

Revisiting the Defined Benefit & Defined Contribution Debate

Alliance for Retired Americans

November 20, 2019

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NIRS is a non-profit, nonpartisan
research organization.



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***The American Pension Crisis
an Alliance for Retired Americans Seminar
November 19-20, 2019***

About Us

The National Institute on Retirement Security was created in 2008. We are a non-profit, non-partisan research organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers and the economy.

Located in Washington, D.C., NIRS' diverse membership includes financial institutions, actuarial firms, employee benefit plans, trade associations, and other retirement service providers.



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Sample of NIRS Research



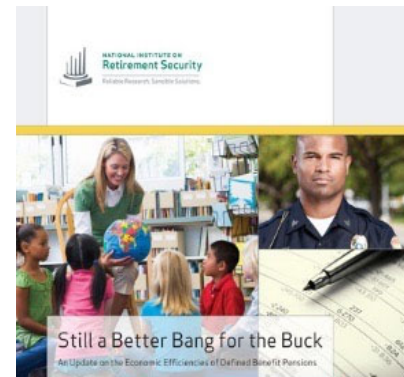
NIRS research is available at: <https://www.nirsonline.org/research/>



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Pensions are More Efficient

- “Still A Better Bang for the Buck” (2014): Defined Benefit (DB) plans cost 48% less than a Defined Contribution (DC) plan to provide equivalent retirement benefits.
- Study help address tendency to conflate “saving money” with shifting risk, shifting cost and cutting benefits.
- This study - updated assumptions, methodology to reflect changing retirement benefit landscape
 - DC plans: lower fees, increased use of Target Date Funds (TDFs).
 - DB asset allocation changes.



DB Plan Strength # 1

Longevity Risk Pooling

- Because they cover large numbers of retirees, DB plans can be funded to last the **average life expectancy** for each person, yet pay monthly benefits to each retiree as long as she lives.
- An individual under a DC plan will want to avoid the risk of running out of money if they live a long life.
- Because individuals must plan for significantly longer than average life expectancy, more money must be accumulated in a DC plan compared to a DB plan.



DB Plan Strength #2

Maintenance of Portfolio Diversification

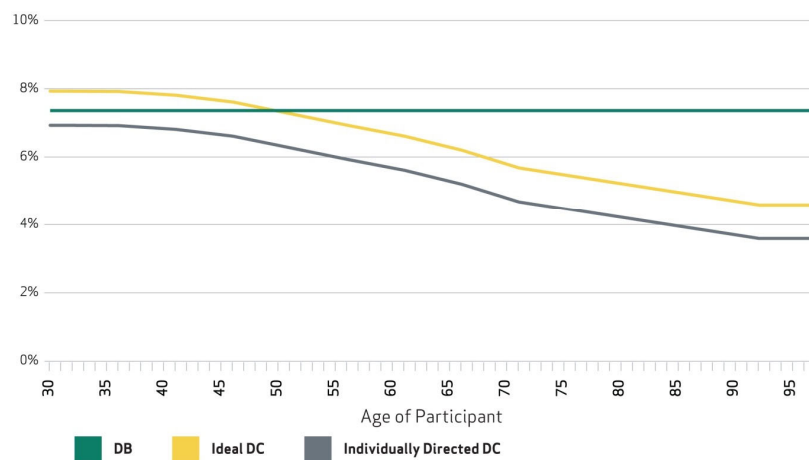
- DB plans can maintain a well diversified portfolio over time – unlike individuals who must adjust risk as they age.
- To protect against market shocks, individuals in DC plans are advised to shift toward more conservative investments as they age, sacrificing some expected return.
- We modeled typical TDF asset allocation until age 71, then gradual shift to 100% fixed income by age 92.
- Lower returns mean more money must be contributed to deliver the same level of benefits.



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As Individuals Shift DC Portfolio Allocation, Expected Return Reduced

Figure 6: Expected Annual Investment Return (Net of Fees)



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DB Plan Strength #3 Lower Fees & Professional Management

Pooled investments in DB plans can lower expenses

- Large group pricing negotiation.
- Avoid expenses of individual record keeping, investment education, investment transactions.



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Lower Fees & Professional Management (cont.)

