Kendra Kloster

From: Mandel, Harry W [Harry.W.Mandel@wv.gov]
Sent: Tuesday, March 10, 2009 11:58 AM
To: Kendra Kloster
Subject: RE: defined contribution retirement plan

Dear Kendra,

Sorry about the delay in responding. We are in the middle of our 60 day session and I have been buried in Actuarial/Fiscal Notes regarding new pension legislation being considered.

I would certainly be willing to consider testifying regarding our DC/DB experience here in West Virginia. Again, timing will be key.

In our situation, the DC plan had the opposite impact on state costs as expected when it was set up. Originally, our 1991 conversion (before my time, I joined WV in 2001) was intended to "stop the bleeding" in the DB plan and provide a "fully funded" DC plan for future benefits. Our DB was frozen for participation with new hires all going into the DC plan from 1991. The original intent missed two key items. The most important is that new hires provide the best source of cash flow for a defined benefit plan, with Normal Cost funding benefits at 100% and no meaningful payouts for several years. The change actually "slowed" the funding recovery for the DB plan. The second item is that the DB plan had a Normal Cost of about 9.5% of payroll. Member contributions in the DB are 6%, leaving an employer current benefit cost of about 3.5% of payroll. As a result, the DC plan contribution rate for employers of 7.5% of payroll was 4.0% higher than the DB current benefit cost, further delaying the application of contribution dollars to the DB Plan due to higher DC contributions.

When 2005 Pension Reform legislation studied the issue, the current DB plan employer Normal Cost was down to 3% of pay. Newly hired members into the DC where shown to have an employer Normal Cost percentage of around 3.5% of pay. Effectively, by reopening the DB plan July 1, 2005, the current benefit costs for new hires were reduced from 7.5% of pay in the DC plan to 3.5% of pay in the DB plan. That difference projected through our funding target of 2034 is the basis of the $1.4 billion in future savings due to the reopening. When DC members were allowed a one-time return election to the DB plan at 75% of the DB benefit, over 75% elected to move from the DC to the DB. The actuarial present value of the contribution savings was over $20 million, even after the market losses through June 30, 2008. An interesting point is that our under 40 group had a higher transfer percentage than our over 60 group.

A key fact often missed in the DB versus DC analysis is that for public employers, the DC plan does not pass all future "risks" to the membership. A private employer can "walk away" from a DC member who runs out of money. When a public DC plan member does not have enough to retire, legislative pressure builds until supplemental benefits are passed. (Actually, our DB plan started as a DC plan in the 1940's and failed miserably until ad hoc benefits through legislation converted it to a full DB plan.) Also, if things are bad enough following retirement, public workers become "welfare recipients" and are still provided benefits by the state. The underlying state guarantee reaches beyond the DC plan itself, but cannot be ignored. Our legislature decided it was better to properly fund a DB and provide retirement income in a dignified manner than to destine a percentage of our future retirees to the welfare rolls.

The other aspect of the retirement question that states must address is that private DC plan participants who run out of funds after retirement will also become welfare recipients funded by the state. Private employers are effectively being allowed to pass their retirement risk to the public sector.

Feel free to contact me with more details if you feel I could be helpful to your cause.

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