

SB

183

SENATE COMMITTEE REPORT

DATE: 2/15/08

FURTHER: Judiciary
Finance

DATE TURNED
IN TO OFFICE: _____

State Affairs Committee considered SENATE BILL NO. 183

SB 183 REPEAL DEFINED CONTRIB RETIREMENT PLANS

"An Act repealing the defined contribution retirement plans for teachers and for public employees; making conforming amendments; and providing for an effective date."

and recommends:

- be replaced with SCS or CS _____ (_____)
- adopt previous SCS or CS _____ (_____)
- attached amendment(s)
- adopt _____ Letter of Intent
- further referral to _____ Committee

SENATE BILL:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	New Title
<hr/>	
HOUSE BILL:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	Technical Title Change
<input type="checkbox"/>	New Title w/ SCR # _____




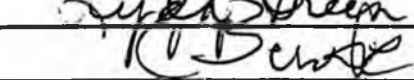

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
Admin	2/15/08	✓			

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
	French	x			
	Staves	✓		x	
	Green		✓		
	Bunde		✓		
CHAIR: 	McGuire	✓			



SENATOR KIM ELTON

SB 183 – Restoring Pension Benefits for Public Employees

Sponsor Statement

SB 183 returns guaranteed pension and health care benefits to Alaska public employees. It will make it easier to recruit and retain teachers, police officers, firefighters, and other public employees.

Analyses by actuaries and the state Division of Retirement and Benefits show that Alaska's defined benefit pension – paying a guaranteed monthly benefit plus health care – costs the same as the new defined contribution system but provides much better benefits. In a worst-case scenario, monthly costs might increase by \$5 per public employee. With SB 183, Alaskans get more benefit for the same cost.

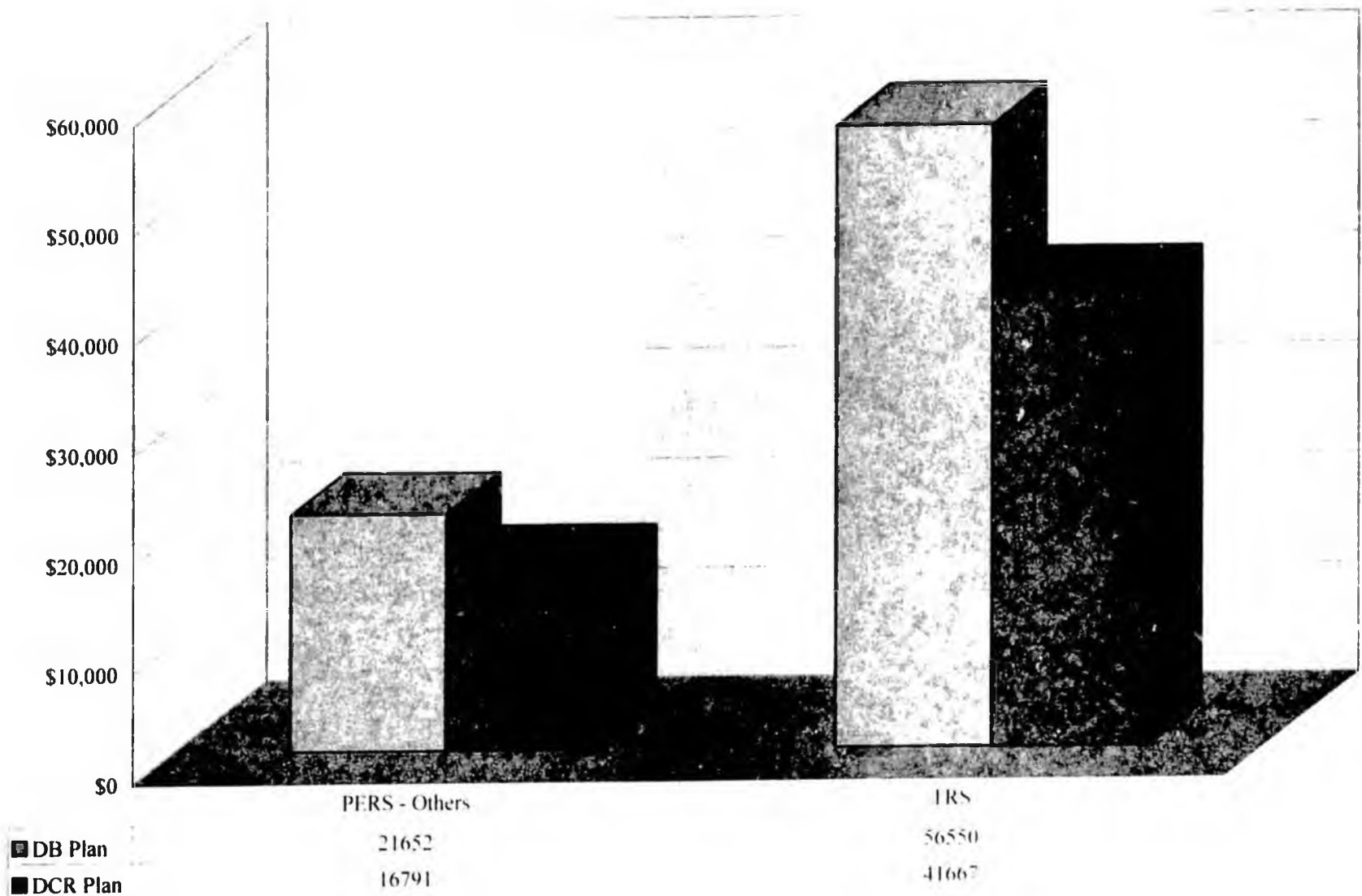
SB 183 repeals the laws putting public employees into risky individual savings account plans, and enrolls them in the least expensive pension plans, the current public employee tier III and teacher tier II. The State already administers these tiers for thousands of members, so no new bureaucracy is required.