- While DB plan investments are professionally managed, individuals tend to underperform
 - Individual investor level returns lag behind long-term returns for any asset class, and most mutual funds.
 - Failure to re-balance, poor timing
 - “Behavioral drag” estimates range from 98 bp to over 200 bp.
- 2014 study is based on additional 1.00%, like 2008 study,
 - 40 bp additional DC expenses, industry average
 - Optimistic 60 bp for “behavioral drag” (individual v fund skill)



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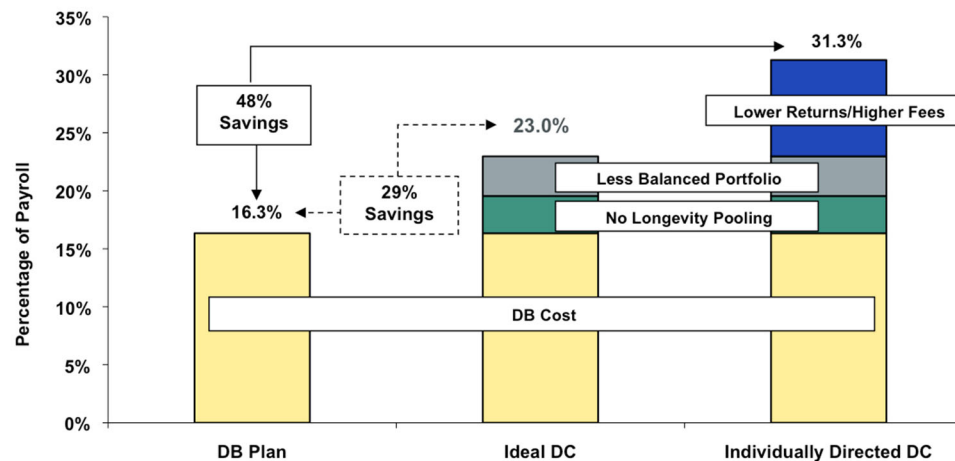
Study Compares Three Plans:

- **DB plan**
 - Asset allocation and fees typical of large public plan.
- **Individually directed DC plan**
 - Target Date Fund (TDF) glide path from equities to fixed income.
 - Industry average fees, modest “behavioral drag.”
- **“Ideal” DC plan**
 - TDF asset allocation glide path.
 - Same fees as DB, no behavioral drag (no individual choice).



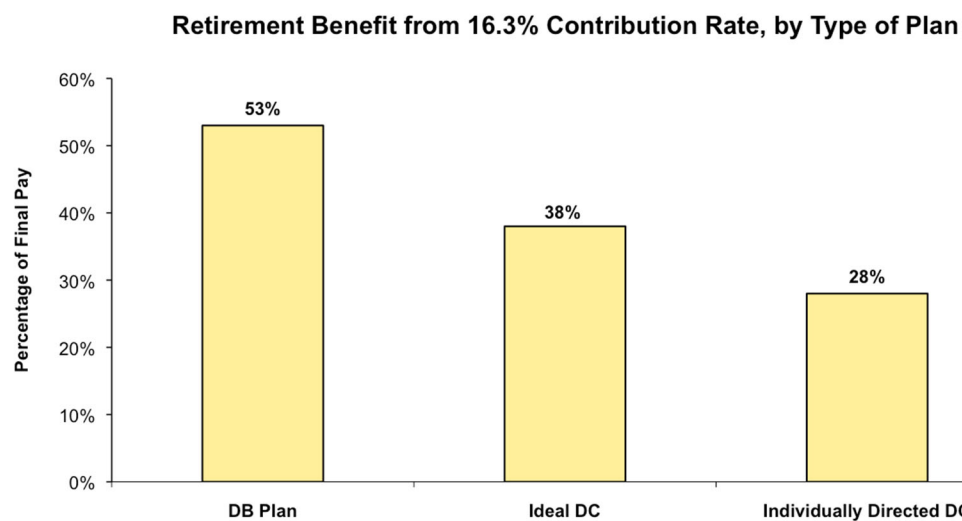
Summary: DB Plan Can Still Deliver Same Benefit at About Half the Cost of DC Plan

Figure 1: Cost of DB & DC Plans as Percentage of Payroll



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Comparison of Benefit Levels for Same Cost

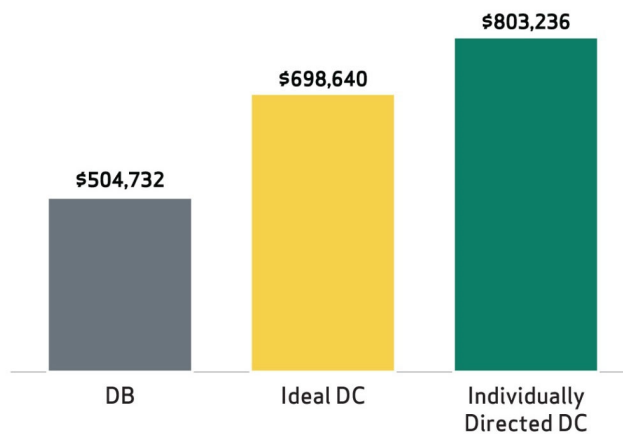


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DB Plan Advantage Significant Post-Retirement

Figure 7:
**Per Employee Amount Required at Age 62
DB Plan vs. DC Plan**



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Conclusions

1. DB plans have built-in economic efficiencies – provide a “better bang for the buck.”
2. These efficiencies drive significant cost savings for taxpayers and employers.
3. Decision makers should continue to carefully evaluate claims that “DC plans will save money.”

