

## Select Committee on Pension Policy

### Alternative Plan Designs

Aaron Gutierrez, JD, MPA  
Senior Policy Analyst

September 16, 2014



Office of the State Actuary  
"Securing tomorrow's pensions today."

### Alternative Plan Types Covered By Recent Media

- Last November, educational briefing on the "big three"
  - DB/DC/Hybrid
- Other plan types available
- Samples in the news
  - Several states considered cash balance plans
  - Report from Center for Retirement Research on New Brunswick Plan
  - Articles in *Time* and the *Economist*, Brookings Institute report on Collective DC plans



Select Committee on Pension Policy



**Today's Presentation**

- Very quick refresher from last year
- Quick introduction to three alternative plan designs with examples
  - Cash balance plans
  - Variable/adjustable DB plans
  - Collective DC
- No action required

Select Committee on Pension Policy



---

Office of the State Actuary  
*"Securing tomorrow's pensions today."* O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx 2

**Refresher: There Is No "One-Size-Fits-All" Plan Design**

- All plan designs have benefits and risks
- Can choose the design that best meets your goals
- Sample goals
  - Income replacement
  - Sustainability
  - Affordability and value

Select Committee on Pension Policy



---

Office of the State Actuary  
*"Securing tomorrow's pensions today."* O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx 3

## Refreshers: There Are Nearly Infinite Gradations Between the Types of Plan Designs

- Lots of overlap between plan designs
- You can add DB elements to a DC plan and vice versa
  - E.g., a DC plan with guaranteed minimum benefits
- Some sources disagree about how to categorize subtle differences

Select Committee on Pension Policy



## Simple Definitions For Comparison

- Defined Benefit
  - Guaranteed lifetime benefits based on formula
- Defined Contribution
  - Stable contributions
  - Benefits based on investment performance
- Hybrid
  - Shares some elements of both concepts

Select Committee on Pension Policy



Select Committee on Pension Policy

## Preview Of Alternate Plan Designs

- Cash balance
  - DB plan that looks like a DC plan
  - Contributions grow at guaranteed rate
- Variable DB
  - Core benefits guaranteed
  - Additional benefits or cost sharing may vary
- Collective DC
  - Contributions pooled and professionally managed
  - Benefits adjusted based on performance and target income


 Office of the State Actuary  
*"Securing tomorrow's pensions today."*

O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

6

Select Committee on Pension Policy

## Cash Balance Plan

- DB plan that can *look like* a DC plan
- Basic idea
  - Contributions are pooled for investment
  - Members have notional accounts
  - Accounts earn interest at a guaranteed rate
  - At retirement, benefits based on balance in account
- Common options include
  - Annuities
  - Guaranteed interest rate could be fixed or tied to an index


 Office of the State Actuary  
*"Securing tomorrow's pensions today."*

O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

7

## Potential Goals Of Cash Balance Plan

- Can reduce investment risk to employer
  - Still some risk to employer if investments don't meet guaranteed rate
- Member receives lifetime benefit
  - Grows at a guaranteed rate throughout career
  - But not guaranteed dollar amount

Select Committee on Pension Policy



## Sample Cash Balance Plan: Kansas "Tier 3"

- Mandatory for most new employees beginning Jan 1, 2015
- Members contribute 6 percent
- Earn "pay credits" based on service
  - From 3 percent of compensation to 6 percent based on service
- Contributions earn guaranteed interest rate of 5.25 percent annually
  - Possible increases based on investment returns
- Annuity at retirement based on account balance
  - Partial-lump sum option up to 30 percent
  - Members can use part of account balance to fund a COLA

Select Committee on Pension Policy



**Variable/Adjustable DB**

- Examples
  - Basic benefits protected, but supplemental benefits adjustable
  - Cost sharing adjustable

Select Committee on Pension Policy



---

Office of the State Actuary  
*"Securing tomorrow's pensions today."*

O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

10

**Potential Goals Of Variable/Adjustable DB Plans**

- Can reduce investment risk to employer
  - Risk still exists, but reduced or removed depending on plan design
- Some guaranteed level of lifetime benefits
- Benefits or other provisions change in pre-defined ways based on investment returns



