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State Cash Balance, Defined Contribution and Hybrid Retirement Plans

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This report describes state retirement plans that depart from the traditional public sector model of defined benefit (DB) plans. The overwhelming majority of statewide retirement plans for public employees and for teachers are DB plans. These provide a guaranteed life-time retirement benefit based on an employee's years of service and final salary. Although most state plans require employee contributions, the amount of benefit is not based on contributions. The plans may include post-retirement benefit adjustments, disability and life insurance, and retiree health insurance, although not all do so.

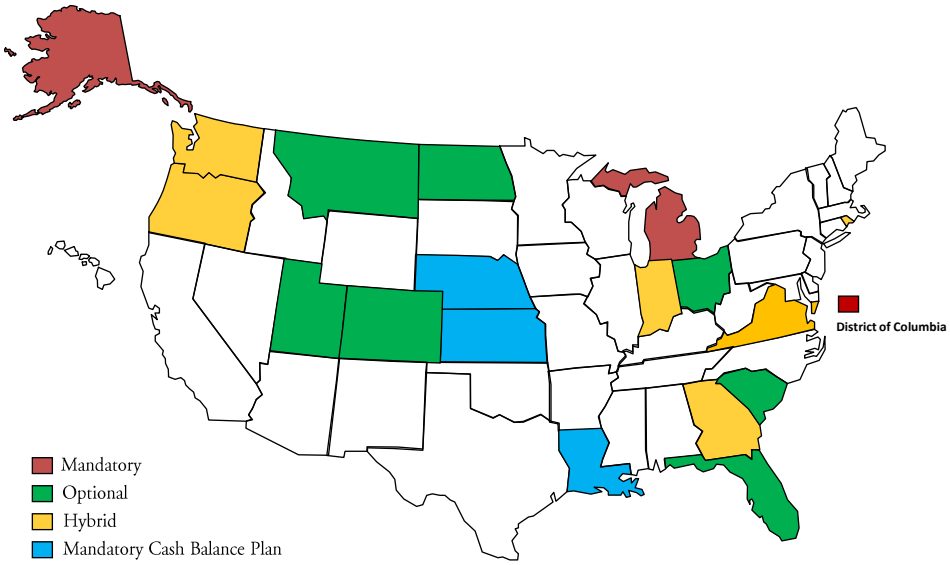
Other models have existed for a long time and have attracted increasing attention in recent years. As long ago as 1967, Nebraska established a defined contribution (DC) plan for state and county employees, similar to 401(k) plans in the private sector. Indiana's public retirement plans have long been what is sometimes called a hybrid plan, in which each member has both a DC and a DB retirement plan.[1] A third model is a cash-balance plan, in which members have individual accounts that carry a guaranteed rate of return and do not require the member to manage investments. Nebraska replaced its DC plan with a cash balance plan in 2002 and Kansas and Louisiana adopted new cash balance plans in 2012.

This report lists state governments plans designed as primary coverage for a state employees or state teachers or both. Primary coverage indicates a plan that eligible employees are required to join, or that is one of two or three alternative plans that employees choose among. Details on the different structures of cash balance, defined contribution and hybrid plans are included below in the discussion of individual state plans. The maps on the following pages indicate where such plans exist.

This report does not include optional deferred compensation plans, like Section 457 plans, which all states offer employees and teachers as a means of augmenting primary pension coverage. Many states have offered defined contribution plans to higher education faculty; this report is not intended to include all such plans.

See National Association of State Retirement Administrators, *NASRA Issue Brief: State Hybrid Retirement Plans* (November, 2011) at
http://www.nasra.org/resources/HybridBrief.pdf

Figure 1. Cash Balance, Defined Contribution and Hybrid Plans for General State Employees



Notes to figure 1:

In most states in the chart, the mandatory or optional plan indicated applies to employees who entered a retirement system after some specified date. Employees hired previously may be under other retirement plan designs. See the state plan descriptions in this document for details.

