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3 States That Shuttered Pension Plans and Paid for It: NIRS

By Danielle Andrus | February 11, 2015 at 01:28 PM

f The National Institute on Retirement Security released in February a [resource guide highlighting the results of three case studies](#)

in (http://www.nirsonline.org/storage/nirs/documents/Case%20Studies/public_pension_case_studies_of_state_pension_plans_that_switched_to_defined_contribution_plans)

tw that show problems in a defined benefit plan can be exacerbated by moving new hires to a defined contribution scheme.

G+ In fact, the NIRS analysis found that retirees receive the same amount of lifetime income from their pension that they could get from a typical DC plan for about half

id (<http://www.alamy.com>) of the cost. Defined benefit plans that are already plagued with underfunding problems, it seems, carry those issues over to defined contribution plans.

NIRS studied three state pension plans and identified three trends:

- Existing underfunding problems did not improve following a switch, and costs increased.
- Workers in the new DC plan also struggled to save enough for a secure retirement, and frequently didn't.
- The best way to address underfunding is to establish a responsible funding policy and stay disciplined about making the full contribution each and every year.

Here is NIRS' analysis of the three states:

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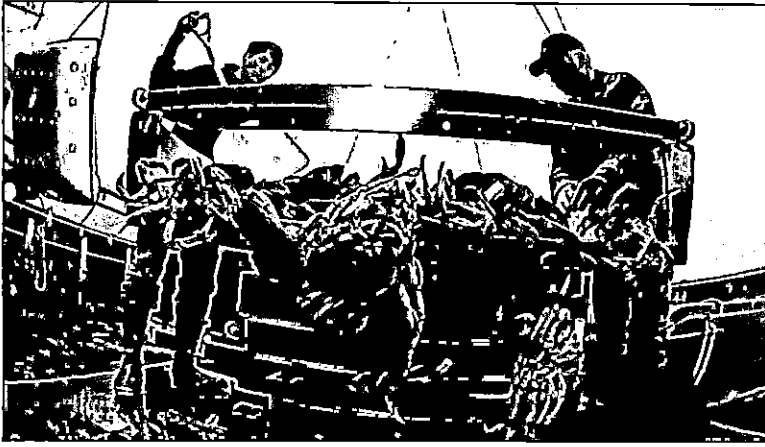
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Alaska

Five years ago, Alaska's Public Employees Retirement System (PERS), Teachers Retirement System (TRS) and retiree medical plan were facing a combined \$5.7 billion unfunded liability. To try to address that liability, the state adopted a mandatory 401(k)-style retirement plan for state employees hired after July 1, 2006.

Instead of correcting the problem, though, the new plan increased underfunding by 20% in 2006, and as of 2013, the combined liability reached \$12.4 billion. Participants in the PERS plan contributed 47% of what was required annually to the plan; TRS participants contributed 45% of the annual required contribution.

The demographics of the plan also changed, according to NIRS' analysis. In 2013, PERS had almost 30,000 retirees, but was collecting contributions from less than 21,000 members. TRS was paying over 11,700 retirees, but only collecting from 6,352 participants.

In 2007, regulators started to introduce bills to reopen the pension plans to new employees, but none of those bills have been passed.

"Losing a significant percent of employees to the DC plan reduced the one steady source of pension funding in Alaska," according to NIRS. "The false promise of the DC switch may have led policymakers to continue to underfund the pension plans, which only worsened the problem."



Michigan



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The Michigan State Employees' Retirement System (MSERS) closed its doors to new hires in 1997, opting to provide those workers with a 401(k) plan with a 4% automatic contribution and a 100% match up to 3%. Employees could contribute up to 7%. Workers already enrolled in MSERS were given the option to switch.

In 1997, MSERS was actually overfunded, NIRS found, but by 2012, the funded level fell from 109% to 60.3%. NIRS noted that there were two significant downturns in that time, but that doesn't fully explain the dramatic drop in funded level. NIRS found that between 2012 and 2013, despite a 12.5% investment return that year, the unfunded liability grew by over \$71 million to \$567 million. Markets have since improved and the state is making larger payments, but the aging population of the plan means it's still underfunded. The annual required contribution for each participant in 1997 was just over \$4,000. By 2013, it was almost \$37,100 per active employee.

Participants in the DC plan aren't much better off, according to NIRS' analysis. As of 2013, 33,000 state workers, about two-thirds, were participating in that plan, but a 2011 report estimated an average benefit of only \$8,200 per year.

NIRS found that even when participants in the DC plan contribute enough to receive the full employer match, the DB payout is greater and costs less. For example, an employee who starts at \$40,000 a year, receives 2% wage increases and 6% investment returns each year for 25 years, would end up with about \$288,000. That gives them about \$1,600 a month, compared with \$2,050 from a DB plan, according to NIRS. Furthermore, the cost of the DB plan is about 8% of pay, while the DC plan costs 10% of pay between the employer and employee contributions.

That shouldn't be a surprise, NIRS noted in its report, since pooling employees in DB plans provides more economies of scale. "Specifically, they save money due to longevity risk pooling, maintaining a more balanced portfolio over a longer time, and achieving higher investment returns due to professional management and lower fees. NIRS has found that for a given level of retirement income, a typical DC plan costs 91% more than a typical DB plan."



West Virginia

West Virginia's Teachers Retirement System (TRS) had suffered underfunding problems at least as far back as 1979, NIRS found, with the state and many school boards failing to even match employee contributions in some years.

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In 1991, the state closed TRS and moved new teachers to a DC plan, overlooking the fact that unfunded obligations aren't reduced when new members leave the DB plan. In 2005, there were nearly 27,000 retirees receiving benefits from the plan with just 18,000 making contributions, and the funding level had fallen to a very painful 25%.

As in the Michigan example, DC participants weren't doing much better. At the end of April 2005, the average balance was less than \$41,500 and less than 6% of teachers over 60 had \$100,000 or more in their account.

The state began re-examining the cost of the switch in 2003 and by 2005, decided to move new hires back into the DB plan. The state had found that the cost of benefits accrued in one year in TRS was about half of that in the DC plan.

Furthermore, the state started making additional contributions to make up for the underfunded years. In 2006, the state made an additional \$290.1 million contribution. The following year, it contributed an extra \$311.8 million and \$807.5 million from a tobacco bond securitization.

The plan was reopened to new hires in June 2008, and teachers who had been hired into the DC plan were given the option to switch to TRS. Almost 79% decided to do so, including 76% who were under 40. The influx of young participants saved the state about \$22 million, according to NIRS.

As of July 2013, the pension plan more than doubled its funded level to 58%. NIRS noted that it's expected to be fully funded by 2034.

"Ultimately, moving from a DB plan to a DC plan can have dire consequence for employees, employers and taxpayers — even when a large unfunded liability exists," according to NIRS.

The NIRS analysis noted that the financial crisis led all states to make "significant changes" to their retirement plans. "As states and municipalities have considered switching from the DB pension to a DC plan, those that have conducted a cost analysis have found that the move would save little to no money in the long term, and could actually substantially increase retirement plan costs in the near term."

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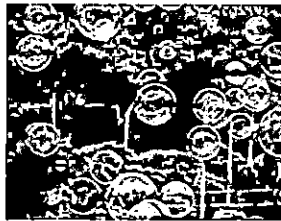
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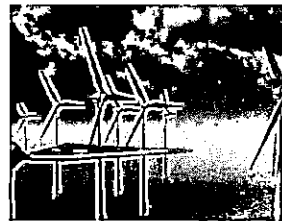
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