A few years ago, Alaska beefed up oversight of the pension system: now two actuaries analyze the health of the pension funds, there are more frequent experience studies, and the state stopped the practice of sometimes paying less than the cost of benefits. SB 183 retains these smart reforms, making Alaska pensions stronger than ever.

The K-12 teachers and university professors who educate our children, the police and firefighters who protect our families, and the public employees who serve our state and cities deserve a secure retirement in return for their service.

I respectfully ask for your support.

**Value of Employer-Paid Benefits
(31-year old new employee)**



Based on data provided by Buck Consultants, letter dated May 4, 2006

Assumes a married member with starting salary of \$35.5/year.



SENATOR KIM ELTON

Memorandum

TO: Sens. Hoffman and Stedman, co-chairs, and Finance Committee members

FROM: Sen. Kim Elton

RE: Defined Benefit/Defined Contribution

DATE: March 30, 2007

Attached are slightly reformatted charts codifying data provided by Buck Consultants in their letter dated March 19, 2007. The Buck letter responds to requests by the committee to disaggregate by tiers data that previously was dumped into only two buckets for comparison purposes—a defined benefit bucket and a defined contribution bucket. Now we have several buckets of data—four PERS buckets (tiers 1-4) and three TRS buckets.

The normal cost charts for PERS and TRS are easy-to-read comparisons of PERS pension and medical costs by tier and TRS pension and medical costs by tier. The third chart, the accrued liability chart, puts dollar amounts to liabilities by tier.

Here are some demonstrable basics revealed by the Buck data:

- the PERS tier 3 DB employees are just slightly more expensive than the new DC employees;
- the new TRS DC employees are very slightly more expensive than the TRS tier 2 DB employees;
- the very slight cost advantage of a PERS tier 4 over a tier 3 is erased when tier 4 employees leave early and take employer dollars that, if left in the system, would help meet pension benefit obligations in the out years; so
- the DB PERS tier 3 and the DB TRS tier 2 fundamentally fixed the problems the governor claimed had to be fixed by his new DC plan.

There also are some other DB/DC inferences that can be drawn:

- recruitment for quality public employees is made more difficult when Alaska is a defined contribution pension system (without even the backstop of the defined Social Security benefit) because professionals can work with other public employers that are just as competitive on wages and almost all of whom provide a defined benefit pension; and
- retention is made more difficult with the portability provisions of the defined contribution because relatively short-term employees can take their contributions as-well-as employer contributions out of the retirement systems and go to

ALASKA SENATE

STATE CAPITOL • JUNEAU, ALASKA 99801-1182 • (907) 465-4947 • FAX (907) 465-2108
SENATOR_KIM_ELTON@LEGIS.STATE.AK.US

another public employer that provides a defined benefit (any federal employer, or any other state, or almost all municipalities or school districts outside Alaska). As we know, a high percentage of teachers and public employees leave before five years and now new DC employees have a special financial inducement to leave—they can cut and run and take the employer dollars, too.

These inferences are now backed with anecdotal Alaska evidence, even after less than a year's experience with tier 4. Further, the anecdotal Alaska evidence mimics the real-life experience of the two states that actually moved to a defined contribution but later back-tracked because of recruitment and retention problems.

Given the instructive Buck numbers that finally compare the immediately previous DB plans to the replacement DC plan and given, too, the cost-sharing bills that will spread the past service costs to employers regardless of tiers, we need to review what we wrought with SB141.

We must not assume our only options now are passing a DC 'fix-it' bill and passing a cost sharing bill that spreads the pain of past service costs. At a minimum we must also decide whether to give new employees a choice of tier 3 or DC in the PERS system or tier 2 and DC in the TRS system. If the cost differences are a wash, why limit the ability of employers to recruit and retain, and limit new employees to a risky defined contribution plan?