Select Committee on Pension Policy



---

Office of the State Actuary  
*"Securing tomorrow's pensions today."*

O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

11

## “New Brunswick” Plan – Variable Benefits

- Benefits adjust to manage cost to employer
- Basic idea
  - Highly protected “base” defined benefit
    - Not 100 percent guaranteed
  - Less protected supplemental benefits subject to financial conditions
  - Actions are predetermined, and can include adjustment to
    - Benefits
    - Contributions
    - Investment policy

Select Committee on Pension Policy



---

Office of the State Actuary O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx  
*“Securing tomorrow’s pensions today.”* 12

## Utah – Variable Contribution Rate

- Contribution rates are capped to limit cost to employer
- Basic idea
  - DB plan funded first
  - Any extra goes to a separate DC portion
- How it works
  - Employer pays 10 percent
  - DB portion paid first
  - If DB contribution rate
    - Is less than 10 percent, the remainder goes to DC account
    - Is more than 10 percent, then member pays the rest
- Examples
  - If DB contribution rate is 8 percent, then 2 percent goes to DC account
  - If DB contribution rate is 11 percent, then member pays 1 percent into DB

Select Committee on Pension Policy



---

Office of the State Actuary O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx  
*“Securing tomorrow’s pensions today.”* 13

Select Committee on Pension Policy

## Collective DC (Netherlands)

- Basic idea
  - Contributions are pooled for investment
  - Notional, or no member accounts
- Benefits based on account balance
  - Board/commission adjusts provisions to balance “target income” with investment performance and financial situation
    - Target is likely a percent of career average salary
  - May include adjustments to more than just investment policy/strategy

Office of the State Actuary  
"Securing tomorrow's pensions today."
O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

14

Select Committee on Pension Policy

## Potential Goals Of Collective DC Plans

- Member receives professional investment management
- Can reduce investment risk of self-directed DC plans
- Other risks (e.g. investment and longevity) depend on how the plan fiduciaries respond to market changes and financial situation

Office of the State Actuary  
"Securing tomorrow's pensions today."
O://SCPP/2014/9-16-14\_Full/7.AltPlanDesigns.pptx

15

## Summary

- All plan designs have benefits and risks
- Can choose the design that best meets your goals
- Alternative plan design examples
  - Cash balance
    - DB plan that looks like a DC plan
    - Contributions grow at guaranteed rate
  - Variable DB
    - Core benefits guaranteed
    - Additional benefits or cost sharing may vary
  - Collective DC
    - Contributions pooled and professionally managed
    - Benefits adjusted based on performance and target income



## Further Reading

- [Governmental Plans Answer Book, 3<sup>rd</sup> Edition](#)
- [http://www.gbm.scotiabank.com/English/bns\\_econ/nbpension.pdf](http://www.gbm.scotiabank.com/English/bns_econ/nbpension.pdf)
- <http://www.ncsl.org/research/fiscal-policy/2012-enacted-state-pension-legislation.aspx#5>
- [https://media.ratings.standardandpoors.com/documents/CreditWeek\\_Pension\\_SpecialReport.pdf](https://media.ratings.standardandpoors.com/documents/CreditWeek_Pension_SpecialReport.pdf)
- [http://www.brookings.edu/~media/research/files/papers/2014/02/26%20public%20pension%20reform/improving%20public%20pensions\\_final.pdf](http://www.brookings.edu/~media/research/files/papers/2014/02/26%20public%20pension%20reform/improving%20public%20pensions_final.pdf)
- <http://www.economist.com/news/britain/21603449-governments-pension-reforms-have-been-bold-not-coherent-workers-collective>
- <http://business.time.com/2013/11/13/the-401k-of-the-future-could-save-retirement/>
- [https://images.magnetmail.net/images/clients/SOA\\_/attach//Risk\\_sharing\\_Designs\\_in\\_Retirement\\_Plans\\_FINAL\\_handout.pdf](https://images.magnetmail.net/images/clients/SOA_/attach//Risk_sharing_Designs_in_Retirement_Plans_FINAL_handout.pdf)
- [http://crr.bc.edu/wp-content/uploads/2013/07/slp\\_33\\_508.pdf](http://crr.bc.edu/wp-content/uploads/2013/07/slp_33_508.pdf)

