

Defined Benefit (DB) and Defined Contribution (DC) Questions and Answers

- (1) Why are some public pension plans considering or moving from DB plans to DC plans?
 - Alaska's contribution rate for teachers is 24.65% and the pension plan has a funded ratio of less than 70%
 - Colorado has a funded ratio of 70% and contribution rates must climb to 20.3% in the next 3 years
 - Retiree health insurance is part of the retirement package for some pension plans and these costs have increased dramatically, e.g. Michigan
- (2) What is driving the costs?
 - Benefit increases
 - Failure to make required annual contributions to fund the DB plan
 - Retiree health costs
- (3) Does Utah have these problems?
 - No. Utah has always contributed the required annual contribution
 - Legislature has not given public employees a material retirement benefit increase in over 20 years
 - Retiree health insurance is not part of the DB pension plan
- (4) Isn't a DB plan funded in the same manner as Social Security?
 - No. Social Security is a pay-as-you-go plan
 - DB plans are advance funded over time
- (5) How is Utah's DB plan funded?
 - 25% of the funding comes from member / employer contributions
 - 75% of the funding comes from investment earnings
- (6) Is a DC plan a retirement plan?
 - DC plans were provided by the IRS as a supplemental way to save money on a tax deferred basis to compliment DB plans
 - DC plans do not guarantee a lifetime retirement benefit for the member and the member's spouse
 - Many companies are offering DC plans in place of retirement plans

(7) Do DC plans offer comparable benefits to DB plans?

- No. Studies show that the same contribution to a DC plan over a member's career will have an annual rate of return between 0.8% and 3.5% less than a DB plan
- Nebraska's experience found that over a 30 year career a member's benefit from a DC plan was 33% less than that of a DB plan, even with the same contributions

(8) Will moving to a DC plan from a DB plan save money?

- In the short term, moving to a DC plan will cost more money, regardless of the contribution rate for the DC plan because DB assumptions change and the contribution rates in a closed plan always go up
- There will be added costs to administer both a DC and a DB plan until the DB plan is phased out (65 - 75 years)
- Savings will only be recognized, in the long term, if the contribution to the DC plan is less than the contribution to the DB plan
- A California study showed that it would cost nearly \$1 billion to move California teachers to a DC plan and would require at least 20 years to recognize savings to cover this added cost

(9) Where will added funding come from to move to a DC plan?

- Take from other programs
- Appropriate additional funds

(10) Does a DC plan meet employer's needs?

- DC plans allow employees to leave government employment and take retirement with them
- DB plans promote longevity in positions; this is important in positions such as teaching, public safety, firefighting, and where "institutional memory" is important
- DC plans do not have the "golden handcuff" effect on senior employees who will stay in public employment to accrue the necessary service to draw their DB pension
- DC plans will require that market wages are paid in order to attract employees; where the state is approximately 20% below market in pay, substantial increases in pay would be required to remain competitive
- During periods of low unemployment or where particular professions are in demand, i.e., information technology, nurses, it may be difficult to attract and retain such people if retirement benefits (DC) are portable

(11) Why offer a DB plan?

- It offers a true retirement benefit for a member's retired life

- Career service employees are rewarded for their commitment to their employer
- It serves as both a recruitment and a retention tool
- Advanced funding over the past years has established an investment fund which provides 75% of the cost of the DB plan
- Lessens the responsibility of employees as financial planners