Normal Cost

Employer Normal Cost Rate	PERS Pension	PERS Medical	PERS Total	# of Active & Retired
Tier 1 (DB)	9.15%	10.46%	19.61%	26,263
Tier 2 (DB)	5.33%	10.41%	15.74%	10,999
Tier 3 (DB)	1.55%	9.28%	10.83%	18,719
Tier 4 (DC)	5.67%	3.99%	9.66%	2,214

Employer Normal Cost Rate	TRS Pension	TRS Medical	TRS Total	# of Active & Retired
Tier 1 (DB)	7.18%	8.02%	15.20%	11,872
Tier 2 (DB)	2.16%	8.96%	11.12%	7,635
Tier 3 (DC)	7.56%	3.99%	11.55%	754

Accrued Liability

Accrued Liability (DB)	PERS Pension	PERS Medical	PERS Total	TRS Pension	TRS Medical	TRS Total
Tier 1	\$5,628,778	\$4,036,751	\$9,665,530	\$3,925,023	\$1,816,223	\$5,741,247
Tier 2	1,123,559	1,334,674	2,458,233	409,562	347,748	757,309
Tier 3	334,854	386,224	721,078	N/A	N/A	N/A
Total	\$7,087,191	\$5,757,650	\$12,844,841	\$4,334,585	\$2,163,971	\$6,498,556
Assets			\$8,442,919			\$3,958,939
Accrued Liability			\$4,401,922			\$2,539,617

INVESTMENT RETURNS: DEFINED BENEFIT VS. 401(k) PLANS

BY ALICIA H. MUNNELL, MAURICIO SOTO, JERILYN LIBBY, AND JOHN PRINZIVALLI*

Introduction

Pension coverage in the private sector has shifted from defined benefit plans where professionals manage the money to 401(k) plans where participants invest their own accounts. The supposition is that individuals are not very good at investing their own money. The question is whether the supposition is borne out by the facts. That is, are returns on 401(k) plans markedly lower than those on traditional defined benefit plans?

This *brief* first reports rates of return on defined benefit and 401(k) plans over the period 1988-2004. The second section then looks at the holdings of the two types of plans to see whether the differences in returns can be explained by a more risky portfolio. The third section speculates about the role fees play in the results. The fourth section explores the implications of the findings for 401(k) participants. The final section reports on Individual Retirement Accounts (IRAs), because the assets in these accounts now exceed holdings in either defined benefit or

defined contribution plans, and most of the money is rolled over from employer-sponsored plans.

The bottom line is that over the period 1988-2004 defined benefit plans outperformed 401(k) plans by one percentage point. This outcome occurred despite the fact that 401(k) plans held a higher portion of their assets in equities during the bull market of the 1990s. Part of the explanation may rest with higher fees, which are deducted before returns are reported to participants. But the one percentage point shortfall understates the investment problem in 401(k) plans, since an aggregate number does not reflect the fact that more than half of participants in 401(k) plans do not follow the prudent investment strategy of diversifying their holdings. Finally, the available data suggest that IRAs produce even lower returns than 401(k) plans, which, if true, implies trouble ahead given the massive amount of money that is being rolled over into these accounts.

* Alicia H. Munnell is the Director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor in Management Sciences at Boston College's Carroll School of Management. Mauricio Soto is a senior research associate, Jerilyn Libby is a research associate, and John Prinzivalli is a student research assistant at the CRR. The authors would like to thank Sylvester Schieber and Brendan McFarland for providing access to Watson Wyatt's previous research and Peter Diamond and Francis Vitagliano for helpful comments.

Rates of Return in Defined Benefit and 401(k) Plans

Financial assets in private sector defined benefit and defined contribution plans (including IRAs) totaled \$8.5 trillion at the end of 2005 (see Table 1). At that time, defined benefit assets accounted for only 23 percent of the total, while self-directed defined contribution plans and IRAs made up the rest. Thus, the question of how individuals fare when investing their own retirement funds is an important one.

TABLE 1. PRIVATE SECTOR RETIREMENT ASSETS, YEAR END 2005

Type of plan	Billions of dollars	Percent of total
Defined benefit	\$1,916.5	22.7%
Defined contribution	2,868.7	33.9
IRAs	3,667.0	43.4
Total	8,452.2	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The first step in assessing the performance is to compare median annual rates of return for defined benefit and 401(k) plans. The analysis focuses on companies that sponsor both types of plans to minimize the effect of company or participant characteristics on the results.¹ The formula for calculating rate of return is one commonly used by actuaries.² It relates the change in assets ($A_t - A_{t-1}$), netting out the impact of benefit payments from the plan (B) and contributions to the plan (C), to initial assets (A_{t-1}) plus half of net inflows (C - B):

$$\text{Rate of return} = \frac{(A_t - A_{t-1}) + B - C}{(A_{t-1}) + \frac{1}{2}(C - B)}$$

The Department of Labor's Form 5500 filings provide data on assets, contributions, and benefits for each plan over the period 1988-2004.³

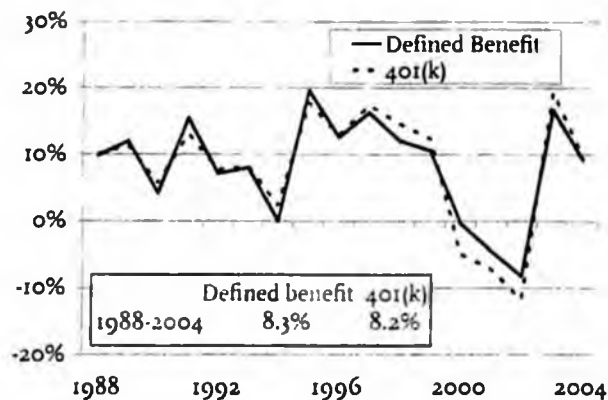
Returns, even median returns, can be calculated in a number of ways. The analysis presented below starts with the simplest approach, and one used in earlier studies, that arrays the plans and reports the return for the plan at the 50th percentile. In terms of the example shown below, the median rate of return would be 5 percent. One obvious question is whether comparing median rates of return is the right exercise, since three-quarters of the total assets in the example are in Plan A earning 10 percent. An alternative measure would be one that weighted returns by plan assets, and then identified the median. Such an approach would yield a return of 10 percent in this example. In our view, this is the preferred approach, although both results are reported below.