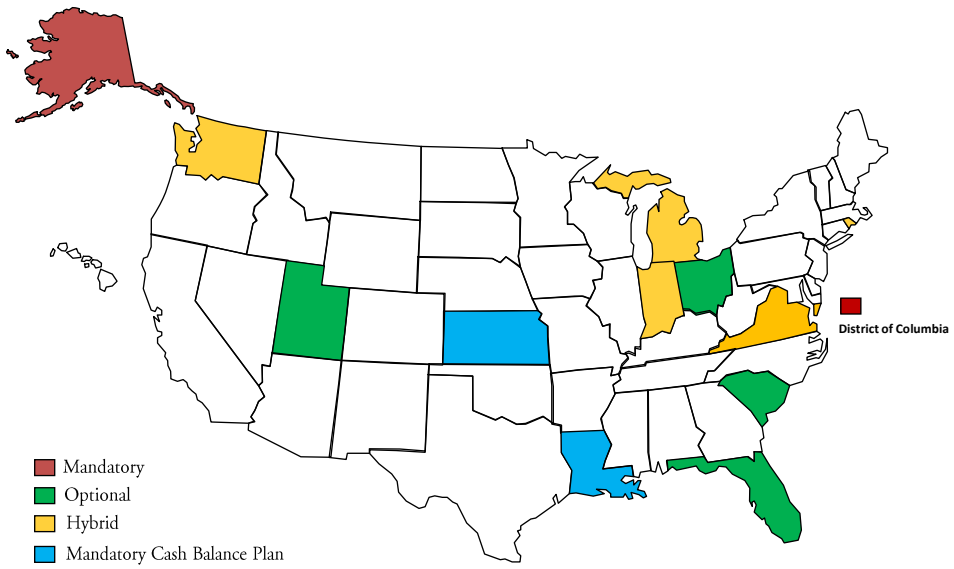
Indiana added an optional DC plan for state employees in 2011.

Kansas in 2012 enacted legislation to create a cash balance plan mandatory for most members of the Kansas Public Employees' Retirement System whose plan membership begins on or after January 1, 2015.

Louisiana in 2012 enacted legislation to create a cash balance plan mandatory for most state employees and post-secondary members of the Teachers' Retirement System whose plan membership begins on or after July 1. 2013. Membership is optional for other members of the Teachers' Retirement System.

Virginia in 2012 enacted legislation to create a hybrid plan for state and local government employees and teachers to include all new employees entering the Virginia Retirement System, other than hazardous duty and law enforcement members, as of January 1, 2014.

Figure 2. Cash Balance, Defined Contribution and Hybrid Plans:
Statewide Teachers' Plans, April, 2012



Notes to Figure 2:

In most states in the chart, the mandatory or optional defined contribution plans and hybrid plans cover employees who entered a retirement system after some specified date. Employees hired previously may be under other plan designs. See the state plan descriptions in this document for details.

Kansas in 2012 enacted legislation to create a cash balance plan mandatory for most members of the Kansas Public Employees' Retirement System whose plan membership begins on or after January 1, 2015. This plan includes teachers.

Louisiana in 2012 enacted legislation to create a cash balance plan that is mandatory for post-secondary members of the Teachers' Retirement System whose plan membership begins on or after July 1. 2013. Membership is optional for other members of the Teachers' Retirement System.

Virginia legislation of 2012 created a hybrid plan for teachers and state and local employees, other than hazardous and law enforcement members, who enter the Virginia Retirement System on or after January 1, 2014.

West Virginia: A West Virginia defined contribution plan for teachers was open for enrollment of members from 1999 to 2005, and has been closed to new members since that time. It is not shown on the map.

Part 1. Cash Balance Plans as Primary Plans

A cash balance plan is a form of hybrid plan that combines elements of DB and DC plans in one plan. In a cash balance plan:

- Each member has an individual account.
- Employees and employers both contribute to the account.
- The member cannot choose how the money is invested.
- Members' accounts are managed in one commingled fund, and members are guaranteed a specified return on their accounts.
- If investment return makes it possible, member accounts can receive additional returns.
- In public plans, upon retirement, the member receives an annuity based on the account balance and may have additional benefit options.

Kansas. In 2012, Kansas enacted legislation to replace its defined benefit plan for most state and local government employees, including education employees, with a cash balance on January 1, 2015. Members will contribute 6 percent of salary to their account.

Employers will contribute amounts ranging from 3 percent to 6 percent depending on how long the member has been employed. The Public Employee Retirement System will direct investments. Members are guaranteed an annual return of 5.25 percent on their accounts. Employees who leave before retirement may withdraw their contributions and the interest on them, but not the employer contributions. At retirement, members' accumulated balances will be converted to annuities, with additional options available.

See Chapter 171, Laws of 2012 (House Bill 2333)

Louisiana. Louisiana enacted legislation in 2012 to create a cash balance plan for most state employees and for post-secondary members of the Teachers' Retirement System of Louisiana, mandatory for those whose membership begins on or after July 1, 2013. It is available as a optional plan to specified other teachers and public employees.

