

University of California

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Trends in Retirement Benefits: Higher Education and Government Employers

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Overview

- In considering retirement plan alternatives, there are four key groups of employers that may be relevant to your consideration
 - Higher education;
 - State government;
 - Health care; and
 - Private sector
- This material will provide some comparisons and observations regarding prevalence and trends among higher education and state government employers

Government Employers: Overview of Pension Plans

- Government retirement landscape very different than higher ed or private sector
 - Higher education has long been dominated by defined contribution plans (403(b))
 - Government dominated by contributory defined benefit (final average pay) plans
- State government plans have (generally) not followed private sector move to DC
 - Move to DC does not address states' pressing short term cash needs;
 - Unique attributes of state plans also reduce impetus to move to DC
 - Factors affecting private sector move to DC not all applicable to states

State Pension Plans: An Overview

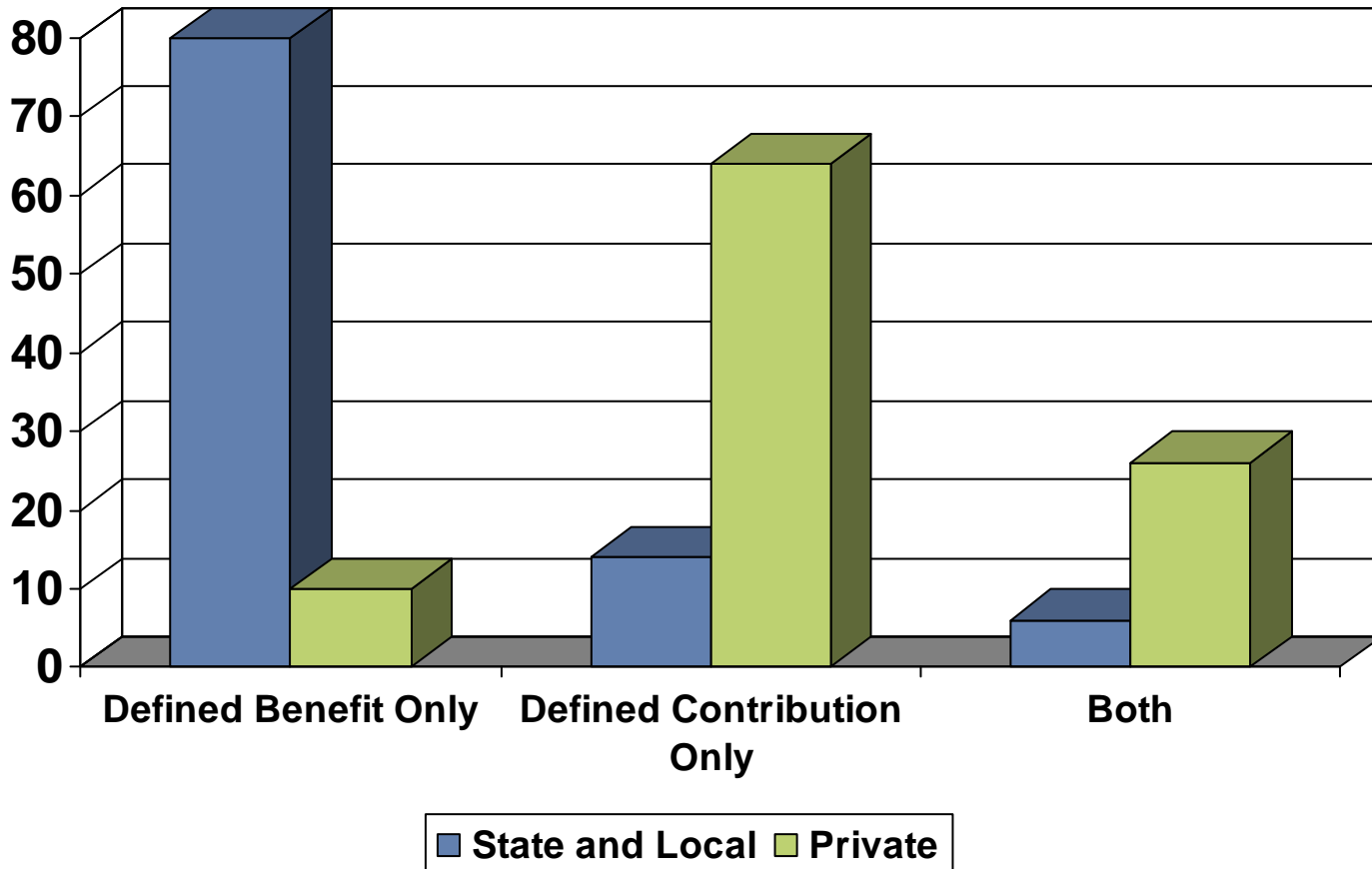
- “Typical” state pension plan is a contributory, final average pay plan with post-retirement COLAs and substantial early retirement subsidies;
 - Median accrual rate 2.2% of pay (where no Social Security) and 1.9% of pay (where Social Security also provided)
 - Age 60 most common NRA (43%), while 35% use age 65 and 14% use age 62 (55 and Social security NRA also used)
 - 72% of state and local government employees covered by Social Security
 - 98% of state and local government employees covered by COLA
 - Median employee contribution rate is 8.0% (no Social security) or 5.0% (with social Security)