EXAMPLE: UNWEIGHTED VERSUS WEIGHTED MEDIANS

Plan	Assets	Rate of return
Plan A	\$75	10%
Plan B	20	5
Plan C	5	2

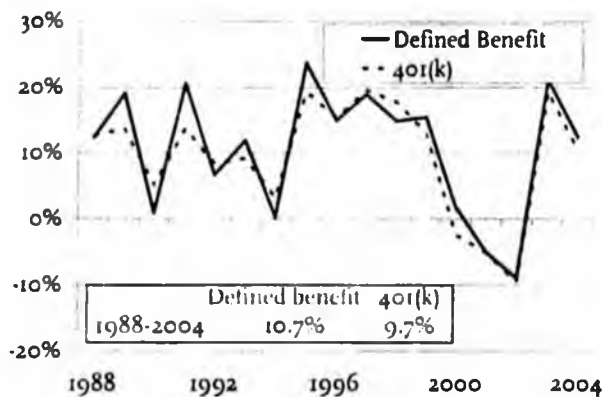
Figure 1 shows the simple medians over the period 1988-2004.⁴ During the period, the average of this measure suggests that the performance of defined benefit and 401(k) plans is virtually identical — 8.3 percent versus 8.2 percent.⁵

FIGURE 1. UNWEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

FIGURE 2. WEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

Figure 2 recalculates rates of return weighting returns by assets in the plan. Two factors change. First, the returns are higher. Second, defined benefit plans appear to have outperformed 401(k) plans by one percentage point (10.7 percent versus 9.7 percent).

The higher return reflects the fact that larger plans have historically performed better than smaller ones (see Table 2). The usual explanation is that large plans can hire better managers and spread fees over a larger base. Size matters much less for 401(k) plans, because the outcome reflects a myriad of individual investment decisions.

TABLE 2. MEDIAN RATES OF RETURN BY ASSET QUANTILE FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004

Asset quintile	Defined benefit	401(k)
Largest 20 percent	10.1%	8.8%
Second	8.9	8.1
Third	8.2	7.8
Fourth	7.4	7.6
Smallest 20 percent	5.6	6.6

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

The Impact of Portfolio Allocation

One question is the extent to which portfolio differences can explain differences in rates of return. Based on historical performance, stocks have a high yield and big fluctuations in annual rates of return; corporate bonds have a lower yield and much less variation; Treasury bills are the most predictable investment but provide the lowest return (see Table 3).

TABLE 3. ANNUAL TOTAL RETURNS ON VARIOUS FINANCIAL INSTRUMENTS, 1926-2005

Financial instrument	Rate of return	Standard deviation
Stocks	10.4%	20.2%
Long-term corporate bonds	5.9	8.5
Intermediate government bonds	5.3	5.7
U.S. Treasury bills	3.7	3.1
Inflation	3.0	4.3

Source: Ibbotson Associates (2006). Based on copyrighted works by Ibbotson and Sinquefeld. All rights reserved. Used with permission.

Table 4 shows a breakdown by type of investment for both defined benefit and defined contribution plans.⁶ Defined benefit plans appear to hold about 59 percent of assets in equities, compared to 35 percent for defined contribution plans.⁷ But that is not the end of the story because mutual funds also reflect equity holdings, and mutual funds are a very important component of the assets of defined contribution plans. In 2005, roughly 78 percent of the mutual fund assets in 401(k) plans were equities.⁸ Applying that percentage to both the defined benefit and defined contribution mutual fund numbers yields total equity holdings of 67 percent in defined benefit plans and 65 percent in defined contribution plans.

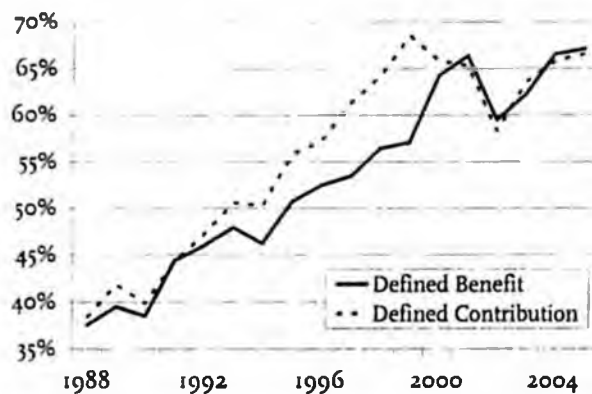
TABLE 4. PERCENTAGE DISTRIBUTION OF ASSETS IN PRIVATE SECTOR DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, YEAR END 2005

Financial instrument	Defined benefit	Defined contribution
Equities	58.8%	35.2%
Mutual funds	10.6	18.5
Bonds	21.9	6.7
Cash	3.1	4.5
GICs	3.6	8.7
Other	2.0	6.4
Total	100.0	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

Figure 3 shows the percentage of the portfolios in equities for defined benefit and defined contribution plans over the period 1988-2005, where a portion of mutual funds are included in equities as described above. The higher share in equities for defined contribution plans in the late 1990s allowed 401(k) plans to outperform defined benefit plans. The reliance on equities also meant that 401(k) participants were hurt more when the stock market collapsed in 2000, and then did better when the stock market recovered.