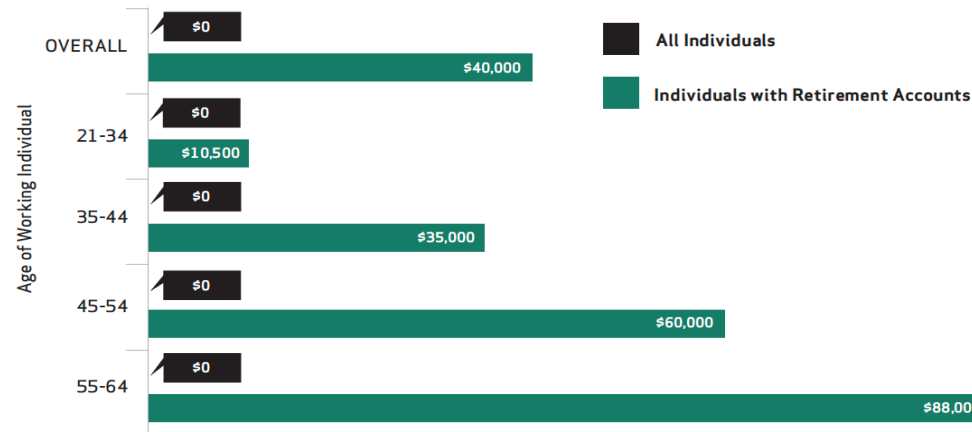


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Savings are Inadequate

Figure 7: Typical Working Age Individual Has \$0 in Retirement Account Assets; Among Individuals with Positive Retirement Accounts, the Median Balance is \$40,000

Median retirement account balance of working age individuals with positive retirement account balances versus median account balances for all working age individuals



Source: Authors' analysis of SIPP 2014, Wave 1 data. Universe is individuals age 21-64. Retirement account ownership status reported for December 2013. Numbers are weighted using final person weight. DB plan ownership is not accounted for.

Source: NIRS Retirement in America: Out of Reach for Most Americans?
at: https://www.nirsonline.org/wp-content/uploads/2018/09/SavingsCrisis_Final.pdf

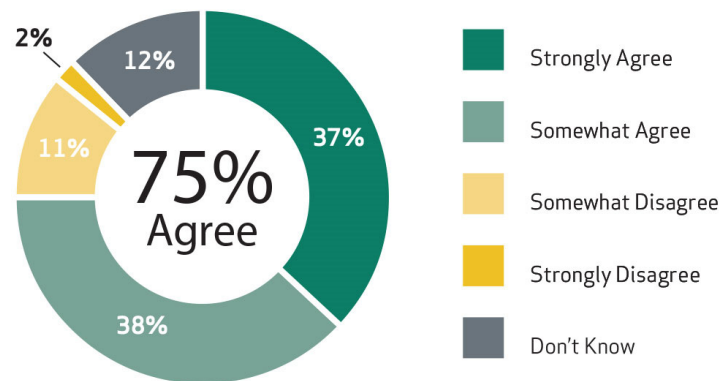


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Americans agree that the nation faces a retirement crisis

Figure 1: **Three-fourths of Americans say the nation faces a retirement crisis.**

To what extent you agree or disagree with the following statement:
America is facing a retirement crisis.



Source: Retirement Insecurity 2019:
www.nirsonline.org/reports/retirement-insecurity-2019-americans-views-of-the-retirement-crisis/

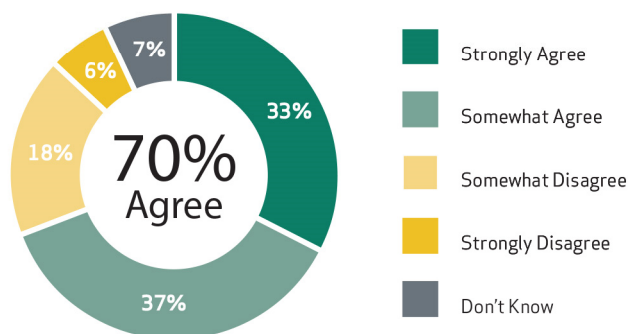


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70% say that workers can't prepare for retirement on their own

Figure 3: **70% say the average worker cannot save enough on their own to guarantee a secure retirement.**

To what extent you agree or disagree with the following statement: The average worker cannot save enough on their own to guarantee a secure retirement.