Sources: 2006 Comparative Study of Major Public Employee Retirement Systems, Wisconsin Legislative Council (December 2007) and State and Local Pensions are Different from Private Plans, Munnell and Soto (November 2007)

Factors Affecting Private and Public Plans

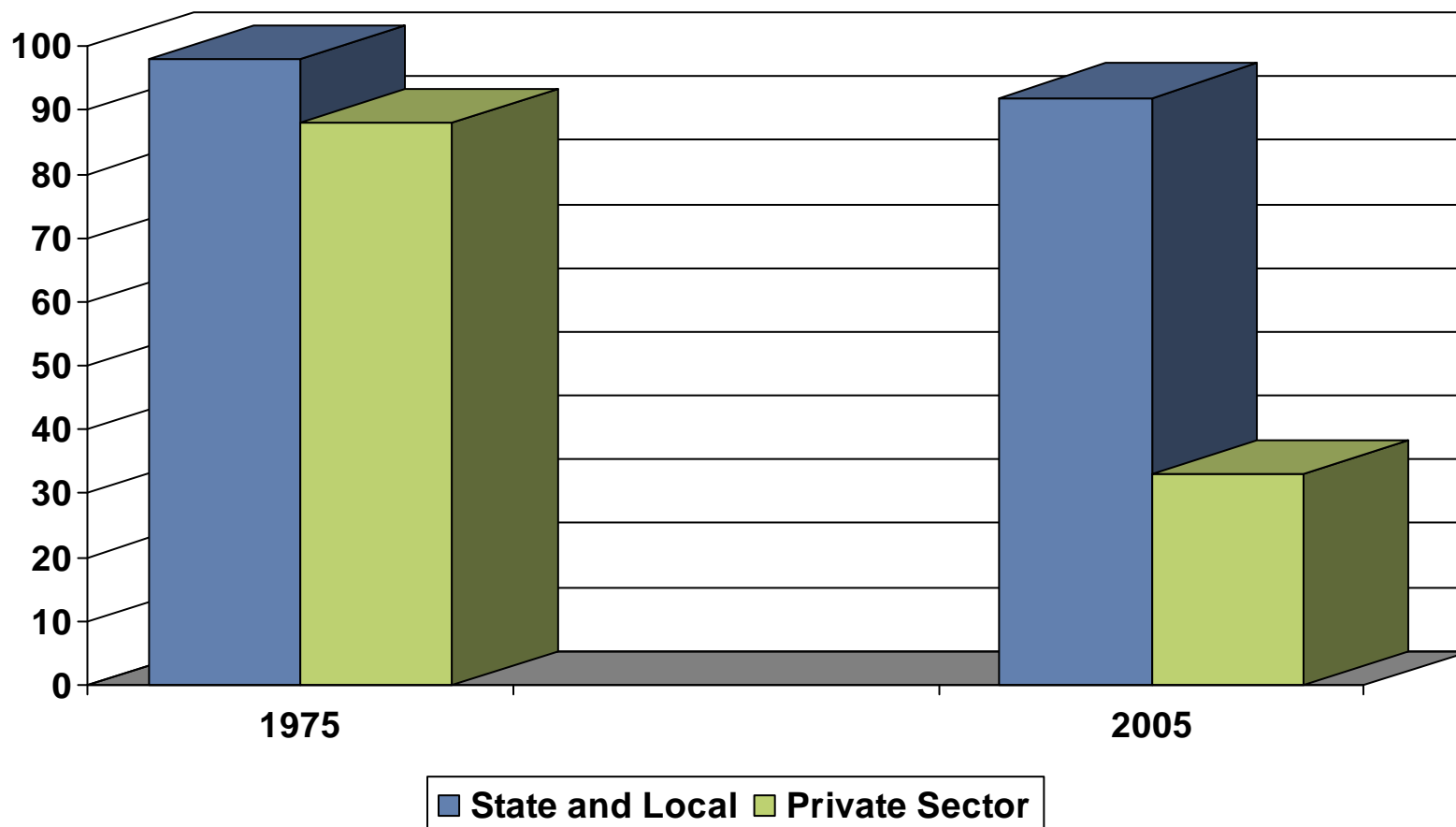
Factor	State Government	Private Sector
Move from “career” employment to “transactional” employment	More likely to retain full career employment	More mobility leads employees to favor DC plans
Asset volatility and equity exposure	Better able to smooth returns and adopt more stable funding strategy	IRS and ERISA rules exacerbate impact of asset swings
Increases in longevity and medical inflation	Render current DB plans (with COLAs) more expensive	Part of long term planning that leads away from DB
Competitive pressures and organizational stability	No real pressures; perpetual existence	Pressure from foreign and domestic startups; threat of bankruptcy
Regulatory burdens and costs	Not applicable	Drives up plan and administrative costs
Union presence	Remains strong	Significantly weakened (<10%)
Growth and increasing maturity of DC plans	Not applicable	Less competitive disadvantage to going DC
Political considerations	Republican-controlled states more likely to move to DC	Not applicable