FIGURE 3. EQUITIES AS A PERCENT OF TOTAL PORTFOLIO, DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, 1988-2005



Sources: Authors' calculations from U.S. Board of Governors of the Federal Reserve System (2006); Investment Company Institute (2005); and Investment Company Institute (2006b).

One interesting aspect of Figure 3 is not the difference between the defined benefit and defined contribution portfolios, but the fact that both professional managers and individual 401(k) participants dramatically increased their holdings of equities over the period. If defined benefit portfolios were optimally balanced in the early 1990s with about 40 percent in equities, what would make 65 percent optimal by the end of the period? In the case of defined benefit plans, an aging beneficiary population would argue, if anything, for less equity investment. Some potential explanations include: 1) professional managers, like individual investors, forgot to re-balance; 2) professional managers, like individual investors, got swept up in the euphoria of the boom and purposely increased their holdings of stocks; 3) sponsors of fully funded defined benefit plans felt like they could gamble with their "surplus" funds; or 4) defined benefit managers wanted to hold the market portfolio and the boom caused equities to increase as a share of the total market. Regardless of the explanation, defined benefit and defined contribution plans both held 40 percent of their portfolios in equities in 1990 and increased their holdings to 65 percent by 2000. The difference is that during most of that period, individual 401(k) investors had higher equity holdings.

The Role of Fees

Another possible explanation for the lower return in defined contribution plans is investment fees, which typically account for 75 to 90 percent of total expenses associated with managing 401(k) plans.⁹ These fees compensate providers of, say, mutual funds for selecting the stocks and undertaking the research that leads to buy and sell decisions. These fees are usually assessed as a percentage of invested assets, and are paid by the employee in that they are deducted directly from investment returns.¹⁰

Mutual funds are the major investment vehicle for 401(k) participants, and Table 5 reports the fees for alternative investments. The fees vary substantially depending on whether the investments are actively managed or follow an index. For example, an actively managed Global Fund costs 1.72 percent of assets annually compared to 0.59 percent for an S&P Index Fund. Given these charges, it is probably reasonable to assume that fees reduce the gross return on 401(k) plans by about one percentage point.

Of course, defined benefit plans also involve some expenses but these are small compared to those associated with 401(k) plans.¹¹

TABLE 5. MUTUAL FUND FEES AS A PERCENT OF ASSETS.
JULY 31, 2006

Category	Fee
Global Fund	1.72%
Equity Income Fund	1.33
Balanced Fund	1.22
Intermediate Bond Fund	0.92
S&P Index Fund	0.59
Institutional Money Market Fund	0.45

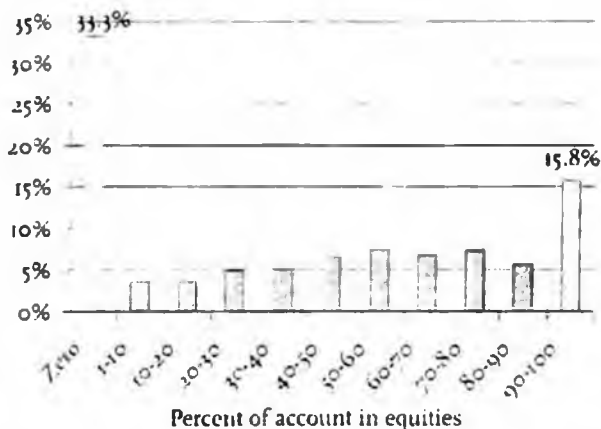
Source: Lipper (2006).

The Implications for Individual 401(k) Participants

So far the discussion has focused only on totals and averages, which tell us little about how individuals might invest. After all, if a plan has 100 participants and half invest all their assets in stocks and the other half all their assets in bonds, the aggregate data suggest that participants are well diversified when in fact they are not. Therefore, it is useful to look at investment data from particular 401(k) plans to see whether the individual participants have balanced portfolios or whether the balance simply reflects offsetting behavior.

As shown in Figure 4, detailed data on the asset allocation of individual participants show that nearly half of all participants have either none of their ac-

FIGURE 4. EQUITIES AS A PERCENT OF 401(k) PARTICIPANT ACCOUNT BALANCES BY PERCENT OF PARTICIPANTS, 2005



Source: Holden and VanDerhei (2006).

count in equities or virtually all of their account in equities. So even though the aggregate data suggest that participants make sensible investment choices on average, the individual data reveal that a majority of participants are not diversified at all. Given their choices, most participants face the risk of ending up with inadequate retirement income or exposing themselves to large swings in the value of their assets.¹² Thus, the one percentage point difference in returns between defined benefit and 401(k) plans understates the poor investment decisions made by individuals.

