

December 20, 2007

State Retirement Plans:

Executive Summary

by Jamee Fuller, CPPA, Dave Patton, CPPA and Jordan Robertson, MPA

Introduction

Over the course of the past decade, several states have moved away from providing their employees with Defined Benefit retirement plans, and have, instead, opted to institute Defined Contribution or 401(k) plans for their employees. Currently, only two states have switched completely over to a Defined Contribution plan for new employees. Many states, however, are reviewing this option.



Reasons why States are Switching

There are several reasons why states are switching from Defined Benefit plans to Defined Contribution plans. The majority of these reasons are rooted in financial considerations for the State. The first of these reasons are the unfunded liabilities that several states are experiencing as the result of a weakened economy and the stock market drop at the beginning of the decade (Goodman, 2006). This was the reason why Alaska changed the benefits provided to their employees. Government leaders believed that a Defined Contribution plan would be less financially taxing on the state in the long run.

A second reason why states are looking at changing their retirement benefits is because of misappropriation of funds or benefit allocations by state governments. When New Jersey began to investigate options to remedy financial concerns in their pension system, the Benefits Review Task Force for the State uncovered misappropriations and allocations of pension funds. As a result, instead of changing to a Defined Contribution retirement plan for new employees, steps were put into place to rectify the problems within the system (The State of New Jersey, 2005).

An additional problem plaguing some retirement services is that the individuals serving on pension system boards have not received formal training or education in making investment decisions. This lack of understanding of fiduciary fields has created significant problems in pension funds that are managed by boards made up of these types of individuals. Some board members have also engaged in unethical practices by doing business with financial investment firms that contribute large sums of money to elected officials, or seek kickbacks from investment firms for agreeing to do business with their organization (Barrett & Greene, 2007).

Many states have also considered switching to Defined Contribution plans to compensate for the rising costs of health care. States that have historically provided retirees with health care benefits as part of a retirement package are suffering monetary problems due to the high cost of providing these benefits.

Information Available from Utah Retirement Systems

The State of Utah is unlikely to change completely over from a Defined Benefit (DB) plan to a Defined Contribution (DC) plan. The Utah State Retirement Systems website provides a pamphlet that analyzes the defined benefit versus the defined contribution plans and argues against phasing State retirement systems from DB solely to DC plans. These arguments include concerns over the State needing to increase wages in order to remain competitive for talent with the private sector if they decrease retirement benefits. Another worry is that the public

sector will experience higher turnover because individuals will lose the incentive to remain in state service to ensure that they receive retirement benefits. Other concerns are that the cost to administer the DB plan would increase; public employees without adequate retirement funding would turn to the welfare system for support; DC plans expire when the money runs out, whereas DB plans are a life-time annuity; and the success of a DC plan is critically dependent on the circumstances of the market at retirement (Utah Retirement Systems, 2007a).

Bills Recently Introduced in the Utah State Legislature

An additional indicator that illustrates that it is unlikely that the State of Utah will switch solely to a defined contribution plan is the nature of the bills regarding retirement that were introduced in the 2007 General Session of the Utah State Legislature. Many of the bills introduced called for increases to the current retirement benefit structure in the State. House Bill 377, however, when introduced, proposed to modify the Utah State Retirement and Insurance Benefit Act to provide for an optional defined contribution retirement plan. This bill would allow new employees hired July 1, 2007, who are eligible to earn service credit under any state retirement system, to make a one-time election to become a member of a defined benefit retirement system or to receive a defined contribution in lieu of a defined benefit. The House eventually substituted a bill for this one—one that looked nothing like the original bill. The original bill obviously showed a desire to move away from DB plans toward DC plans, by allowing employees to opt out of the DB plans and exclusively contribute to DC plans. Eventually the substitution bill was placed in the House file for defeated bills (Utah State Legislature, 2007). The overall attitudes exemplified by the Utah State Legislature are toward increasing benefits for employees instead of reducing them. This is not parallel with the attitudes of other states prior to changing from a DB plan to a DC plan. Most states also commissioned task forces or committee groups to review alternatives in their retirement funding options prior to switching over. The State of Utah has not yet done this, further indicating that there are no plans in the near future to consider such a drastic change.

Conclusion

From information gathered from other states, the Utah Retirement Systems website, and the bills that were introduced into the 2007 General Session, it is unlikely that the State of Utah will change its retirement benefits for state employees in the near future. The State is not experiencing some of the same financial concerns that other states have experienced, such as significant unfunded liabilities and healthcare costs. No information or research has shown that the State of Utah misappropriates in any way the money that is earmarked for their pension funds, or that the State is offering benefits to people who are ineligible to receive them (Utah Retirement Systems, 2007b). The State also currently has seven individuals serving on the board for the Utah Retirement Systems, and four of the seven are distinguished as representing the "investment community." These individuals have received formal education in making proper investment decisions for the pension fund.

There are significant implications associated with changing from a Defined Benefit Pension plan to a Defined Contribution plan. The worries associated with switching to a Defined Contribution plan have been expressed by the Utah Retirement Systems as reasons why it is doubtful that the State will switch from a DB plan to a DC plan.

References

Barrett, K. & Greene, R. (2007). The \$3 Trillion Challenge. *Governing* 21(1), 26-32.

Goodman, J. (2006). Legislatures 2006: Issues to Watch. *Governing Online*. Retrieved November 26, 2007, from <http://www.governing.com/archive/2006/jan/issues.txt>

The State of New Jersey Benefits Review Task Force. (date). *The Report of the Benefits Review Task Force to Acting Governor Richard J. Codey*. Retrieved November 26, 2007, from http://www.state.nj.us/benefitsreview/final_report.pdf

Utah Retirement Systems. *Defined Benefit (DB) and Defined Contribution (DC) Questions and Answers*. Retrieved November 19, 2007, from <http://www.urs.org/general/pdf/DBvsDCQuestions.pdf>

Utah Retirement Systems. *Defined Benefit Plans (DB) vs. Defined Contribution Plans (DC)*. Retrieved November 19, 2007, from http://www.urs.org/general/pdf/db_vs_dc.pdf

Utah State Legislature. (2007). *Bills and Resolutions 2007 General Session Bill Documents List*. Retrieved November 19, 2007, from <http://www.le.state.ut.us/session/2007/bills.htm>

View the [full report](#)

Published by [Center for Public Policy & Administration](#).

Copyright © 2008 The University of Utah. All rights reserved.

The Center for Public Policy & Administration offers research, education and services to public and nonprofit organizations that will strengthen administration, leadership and public policy making.

Powered by [IMN](#)