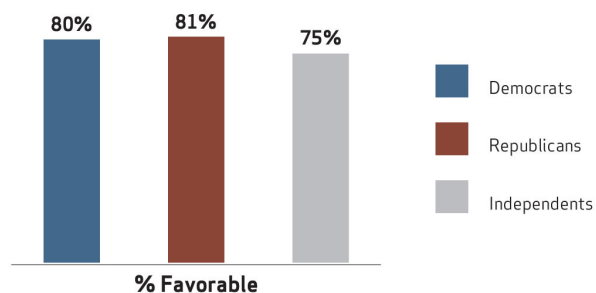
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Source: Retirement Insecurity 2019:
www.nirsonline.org/reports/retirement-insecurity-2019-americans-views-of-the-retirement-crisis/

Strong favorability for pensions across party lines

Figure 17: Across party lines, Americans have highly favorable views about pensions.

"Traditional pension plans" refers to a retirement plan where you receive a regular monthly check in retirement where the payment amount is based on your salary at retirement and how many years you worked. This is sometimes called a defined benefit pension (DB) plan or a group retirement plan. How would you describe your overall view of this type of pension?



Source: Retirement Insecurity 2019:

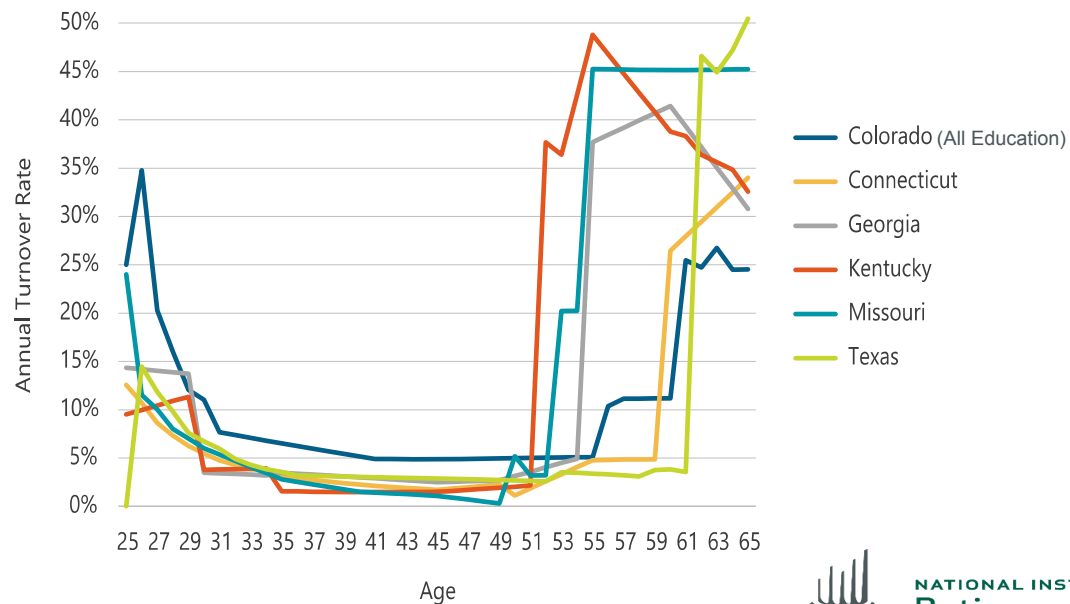
www.nirsonline.org/reports/retirement-insecurity-2019-americans-views-of-the-retirement-crisis/



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Pensions Help Deliver strong Mid-career Retention

Figure 3
Annual Turnover Rates for Teachers Hired at Age 25



Source: Teacher Pensions Vs. 401k's in Six States:
<https://www.nirsonline.org/reports/teacher-pensions-vs-401k/>



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Result: Career Employment Becomes Commonplace

Table 4
Projected Teacher Age and Service Years at Exit

Teacher Pension Plans	Median Service Years	Median Age	% with 20+ Service Years
Colorado	17	57	43%
Connecticut	28	60	76%
Georgia	23	57	59%
Kentucky	26	54	63%
Missouri	27	55	73%
Texas	26	62	67%
6-State Average	25	58	65%

Note: Authors' analysis based on retirement system active membership data and actuarial assumptions as of FY 2017. 6-state averages are weighted by teacher membership count.