TABLE 6. ASSET HOLDINGS AND IRAs BY INSTITUTION, YEAR END 2005

Institution	Percent of total
Mutual funds	39.0%
Life insurance companies	11.1
Money market mutual funds	4.4
Commercial banking	4.6
Saving institutions	1.5
Credit unions	1.3
Other self-directed accounts	38.0
Total	100.0
Memorandum: total assets (billions)	\$3,667.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The Inclusion of IRAs

It has become impossible to ignore the role of IRAs. As shown earlier in Table 1, IRAs now hold more money than either defined benefit or defined contribution plans. And even though most IRAs are not sponsored by employers, the Investment Company Institute (2006b), the national association for mutual fund companies, reported that 94 percent of the money flowing into traditional IRAs was rolled over from employer-sponsored plans in the period 1997-2003.¹³ Although detailed information is not available, it is probably reasonable to assume that most of the rollovers come from defined contribution plans — although lump-sum payments are becoming increasingly common in defined benefit plans.

Only limited information is available on the asset allocation in IRAs. The Flow of Funds data show only the type of institution holding the account, as opposed to the type of asset in the account (see Table 6). About 73 percent of the mutual fund assets — the

largest component — are in stock.¹⁴ But no information is available on the composition of IRA assets held by other institutions, which hold the majority of the assets.

The Investment Company Institute (2006a) provides data on beginning-year assets, year-end assets, contributions, rollovers, and withdrawals for traditional IRAs that make it possible to calculate the aggregate average return for the period 1998-2003. Table 7 summarizes these results and compares them to returns earned on defined benefit and 401(k) plans over the same period. If estimates of the flows into and out of IRAs are correct, the rate of return numbers suggest that IRA investments produced significantly lower returns than either defined benefit or 401(k) plans during the six-year period.¹⁵ More important than the precise numbers, however, is the message that the performance of IRAs will have a significant impact on the retirement security of people in the future.

TABLE 7. RATE OF RETURN FOR IRAs, DEFINED BENEFIT PLANS AND 401(k)s, 1998-2003

Year	IRA	Defined benefit	401(k)
1998	13.6 %	14.9 %	17.8 %
1999	15.7	15.5	13.1
2000	-6.0	1.8	-2.4
2001	-4.6	-5.1	-5.1
2002	-8.1	-8.9	-9.5
2003	12.1	21.2	19.4
1998-2003	3.8	6.6	5.6

Source: Authors' estimates based on Investment Company Institute (2006a).

Conclusion

Three main conclusions emerge from this review. First, defined benefit plans outperformed 401(k) plans over the period 1988-2004. This conclusion is most evident using the weighted median. A higher equity allocation most likely led to higher 401(k) returns during the 1990s, while fees inevitably reduced returns. These two effects may well have balanced each other out, leaving a one percentage point shortfall due to poor timing and other investment mistakes.

Second, lower returns are only one component of the investment problems facing 401(k) investors. The other is that despite a reasonable mix for 401(k) assets in the aggregate, nearly half of 401(k) participants are either nearly fully invested in stocks or hold no stocks at all. That is, nearly 50 percent of participants are not diversified in their retirement accounts. The combination of the lack of diversification and the lower returns suggests that introducing balanced portfolios as a default, which would remove the individual from the decision making, would significantly improve the performance of 401(k) plans.

Finally, IRAs are now bigger than either defined benefit or defined contribution plans, and their performance is going to have a major impact on retirement security in the future. Preliminary data suggest that IRAs underperform employer-sponsored plans. IRAs are too big and important a form of retirement saving to not know what is going on with these accounts. Some mechanism is needed to identify the asset allocations in these accounts as well as document the inflows and outflows. Only by including IRAs will it be possible to understand fully how well people are investing for retirement.

Endnotes

- 1 This formulation follows Watson Wyatt (2002 and 2003). Calculations for the entire universe of plans showed very similar results.
- 2 Including one half of contributions less benefits assumes that net inflows occur at an even rate over the year so that on average half the annual net inflows are available for investment. This assumption is necessary because the Form 5500 lacks detailed information on the timing of benefits and contributions over the year.
- 3 See Buessing and Soto (2006) for a detailed description of the Form 5500 data.
- 4 The median refers to the across-firm rates of return per year for defined benefit and defined contribution plans. The average returns shown are the arithmetic means of the median rates of return over the period 1988-2004. The geometric means do not differ widely from the arithmetic means calculated for the unweighted and weighted median rates of return. Appendix Table A1 shows the unweighted and weighted median rates of return as well as the arithmetic and geometric means.
- 5 For the 1990-2002 period, the results are similar to results from Watson Wyatt (2004) with defined benefit plans outperforming 401(k) plans. The difference in defined benefit and 401(k) returns is 0.35 percent while Watson Wyatt showed a difference of 0.56 percent for this period. The improved performance of 401(k)s over the 1988-2004 period comes simply from adding four more years of data to what was a very close outcome.
- 6 Separate data on 401(k) plans are not available on a comparable basis. But in 2004, 401(k) assets accounted for 88 percent of total private sector defined contribution assets for plans sponsored by employers with 100 or more employees. See Munnell and Perun (2006).
- 7 Since most 401(k) participants invest through mutual funds, the high number for "Equities" for defined contribution plans (that is, direct equity holdings as opposed to equities held through mutual funds) in Table 4 is surprising. The explanation is that "Equities" include pools of stocks that companies set up themselves for their 401(k) plans; only mutual funds bought off the shelf are included in the mutual fund line. The other large category of direct equity holdings is employer stock. The final category of direct equity investment arises from a relatively small percentage of 401(k) participants who invest directly through brokerage accounts.
- 8 Investment Company Institute (2006a).
- 9 Munnell and Sundén (2004).
- 10 Fees are generally not explicitly reported in the Form 5500. See U.S. Department of Labor (2004).
- 11 Council of Institutional Investors (2005).
- 12 Of course, critics contend that assessing individuals' 401(k) holdings without knowing their entire asset holdings is of limited value. They argue that most people who save through a 401(k) plan also have Social Security, human capital, defined benefit pension wealth, housing, and taxable savings. But for most people taxable savings are miniscule, and their 401(k) plan is their major financial asset. Thus the investment allocation within their 401(k) plan is important.
- 13 In 2005, assets in traditional IRAs accounted for 90 percent of total IRA assets. This share was down slightly from 95 percent in 1997.
- 14 Investment Company Institute (2006a).
- 15 One likely explanation for the lower returns in IRAs is that IRAs are often held by older workers who have rolled over their 401(k) assets. Older workers tend to invest in assets with lower returns to avoid the potentially large fluctuations that are associated with riskier investments.

