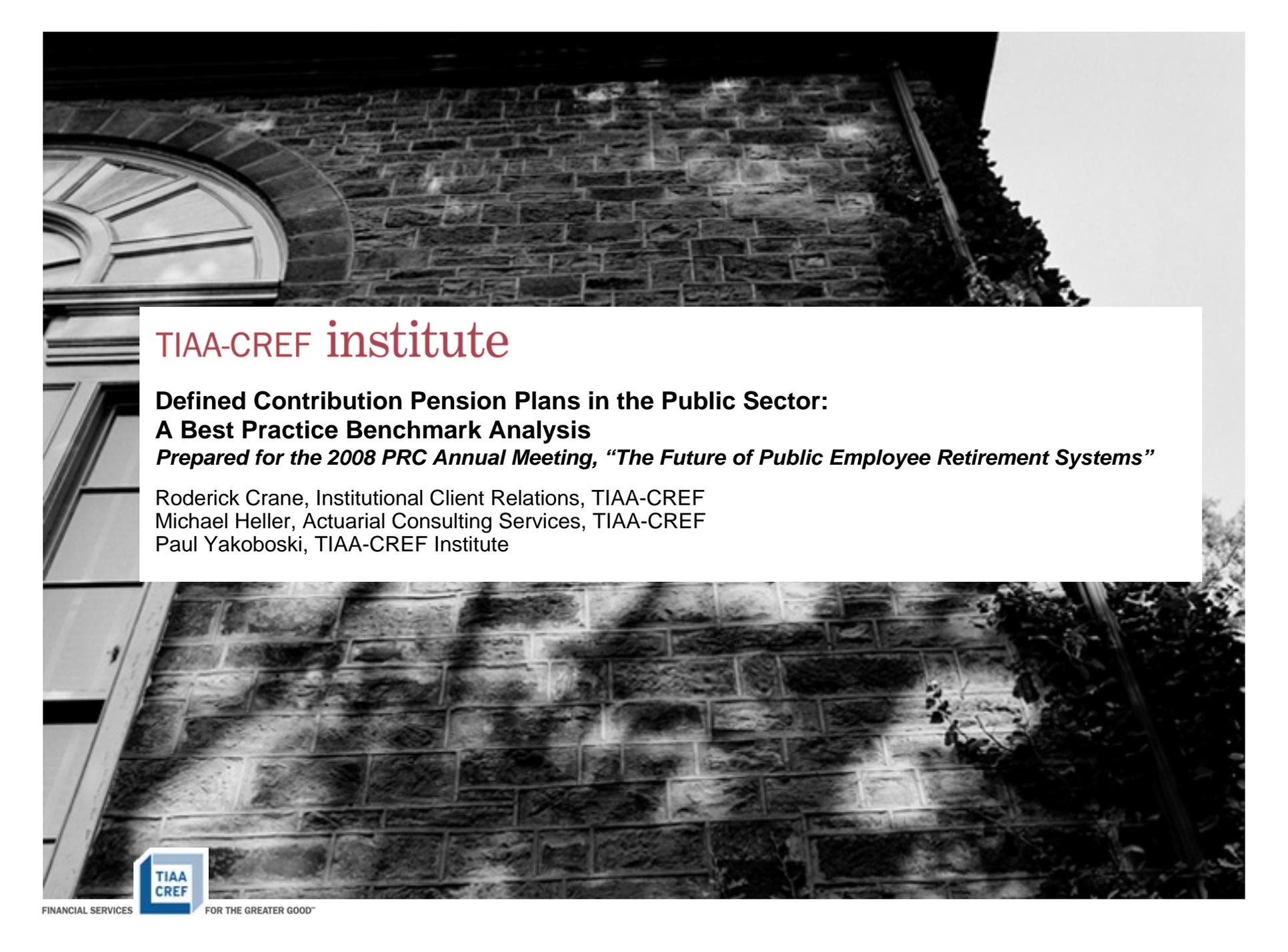


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Defined Contribution Pension Plans in the Public Sector: A Best Practice Benchmark Analysis

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Scope and Purpose

- This is not a DB vs. DC discussion.
- It's about designing a defined contribution plan that will best be able to meet both employer and employee objectives.
- It's about a “revolutionary” notion that primary DC retirement plans should be designed to function as DC “pension plans.”
- It's about DC plans that primarily focus on providing retirement income.
- It's about identifying and managing risks that threaten achieving employer and employee retirement benefit objectives.