Employee contributions will be 8 percent of salary. Each member account will receive an employer credit of 4 percent of salary annually as well as interest on the account, which will be pinned to the actuarial rate of return on investments of the Louisiana State Employees' Retirement System, but which will not fall below zero. Members of five years' standing who leave the system may withdraw their total balance, including the interest earnings, or leave it with the system. When members reach retirement age, they may convert the account to an annuity or choose among a variety of cash benefits.

See Chapter 483, Laws of 2012 (House Bill 61)

Nebraska. The primary Public Employee Retirement System plan was a defined contribution plan from 1967 to 2002. It was closed to new employees on January 1, 2003, and replaced with a cash balance plan. Members of the DC plan were allowed to transfer to the cash balance plan at the time, and enrollment has periodically been reopened to DC plan members since that time.

Employees contribute 4.8% of salary to the plan. Employer contributions are set at 156 percent of the employee contribution (7.488 percent) of salary. Members are guaranteed an annual return of at least 5% a year. The account can receive a higher return, depending on the federal mid-term rate and on investment earnings. At retirement, the employee may buy an annuity, or withdraw the balance in a lump sum or in installments.

See *Nebraska Statutes* Sections 84-1301 through 84-1333 and Buck Consultants. *Benefit Review Study of the Nebraska Retirement Systems*. August 2000 http://nlc1.nlc.state.ne.us/docs/pilot/pubs/nebraska_benefit_review_study.pdf

Part 2a. Defined Contribution Plans as Primary Plans

These plans are the government's primary, mandatory retirement plan for the designated class of employees.

Alaska. In 2005, the Legislature voted to close its defined benefit plans for public employees and teachers to new enrollment and to replace the defined benefit plans with defined contribution plans, effective July 1, 2006. Nonvested employees of the defined benefit plans for public employees and for teachers were permitted to transfer to the new defined contribution plans.

See Senate Bill 1, First Special Session of 2005, *Alaska Statutes*, chapter 14.25. http://www.legis.state.ak.us/basis/statutes.asp?title=14#14.25

The District of Columbia. In 1987, the District closed its defined benefit plan to new employees and replaced it with a defined contribution plan and Social Security membership.

See *District of Columbia Official Code* Title 1, Chapters 7 and 8.

Michigan. A state defined contribution plan has been mandatory for new state employees since March 31, 1997. Members of the closed defined benefit plan were allowed to transfer to the new DC plan if they chose. The state contributes 4% of salary to each employee's account. Employees may choose whether to contribute at all, but may contribute as much as 12% of salary. The state will match an additional 3% above its 4% basic contribution, for a maximum 7% employer contribution. Employer contributions go into a 401(k). Employee contributions above the initial 3% may go into the 401(k) or into a 457 plan.

See Public Act 487 of 1996 (House Bill 6229) as compiled at *Michigan Compiled Laws*, Chapter 38, sections 1 – 69. http://legislature.mi.gov/doc.aspx?mcl-Act-240-of-1943

2011 legislation required active members of the closed defined benefit plan for state employees to begin making a contribution of 4 percent of compensation toward pension costs beginning April 1, 2012, or freezing the service credit they have earned in the DB plan and converting to the DC plan for future service. Those who fail to make an explicit choice will be enrolled in the DC plan.

See Public Act 264 of 2011 (House Bill 4701).

Minnesota. The Defined Contribution Plans (DCP) administered by the Public Employees' Retirement Association are tax deferred retirement savings programs established by the Minnesota Legislature in Minnesota Statutes, Chapter 353D. The DCP is exclusively for physicians, elected local governmental officials, city managers, and governmental volunteer ambulance service personnel.

Members of the DCP designate a percentage of total contributions to be placed in one or more of seven accounts of the Minnesota Supplemental Investment Fund. Employee and employer contributions are combined and used to purchase shares in the accounts selected by the employee. Upon termination of service a DCP member is entitled to a lump-sum payment of the values of shares held, with interest or dividends that have accrued. No monthly retirement benefits are available. Contribution rates vary by member classification.

See http://www.mnpera.org/index.asp?Type=B_BASIC&SEC={8219D0EF-DA92-4EB9-B225-A9B5B8A2965C}

Utah. Legislation enacted in 2010 provided a defined contribution plan as one option available to state and local government employees hired on or after July 1, 2011. The alterative option is a hybrid plan, described below in this report. The defined contribution plan will provide individual employee accounts to which employers will contribute 10% of employee compensation for public employees, legislators and the governor. The contribution rate will be 12% for public safety and firefighter members. Employees are not required to contribute but may do so, either to the same DC plan or to any other DC plan the employer offers. Employee contributions (if any) are immediately vested. Employer contributions will be vested after four years' covered employment. Employees may direct the investment of their contributions and the investment of employer contributions after those are vested.