References

- Buessing, Marris and Mauricio Soto. 2006. "The State of Private Pensions: Current 5500 Data." *CRR Issue in Brief* 42. Chestnut Hill, MA: Center for Retirement Research at Boston College.
- Council of Institutional Investors. 2005. "Protecting the Nest Egg: A Primer on Defined Benefit and Defined Contribution Retirement Plans." Washington, DC.
- Holden, Sarah and Jack VanDerhei. 2006. "Appendix: Additional Figures for the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project for Year-End 2005." *Perspective* 12(1A). Washington, DC: Investment Company Institute.
- Ibbotson, Roger G. and Rex A. Sinquefeld. 2006. *Stocks, Bonds, Bills, and Inflation*. Chicago: Ibbotson Associates, Inc.
- Investment Company Institute. 2006a. "The U.S. Retirement Market, 2005." Washington, DC.
- _____. 2006b. "Personal Communication with ICI Senior Economist Sarah Holden." Washington, DC.
- _____. 2005. "Appendix: Additional Data on Mutual Funds and the U.S. Retirement Market in 2004." *Fundamentals* 14(4A): 1-12.
- Lipper. 2006. "Personal Communication with Derek D. Lewis." New York, NY.
- Munnell, Alicia H. and Pamela Perun. 2006. "An Update on Private Pensions." *CRR Issue in Brief* 50. Chestnut Hill, MA: Center for Retirement Research at Boston College.
- Munnell, Alicia H. and Annika Sundén. 2004. *Coming up Short: The Challenge of 401(k) Plans*. Washington, DC: Brookings Institution Press.
- U.S. Board of Governors of the Federal Reserve System. 2006. *Flow of Funds Accounts of the United States: Flows and Outstandings, 1985-2006*. Washington, DC.
- U.S. Department of Labor, Employee Benefits Security Administration, Office of Participant Assistance. 1990-2006. *Annual Return/Report Form 5500 Series of Plan Years 1988-2004*. Washington, DC: U.S. Government Printing Office.
- U.S. Department of Labor, Employee Benefits Security Administration. 2004. *Report of the Working Group on Plan Fees and Reporting on Form 5500*. Washington, DC: U.S. Government Printing Office.
- Watson Wyatt. 2004. "Defined Benefit vs. 401(k): The Returns for 2000-2002."
- _____. 2003. "Defined Benefit vs. 401(k): An Updated Analysis."
- _____. 2002. "Defined Benefit vs. 401(k): The Surprising Results."

APPENDIX

Appendix A

TABLE A1. UNWEIGHTED AND WEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(k) PLANS, 1988-2004

Year	Unweighted		Weighted	
	Defined benefit	401(k)	Defined benefit	401(k)
1988	9.8	10.1	12.4	12.7
1989	12.0	11.3	19.1	13.7
1990	4.2	5.7	1.0	5.2
1991	15.4	13.1	20.6	13.7
1992	7.1	7.7	6.8	8.5
1993	8.0	8.2	11.9	9.2
1994	0.0	2.3	0.3	3.2
1995	19.6	17.8	23.7	19.3
1996	12.6	12.9	15.0	15.4
1997	16.3	17.4	19.0	19.6
1998	12.1	14.6	14.9	17.8
1999	10.6	12.4	15.5	13.1
2000	-0.3	-4.9	1.8	-2.4
2001	-4.4	-7.1	-5.1	-5.1
2002	-8.2	-11.7	-8.9	-9.5
2003	16.7	19.4	21.2	19.4
2004	9.3	9.7	12.5	10.5
Arithmetic Mean	8.3	8.2	10.7	9.7
Geometric Mean	8.0	7.8	10.2	9.3

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

AN ISSUE IN BRIEF
CENTER FOR
RETIREMENT
RESEARCH
AT BOSTON COLLEGE

About the Center

The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future.