Methodology

- Identify basic principles for DC pension design
- Identify best practice design benchmarks
 - Risk areas
 - Design features that manage risks
- Comparative analysis of major public DC pension plans vs. best practice benchmarks

Principles for Effective DC Pensions

Principle #1: Retirement plans should focus on providing adequate and secure income throughout retirement.

Principle #2: Retirement income adequacy and security is a shared employer/employee/ government responsibility.

Principle #3: It is important for all individuals to have access to a well-designed employer-sponsored retirement program.



Principles for Effective DC Pensions

Principle #4: Effective retirement programs require an appropriate investment offering that is designed to achieve the objectives of the plan.

Principle #5: Effective retirement programs require a broad range of integrated participant services.

Principle #6: Retirement programs are more effective with competent fiduciary mechanisms.



The Foundational Principle

Principle #1: Retirement plans should focus on providing adequate and secure income throughout retirement.



DC Pension Risks

- Failure to participate
- Failure to vest
- Inadequate funding
- Inadequate investment return
- Inappropriate asset allocation
- Outliving retirement assets
- Inflation
- Retirement asset leakage

Other Risks:

- Death and disability
- Excessive administration costs and fees



Core DC Plan: Best Practice Design

Plan Design Feature	Best Practice Benchmarks
Eligibility and Participation	<ul style="list-style-type: none"> ▪Mandatory enrollment/participation ▪No age restrictions ▪No more than 1-year waiting period
Vesting	100% after 1-year
Total Contributions (Employer and Employee)	At least 12% of pay if covered by Social Security; 18-20% of pay if not covered by Social Security
Investments	<ul style="list-style-type: none"> ▪Mandatory or default into lifecycle/target date ▪Limited array of 15-20 participant directed investments covering the major asset classes ▪Individual investment advice for participant directed investments ▪Broad-based employee investment education

Core DC Plan: Best Practice Design

Plan Design Feature	Best Practice Benchmarks
Distributions	<ul style="list-style-type: none"> ▪ Limited or no hardship or loan features ▪ Distributions limited to plan's retirement age <ul style="list-style-type: none"> - Except small benefit accumulations ▪ Some mandatory level of guaranteed life annuity income ▪ Limited lump-sum distributions ▪ Provide inflation protected options and features
Administrative Structure and Fees	<ul style="list-style-type: none"> ▪ Avoid multiple vendor recordkeeping structures where possible ▪ Single point of contact for participants ▪ Larger plans benchmark: Total administrative and investment costs \leq 100 basis points
Other participant services	Employee and retiree retirement and financial planning services delivered through multiple modes: call center, internet and in-person

Core DC Plans: Best Practice Design

Ancillary Benefits

Disability and pre-retirement death benefits included in overall design



Major Public Sector Core DC Plans

- Alaska Defined Contribution Retirement Plan
- Colorado Public Employees' Retirement Association (PERA) Defined Contribution Plan
- District of Columbia Defined Contribution Plan
- Florida Retirement System Investment Plan
- Michigan 401(k) Plan
- Montana Public Employee Retirement System Defined Contribution Retirement Plan
- Nebraska Defined Contribution Plan (which closed to employees hired on or after 1/1/2003)
- North Dakota Public Employee Retirement System Defined Contribution Plan
- Ohio Public Employee Retirement System Member-Directed Plan
- South Carolina Optional Retirement Plan
- West Virginia Teachers Defined Contribution Plan
- Indiana University
- Michigan State University
- Purdue University
- State University of New York
- University of Iowa
- University of Michigan
- University of Washington



Core DC Plans vs. Best Practices

Participation

- Mandatory participation is uniformly required
- Entry date is typically immediate

Vesting

- The state plans typically use 5-year vesting schedules; graded and cliff are both common
- The higher education plans, except for one, use immediate vesting