See Chapter 266, laws of 2010 (Senate Bill 63)

West Virginia. In 1991, the state created a defined contribution plan for teachers and closed its defined benefit plan to new enrollment. In 2005, the defined contribution plan was closed to new enrollment. In 2006, the members of the defined contribution plan voted to merge it with the state's defined benefit plan for teachers. Various legal challenges ensued, which were resolved in May 2008 through legislation that allowed individual members of the defined contribution plan to choose whether to transfer each person's membership to the West Virginia Teachers Retirement System (a defined benefit plan).

See *West Virginia Code*, Chapter 18, Article 7B. and PlanSponsor Magazine, "State Plan Sponsor of the Year: A Lesson in Funding" (December 2009). http://www.plansponsor.com/MagazineArticle.aspx?id=4294990027

A Number of States in recent years have created defined contribution plans as the primary coverage for elected officials and political appointees. To some degree these plans are a response to term limits for legislators and other elected officials. Such states include Colorado, Louisiana, Nevada, Utah, Vermont and Virginia. In Colorado, legislative staff hired after July 1, 1999, have had the choice of a defined contribution retirement plan. 2008 legislation extended the Utah optional defined contribution plan to some legislative staff.

Part 2b. Defined Contribution Plans as an Optional Primary Plan

In the states listed below, new employees may elect to be members of a defined benefit plan or a defined contribution plan, but must be a member of one or the other. Under current law in these states, both kinds of plan remain open to new members, and limited transfer between them is available.

Colorado. In 2004, Colorado created a defined contribution plan as an option for state employees, effective January 1, 2006. On the same date, Colorado opened its existing defined contribution plan for elected officials to general membership, giving new employees one defined benefit and two defined contribution plans among which to choose. Chapter 73, Laws of 2009, closed the elected officials' plan to new members, but the defined contribution plan created in 2004 remains as a option for new state employees.

Florida. In 2000, the state established a defined contribution plan (the Florida Retirement System Investment Plan) as an optional alternative to its defined benefit plan. Existing DB members could join the new plan. Existing members also were given a third option of transferring to a hybrid plan (described below) that combines features of DB and DC plans. The third option is not available to employees who joined the workforce after the creation of the alternative plans.

Indiana. In 2011, Indiana established a defined contribution (DC) plan as an option for new state employees. A state employee who does not make an explicit choice to become a member of the DC plan becomes a member of the Public Employees' Retirement Fund (PERF), which is a hybrid plan, described below.

The bill requires the PERF Board of Trustees to establish the same investment options for the DC plan that are available for the investment of a PERF member's annuity savings account. It provides that a member's contribution to the Plan is 3% of the member's compensation and is paid by the state on behalf of the member. It also provides that the state's employer contribution rate for the Plan is equal to the state's employer contribution rate for PERF. It also provides that the amount credited from the employer's contribution rate to the member's account shall not be greater than the normal cost of PERF with any amount not credited to the member's account applied to PERF's unfunded accrued liability.

The bill establishes a minimum state employer contribution of 3% of plan members' compensation.

The bill establishes a five-year vesting schedule for employer contributions, and requires a member who terminates state employment before the member is fully vested to forfeit amounts that are not vested. It establishes provisions for the withdrawal of amounts in member accounts. The bill also authorizes rollover contributions to the plan.

See Public Law No. 22-2011 (Senate Bill 524).

Montana. In 2002, the state created an optional defined contribution plan for state, local, university, and school district employees other than teachers. Current members of the defined benefit plan were allowed one year to transfer to the new plan.The plan covers eligible employees of the state, university system, local government and certain employees of the school districts that elect the defined contribution plan. All new hires initially are members of the Public Employee Retirement System defined benefit pan, and have a 12 month window in which they may make an irrevocable choice between the defined contribution plan and the DB plan. The defined contribution plan provides retirement, disability and death benefits to plan members and their beneficiaries. Employees contribute 7.17% of salaries, and employers contribute 7.37% of salaries to the plan.

See Montana Codes Annotated Title 19, chapters 2 and 3.

North Dakota. In 1999, the state created an optional defined contribution plan for "exempt" or non-classified state employees, 75% of whom are employees in the higher education system.

Ohio. From 1998 through 2002, the state created optional defined contribution plans for education employees, teachers and general state and local government employees. Employees not yet vested in the state defined benefit plan had the option of moving to the new plan. As noted below, Ohio also offers a third optional plan, a hybrid plan with both defined benefit and defined contribution features.