To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

Affiliated Institutions

American Enterprise Institute
The Brookings Institution
Center for Strategic and International Studies
Massachusetts Institute of Technology
Syracuse University
Urban Institute

Contact Information

Center for Retirement Research
Boston College
Fulton Hall 550
Chestnut Hill, MA 02467-3808
Phone: (617) 552-1762
Fax: (617) 552-0191
E-mail: crr@bc.edu
Website: <http://www.bc.edu/crr>

The Center for Retirement Research thanks AARP, AIM Investments, AXA Financial, Citi Street, Fidelity Investments, John Hancock, Nationwide Mutual Insurance Company, Prudential Financial, Standard & Poor's and TIAA-CREF Institute for support of this project.

© 2006, by Trustees of Boston College, Center for Retirement Research. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that the authors are identified and full credit, including copyright notice, is given to Trustees of Boston College, Center for Retirement Research.

The research reported herein was supported by the Center's Partnership Program. The findings and conclusions expressed are solely those of the authors and do not represent the views or policy of the partners or the Center for Retirement Research at Boston College.

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SB 183
 () Publish Date: _____

Identifier (file name): SB183-DOA-DRB-2-15-08 Dept. Affected: Administration
 Title: "An Act repealing the defined contribution retirement plans..." RDU: Centralized Administrative Services
 Component: Division of Retirement and Benefits
 Sponsor: ELTON, McGuire, Ellis, Wielechowski
 Requester: _____ Component Number: 64

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous		346.6	0.0	298.8	254.0	281.0	284.0	267.0
TOTAL OPERATING		346.6	0.0	298.8	254.0	281.0	284.0	267.0

CAPITAL EXPENDITURES								
-----------------------------	--	--	--	--	--	--	--	--

CHANGE IN REVENUES ()								
-------------------------------	--	--	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF		346.6	0.0	298.8	254.0	281.0	284.0	267.0
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other Interagency Receipts								
TOTAL		346.6	0.0	298.8	254.0	281.0	284.0	267.0

Estimate of any current year (FY2008) cost: 1,267.4

POSITIONS

Full-time								
Part-time								
Temporary								

ANALYSIS: (Attach a separate page if necessary)

Currently, those who join a PERS or TRS employer are enrolled in the defined contribution retirement (DCR) plan (PERS Tier IV and TRS Tier III). This bill would allow those current members and new members to choose between enrolling in the defined benefit (DB) plan or the DCR plan. There are currently 6,157 DCR members who are currently (active) employees. Since the inception of the DCR plan, and based on the number of members who converted from the DB plan to the DCR plan during the choice period created when the DCR plan was created (SB 141), the Division estimates that up to 75% of the members would enroll in the DB plan.

(continued on second page)

Prepared by: Pat Shier, Director
 Division: Division of Retirement and Benefits
 Approved by: Rachael Petro, Deputy Commissioner
Department of Administration

Phone 465-4817
 Date/Time 2/15/08 12:00 AM
 Date 2/15/2008

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

BILL NO. SB 183

ANALYSIS CONTINUATION

This bill information is based on the likely scenario of a PERS cost share program proposed in SB 125. Under a cost share plan the State assumes a greater share of the risk and cost for PERS. TRS is already a cost share plan.

Buck Consultants used data from the most recent draft retirement system valuation for the period ending June 30, 2007. The assumptions, plan provisions, and methods used are also from the same draft actuarial valuation report. The above numbers represent the net increased cost to the State of Alaska if 75% PERS / TRS eligible members choose the defined benefit (DB) plan.

Included in the costs are the effects of adverse selection, expected when new employees closer to retirement age choose the DB plan in greater proportion than younger employees. The DB plan cost for these older employees is higher because there is a shorter time to accumulate the assets needed to pay for the benefit.

The sums also contemplate the effect of recent favorable healthcare experience for both PERS and TRS, and the relatively higher employer contribution of 7% of payroll for the TRS DCR plan. A year or two of more typical health cost experience (less favorable) would affect DB costs much more significantly than DCR costs. Unfavorable health cost experience was a significant contributing factor in the move to the DCR plan through SB 141.

The sums consider that investment, mortality and health care cost risks are borne by the employer in a DB plan. This risk causes volatility over the short-term in determining the annual cost that will sufficiently meet the long-term benefit obligation, due in large part to the significant risk associated with DB health care plan design. The employer contribution rates in the DCR plan are not subject to this short-term volatility due to the design of the DCR health plan and because the members bear more of the risk in the DCR plan. As a result, employer DCR contribution rates are stable and not subject to volatility.

There are additional costs associated with conversion of the Division's Combined Retirement System (CRS) database which accounts for employer and employee contributions. Moving to a system which accommodates member choice is not particularly difficult but converting any existing DCR members will require extensive manual processing. The Division has estimated a significant amount of contractor time for adding choice elements to the CRS system because core staff is otherwise engaged, and the Division has recently lost some expertise in the legacy system. The preliminary estimate is nearly \$1.3 million and will be required in FY08 so that changes can be made to accommodate a July 1, 2008 effective date.

Section 26 of the bill prescribes a method of converting DCR time and contributions to DB time in service. This process will require an actuarial valuation for each individual's conversion, and cannot be determined accurately at this time.