Core DC Plans vs. Best Practices

Contributions

- State plans
 - Social Security covered: Total contribution rates range from 4% to 12.3%
(2 of 8 meet or exceed the 12% best practice rate)
 - Non-Social Security: Total contribution rates range from 13% to 18.15%
(2 of 4 meet or exceed the 18% best practice rate)
- Higher Education plans
 - Total contribution rates range from 10% to 20%
(6 of 7 meet or exceeds the 12% best practice rate)



Core DC Plans vs. Best Practices



Investments

- All permit participant directed investments
- # of investment options
 - 10 of the 11 state plans range from 9 to 28; one has 70 options
 - Higher education range from 10 to 150; only one less than 30
- Default investments
 - State plans: 2 of 11 default to target date lifecycle
 - Higher education: 4 of 7 default to target date lifecycle
 - The remaining default to a mix of other funds including: a QMA, balanced funds, and moderate target risk funds and money market

Core DC Plans vs. Best Practices



Distributions

- Only 2 permit hardship and loans
- None of the plans require annuitization at retirement
 - All but 3 of the state plans offer an annuity option
 - All of the higher education plans offer an annuity option
- All of the plans allow full lump sum distributions upon termination and retirement

Inflation Protection

- All of the plans allow some exposure to equities after retirement
- 3 state plans offered some form of inflation protected annuity
- All of the higher education plans offered some form of inflation protected annuity



Core DC Plans vs. Best Practices

Participant Education

- All of the plans provided basic participant education via multiple channels
 - Investments
 - Retirement planning

Participant Investment Advice

- 3 of the state plans do not provide individualized participant investment advice
- All but one of the higher education plans provide individualized participant investment advice



Core DC Plans vs. Best Practices

Administrative Structure

- All but one of the state plans use a single recordkeeper structure
- Multiple recordkeepers is the norm for the higher education plans

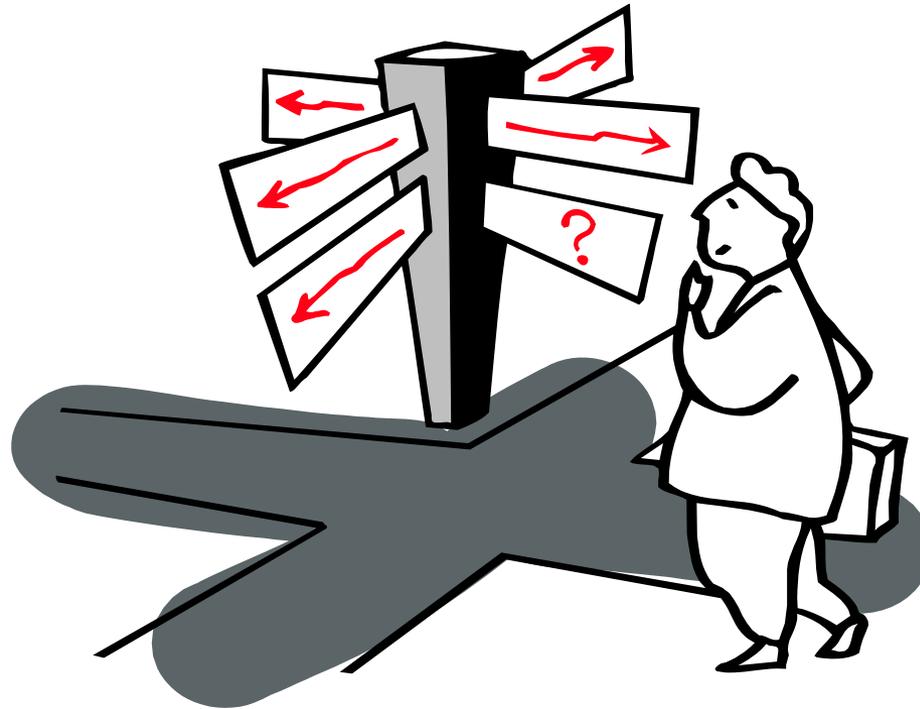


Conclusion—A Mixed Scorecard

- Many of the public core DC plans meet many of the identified best practices
- None meet all of the best practices
- Key risk areas remain that could be managed better through plan design, particularly:
 - Investment risk
 - Longevity risk
 - Inflation risk



Questions?



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