Source: Teacher Pensions Vs. 401k's in Six States:
<https://www.nirsonline.org/reports/teacher-pensions-vs-401k/>



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Personal Observations

- 401k Inefficiencies will grow as demographics change
- Start money managing career in your 60's, while exiting fiduciary protections?
- If DC plans were replacing DB plans, asset ownership would be widespread. Instead, we see increased concentration.
 - ➔ Are DC plans replacing DB, or for a different group?
- Union members often have DB plans (large, public, industry)
- Cognitive decline



What Could Go Wrong?

POLITICO

From Hawaii to Italy, free trips fuel retirement savings sales push

By **PATRICK TEMPLE-WEST** | 04/16/2018 10:16 AM EDT

Financial firms that reward salespeople with free vacations for promoting retirement investments — including some high-fee products — are pressing the Securities and Exchange Commission for leniency in a looming rule covering sales practices.

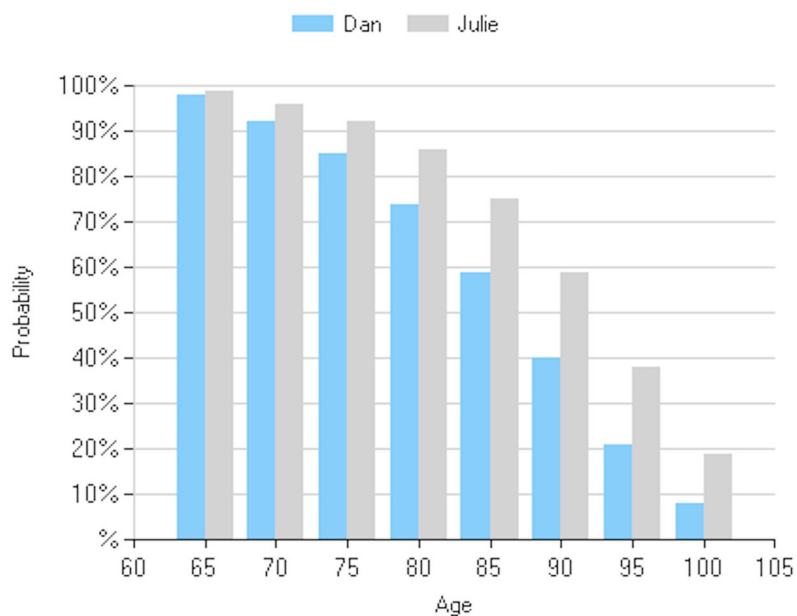
On April 18, the SEC is scheduled to propose new regulations for financial advisers who offer savings products such as mutual funds and variable annuities.



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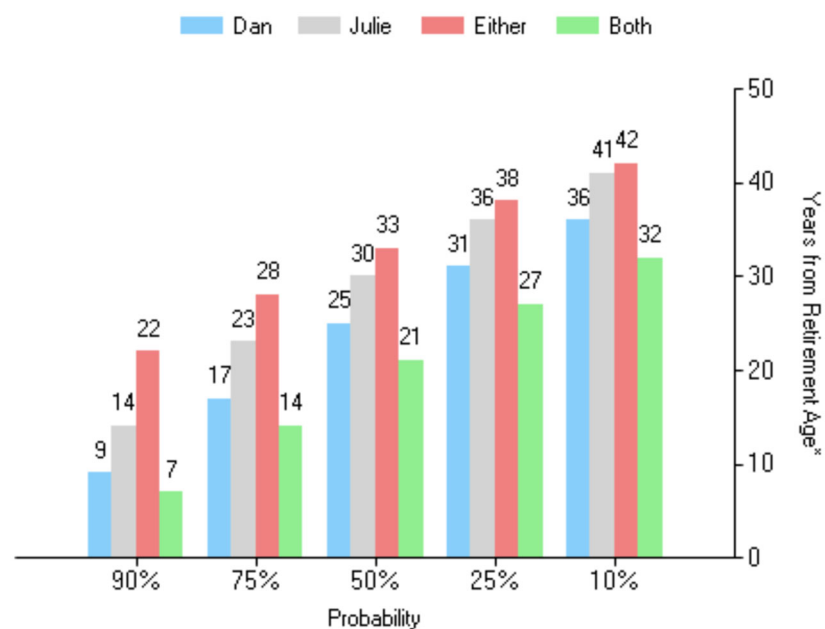
Actuaries Longevity Illustrator



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Decumulation: Master These Probabilities



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Some Signs of Convergence?



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Questions?



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