Retirement Plan Structures



Source: State and Local Pensions are Different From Private Plans, Munnell and Soto (November 2007)

DB Pension Coverage: Government vs Private Sector



Source: Why Have Defined Benefit Plans Survived in the Public Sector?,
Munnell and Soto (December 2007)

Plan Design Considerations

- Traditionally:
 - DB design placed broad array of risks on employer (asset performance, longevity, inflation, early retirement costs), and
 - DC placed risks on employees; this risk bearing by employees was not a great concern when DC plans simply supplemented DB plans
- Range of designs has blurred these lines (e.g., cash balance accruals have some DC attributes)
- Only “constant” truth is that (legally) DC plans always reflect individual accounts and DB plans are pooled assets

Retirement Plan Design Alternatives

	Reward Age and/or Service	Investment Risk
Traditional FAP	*****	Employer
Career average	***	Employer
Flat dollar DB	***	Employer
Cash Balance	***	Mixed
Pension Equity	****	Employer
Age or Service Weighted DC	***	Employee
Matched DC	*	Employee
% of Pay DC	*	Employee
Target benefit plan	*****	Employee

Trends in Government Plans

- ▣ In recent years, state government plans have moved away from traditional model in small increments:
 - A few states have moved completely to DC (Michigan and Alaska);
 - Some have offered DB vs. DC choice (Colorado, Florida, Montana, North Dakota, Ohio and South Carolina);
 - Others have moved to plan structures that rebalance the values provided through DB (previously 100%) and DC (previously 0%), with lower DB accruals and more DC amounts (Georgia, Indiana, Oregon, Texas and Washington);
 - “Hybrid” DB design adopted by one state (Nebraska; replaced DC plan);
 - Some states experimenting with increasing benefits only if fund performance exceeds thresholds (Colorado and Nebraska)

Lessons from Governmental Employers

- Designs adopted by comparators instructive—but only up to a point
- Slow movement away from traditional designs among governmental employers reflects unique circumstances of these employers with respect to governance and structure
- On the other hand, some of the innovative designs adopted by these entities (such as retirement designs selected by Arizona and Nebraska) also reflect unique legal flexibility afforded to these employers
- Plan design process (especially for a governmental employer) provides a tremendous amount of flexibility
 - Not limited to historical notions of DB or DC
 - Can reallocate roles, responsibilities and risks to meet your specific situation
 - Focus on goals and plan objectives is particularly helpful

Overview of Higher Education Retirement Plans

- Higher education plans reflect the split between private and public
 - Private schools overwhelmingly defined contribution (exclusively); these plans have not been subject to much change in recent years
 - Public universities are more evenly split between defined benefit and defined contribution; DB component is evolving in response to financial pressures
 - Public universities also willing to give faculty and staff employees choice between DB and DC
- Review of LRF comparator group reflects these trends

LRF Comparators: Private Universities

- ▣ Four comparators: Harvard, MIT, Stanford and Yale
 - Harvard, Stanford and Yale rely exclusively on DC plans for retirement income
 - MIT has both DB and DC plans:
 - > Cash balance DB, with “notional” accounts receiving pay credits of 5% of pay, plus market-based “interest” credits
 - > Matched savings plan
 - MIT cash balance plan has many DC attributes and shifts key economic risks to faculty and staff employees (e.g., inflation, early retirement, longevity, and investment returns)

LRF Comparators: Public Universities

- Four comparators: SUNY-Buffalo, Illinois, Michigan and Virginia
- Three (SUNY, Illinois and Virginia) have historically maintained (and continue to maintain) “traditional” DB plans with retirement annuities based on 3- or 4-years’ highest average pay
 - All three also offer employees the choice to participate in DC plan alternative
 - Employer contribution rates vary, but all max out at >10% of pay
 - SUNY and Virginia plan part of larger state plan; Illinois is stand alone plan for all state universities and colleges
- Michigan is DC only; this is consistent with fact that Michigan is one of two states with DC plans as exclusive vehicles for state employees

Lessons from Higher Education

- Private schools remain focused on plans that are highly portable and that allocate many financial risks to faculty and staff employees
- Public universities reflect tension between DC orientation of private comparators and DB bias within state governments
 - Choice programs reflect least contentious way to address this tension
 - These approaches may save money in long term, but savings not assured and will take many years to materialize (if ever)
- All or nothing choice among public comparator group differs from “hybrid” strategy used by various statewide plans, where employees receive employer contributions to both DB and DC plans