

All findings, interpretations, and conclusions of this presentation represent the views of the author(s) and not those of the Wharton School or the Pension Research Council. © 2008 Pension Research Council of the Wharton School of the University of Pennsylvania.  
All rights reserved.



## TIAA-CREF institute

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

*Prepared for the 2008 PRC Annual Meeting, "The Future of Public Employee Retirement Systems"*

Roderick Crane, Institutional Client Relations, TIAA-CREF  
Michael Heller, Actuarial Consulting Services, TIAA-CREF  
Paul Yakoboski, TIAA-CREF Institute



# 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"> <li>▪Mandatory enrollment/participation</li> <li>▪No age restrictions</li> <li>▪No more than 1-year waiting period</li> </ul>  |
| 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"> <li>▪Mandatory or default into lifecycle/target date</li> <li>▪Limited array of 15-20 participant directed investments covering the major asset classes</li> <li>▪Individual investment advice for participant directed investments</li> <li>▪Broad-based employee investment education</li> </ul> |

# Core DC Plan: Best Practice Design

| Plan Design Feature               | Best Practice Benchmarks  |
|-----------------------------------|---|
| Distributions                     | <ul style="list-style-type: none"> <li>▪ Limited or no hardship or loan features</li> <li>▪ Distributions limited to plan's retirement age                             <ul style="list-style-type: none"> <li>- Except small benefit accumulations</li> </ul> </li> <li>▪ Some mandatory level of guaranteed life annuity income</li> <li>▪ Limited lump-sum distributions</li> <li>▪ Provide inflation protected options and features</li> </ul> |
| Administrative Structure and Fees | <ul style="list-style-type: none"> <li>▪ Avoid multiple vendor recordkeeping structures where possible</li> <li>▪ Single point of contact for participants</li> <li>▪ Larger plans benchmark: Total administrative and investment costs <math>\leq</math> 100 basis points</li> </ul>   |
| 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

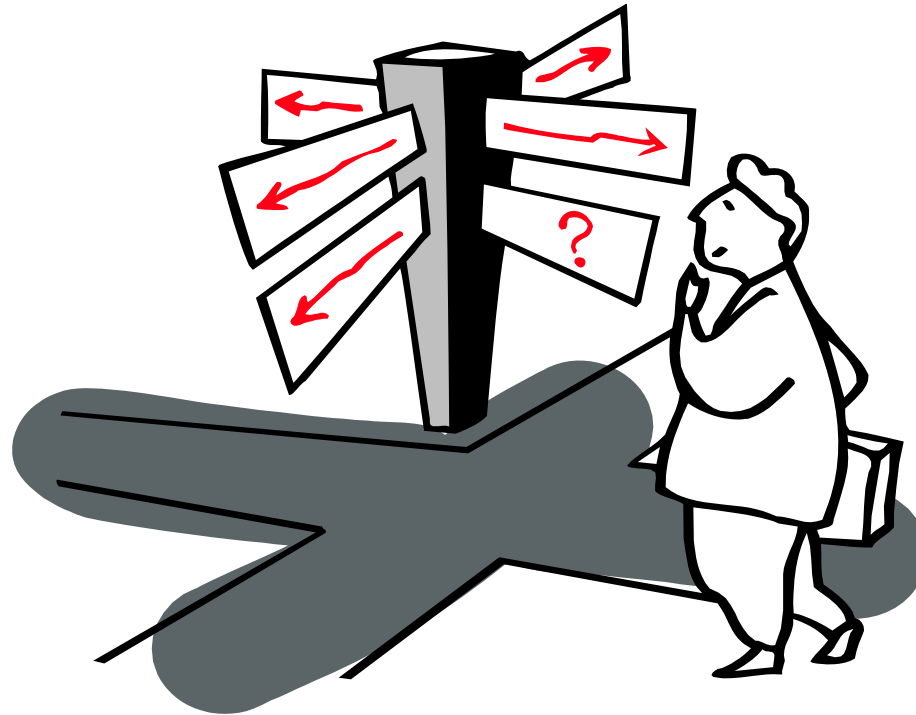


# Conclusion—A Mixed Scorecard

- 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?



TIAA-CREF Individual & Institutional Services, LLC, and Teachers Personal Investors Services, Inc., members FINRA, distribute securities products. Annuity products are issued by TIAA (Teachers Insurance and Annuity Association), New York, NY. Advice and Planning Services is a division of TIAA-CREF Individual & Institutional Services, LLC.

***Investment products are not FDIC insured, may lose value and are not bank guaranteed. You should consider the investment objectives, risks, charges and expenses carefully before investing. Please call 877-518-9161 or go to [www.tiaa-cref.org](http://www.tiaa-cref.org) for a current prospectus that contains this and other information. Please read the prospectus carefully before investing.***

Copyright 2008.

