DC plans deliver less income than DB plans, study shows

By Editorial Staff *Wed, Mar 15, 2017*

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The historic shift from defined benefit to defined contribution retirement plans over the past few decades has produced an overall reduction in the guaranteed retirement income available to retirees, according to a new research **brief** from the Center for Retirement Research at Boston College.

"Employer-sponsored plans are providing less income today than in the past," the brief said. Expansion of DC coverage, wider use of auto-enrollment and auto-escalation of contributions, and reduced leakage would help turn the situation around, wrote authors Alicia Munnell, Wenliang Hou and Anthony Webb.

DB plans produced more income in part because their professionally managed investments enjoyed higher returns and because they have access to "actuarially fair" annuities that cost about 15% less retail annuities available to retirees from DC plans, the study showed. Some DC participants appear to be making up their shortfall by retiring later than DB plan participants.

The researchers' data on the amount and distribution of retirement wealth, the amount of retirement income it produces, and the pattern of replacement rates for households ages 51-56 in 1992, 1998, 2004, and 2010 came from the *Health and Retirement Study* (HRS).

Among the findings:

- Retirement wealth has been relatively steady or declining, depending on whether the starting year is 1992 or 1998.
- DC wealth is more concentrated in the top quartile of education than DB wealth, and this concentration will become more evident in the aggregate wealth measure as the shift from DB to DC plans evolves.
- While DB participants face actuarially fair annuities, DC participants have to buy annuities on the open market where marketing and other costs reduce annuity factors by about 15-20%.
- The interest rate used to calculate commercial annuity rates has declined sharply since 1992, while the interest rate assumption for DB annuities has stayed at 5.8%. The lower yield on DC wealth and its increasing importance over time has led to a decline

in the total wealth-to-income ratio.
- The shift from DB to DC has reduced the amount of retirement income per dollar of wealth because DC participants have to pay more for annuities, and annuity rates fell as interest rates dropped.
- Even with later retirement ages, flat retirement income combined with rising wages has produced declining replacement rates. Thus, retirement income from employer plans has been contracting.
- Coverage has declined from 68% in 1992 to 63% in 2010. (A household is classified as being covered by a retirement plan if one or both spouses is currently receiving DB benefits, is covered by a DB pension or participating in a DC plan on a current job, or has DB or DC assets from a past job.)
- DC wealth is skewed more toward those with more education and higher earnings, with the top quartile holding 52% of total DC wealth in 2010 compared to 35% of DB wealth.

Without significant changes to the DC system, the authors warned, “future retirees will be much more dependent on Social Security than those in the past, which is problematic given the reduced support due to the rising Full Retirement Age and the need to close the program’s long-term funding gap.”