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State employees prefer DB to DC, NIRS/Milliman study shows

By Editor Test *Wed, Oct 5, 2011*

The study analyzed seven state retirement systems that offer a choice between DB and DC plans to find that the DB uptake rate ranged from 98% to 75%, with the balance choosing the DC plan.

When given a choice, public sector employees definitely prefer defined benefit pension plans to defined contribution plans, according to a study by the National Institute for Retirement Security and Milliman called *Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers.*

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The six states whose seven plans were analyzed for the study included Colorado (88%/12% DC/DB election), Florida (25%/75%), Montana (3%/97%), North Dakota (2%/98%), Ohio (public employee 4%/96%, and teachers plans 9%/91%) and South Carolina (18%/82%).

The authors of the study also looked at the experiences of Nebraska and West Virginia. Nebraska offered some employees hired between 1964 and 2003 only a DC plan, but also maintained a DB plan for other employees. Over 20 years, the average investment return in the DB plan was 11% percent, and the average return in the DC plans was between 6% and 7%.

"West Virginia closed their Teachers' DB plan to new hires in 1991 in response to funding problems and put all new hires in a DC plan. Unfortunately this did not solve the funding problem, and many teachers found it difficult to retire when relying only on the DC plan," said Mark Olleman, a Milliman actuary who co-authored the report.

"West Virginia performed a study, found a given level of benefits could be funded for a lower cost through a DB plan, and put all teachers hired after July 1, 2005, in the DB plan as a cost-saving measure. So both Nebraska and West Virginia found a DC plan did not achieve their goals and changed from DC to DB."

The new study found that:

- When given the choice between a primary DB or DC plan, public employees overwhelmingly choose the DB pension plan.
- DB pensions are more cost efficient than DC accounts due to higher investment returns and longevity risk pooling.
- DC accounts lack supplemental benefits such as death and disability protection. These can still be provided, but require extra contributions outside the DC plan which are therefore not deposited into the members' accounts.
- When states look at shifting from a DB pension to DC accounts, such a shift does not close funding shortfalls and can increase retirement costs.
- A "hybrid" plan for new employees in Utah provides a unique case study in that it has capped the

pension funding risk to the employer and shifted risk to employees.