylvania Retirement Systems, the Commonwealth and the public school districts.” (p. 30)
3. The impact of the establishment of a DC Plan on fiduciary duties can include contract impairment and serious due process issues. (p. 33)

Study of Retirement Plan Designs for the State of Colorado

Date: November 20, 2001

Source: Prepared by Buck Consultants, Inc. for the Office of the State Auditor
http://www.state.co.us/gov_dir/audit_dir/2002/2002perf/1409.pdf

Relevant Findings:

This report contains the results of a comprehensive study of defined benefit and defined contribution retirement plan designs for members of the Colorado Public Employees’ Retirement Association. The report presents the following findings and conclusions:

1. Employees who remain in employment until they are eligible for early retirement are better off under a DB plan than a DC plan. (p. 2)
2. In order for a DC plan to provide the same benefit value as a DB plan, the DC plan would need a higher investment return or be funded with higher contributions. (p. 5)

ADDITIONAL RESOURCES

The following organizations’ public web sites contain useful information for promoting and defending defined benefit retirement plans. Web site addresses are provided as a convenience. Listing here does not imply endorsement by NEA of any site. NEA is not responsible for information on a listed site.

The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)

The AFL-CIO is a voluntary federation of 64 national and international labor unions. The AFL-CIO works to garner support for policies that promote pensions and strengthen worker protections. The web site contains useful information on pension fund-related issues and DB/DC developments.

www.aflcio.org

The Center for Working Capital

The center is a 501c(3) nonprofit organization created by the AFL-CIO to develop a program of trustee training and education to assist pension fund trustees in fulfilling their fiduciary duties. The center publishes a variety of resource materials.

www.centerforworkingcapital.org

National Association of State Retirement Administrators (NASRA)

NASRA is a non-profit association comprised of the administrators of the state retirement systems for the 50 American states, the District of Columbia, and the territories of American Samoa, Guam, Puerto Rico and the Virgin Islands, and of certain other statewide retirement systems. The NASRA web site contains links to resources on DB/DC issues.

www.nasra.org/resources.htm

National Council on Public Employee Retirement Systems (NCPERS)

NCPERS is a national, nonprofit public pension advocate. NASRA represents pensions on Capitol Hill, provides trustee education, and delivers essential pension information to trustees, administrators, and public officials.

www.ncpers.org

National Council on Teacher Retirement (NCTR)

NCTR is a national organization dedicated to safeguarding the integrity of public retirement systems in the United States and its territories to which teachers belong, and to promote the rights and benefits of the members of the systems. NCTR membership

includes 77 state, territorial, local, and university pension systems. The web site features material on defined benefit vs. defined contribution, Social Security privatization, and more that can be used to rebutt some of the arguments in favor of defined contribution plans.

www.nctr.org

Service Employees International Union (SEIU)

SEIU is a union of 1.6 million working people and 120,000 retirees. SEIU members participate in 49 public pension funds and in 19 private funds. The union's web site contains useful information on protecting retirement security, information about DB/DC concerns, and a resource feature with links to many related web sites.

www.seiu.org

White Paper



National Association of State Retirement Administrators

**Myths and Misperceptions of
Defined Benefit and Defined Contribution Plans**

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