South Carolina. In 2000 and 2002, the state created optional defined contribution plans for existing and new state and local government employees and teachers.

Part 3. Hybrid Plans

These plans provide features of both defined contribution and defined benefit plans. One form of hybrid plan is the cash balance plan. A somewhat more common form in state government provides each member with both a defined benefit plan and a defined contribution account.

As a general rule, these plans maintain a defined contribution plan for employee contributions and a defined benefit plan for employer contributions. The Georgia plan created in 2008 and the Michigan teachers' plan of 2010 differ from this general rule in that

employees may continue in the defined benefit portion of the plan but terminate their participation in the defined contribution component.

Florida. In 2000, when the state established its optional defined contribution plan, members of the existing DB plan were given a third option of transferring to a hybrid plan. The third option has not since been available to new employees.

Georgia. Act 757 of 2008 (Senate Bill 328) created a hybrid retirement plan for Georgia state employees. The "Georgia State Employees' Pension and Savings Plan" (GSEPS) provides a defined benefit plan (DB) and 401(k) plan for new hires on and after January 1, 2009 and an opt-in to those employees who belonged to the Employee Retirement System (ERS) on December 31, 2008. The ERS Board of Trustees will administer the new plan.

People who first or again become an employee entitled to membership in ERS on or after January 1, 2009 will be required to join GSEPS. The DB formula will be 1% for each year of service times the average of the highest 24 consecutive calendar months of salary while a member. The formula can be increased in the future up to 2% by the board of trustees provided funds are appropriated by the General Assembly. Vesting in the DB is 10 years.

GSEPS members will be automatically enrolled in the 401(k) plan and will have a one-time 90 day window to opt out of the 401(k) and receive a refund of the account balance at that time. Participating members can stop and start 401(k) participation at any time thereafter. However, funds in the 401(k) must remain in the fund until separation. Participation in the 401(k) requires a mandatory employee contribution of 1% of compensation with voluntary elective contributions after the first 1%. Each employer will match the first 1%, plus a 50% match for each percent above the first 1% up to a total 3% employer match. Participants may contribute up to the IRS maximum limit each year. Employee contribution are vested when made, and employer contributions are vested over five years at a rate of 20% per year.

Indiana. For decades, retirement plans for state employees and teachers have consisted of an Annuity Savings Account (a defined contribution component) made up of employee contributions and a defined benefit funded by employer contributions. The state employee plan was created in 1945; the teachers' plan was instituted in 1921.

Michigan. Act 75 of 2010 (SB 1227) created a hybrid retirement plan for members of the Public School Employees Retirement System.

Employees first hired on or after July 1, 2010, will be placed in a new "hybrid" pension plan, with a blending of defined benefit (DB) and defined contribution (Tier 2) components. A person under this plan will not be able to receive pension payments until age 60, and will be required to have worked at least 10 years as a public school employee. The purchase of service credit by these employees is prohibited, and cost-of-living adjustments to the pension are not provided. An employee will have to contribute $510 annually plus 6.4% of salary above $15,000, in addition to the Tier 2 contributions described below.

An employee under this plan will have to contribute 2.0% of salary to his or her Tier 2 account, unless affirmatively electing not to contribute or to contribute a lesser amount. The employer will have to match 50% of the employee's first 2.0% of salary contribution, for a maximum total employer payment of 1.0% of salary deposited into the Tier 2 account. This is in addition to the employer cost for the DB pension of this employee. The employee will be allowed to contribute more than 2.0% of salary, but the employer will not match more than 1.0%, unless choosing to do so under a locally negotiated agreement. An employee described here is immediately vested in his or her own contributions, and will vest in employer contributions as follows: 25% after two years of service, 75% after three years of service, and 100% after four years of service.

The defined benefit side of this hybrid plan will use a five-year period on which to calculate the final average compensation (FAC), likely generating a lower FAC than is in current law. (For Basic Plan members, the time frame is five years; for MIP members, the time frame is three years.) Also, under this plan, the actuary will be required to assume a 7.0% rate of return on the investments in the portfolio (rather than the 8.0% rate under current law). The actuary may determine a different employer contribution rate for these members.
See Act 75 of 2010 (SB 1227).

Ohio. The retirement plan revisions from 2000 through 2002 that created an optional defined contribution plan for Ohio teachers and other employees also created the third option of a hybrid defined-benefit/defined contribution plan.

Oregon. The public employee retirement plan (which includes teachers and other education personnel) created in 2003 consists of a defined benefit program called "the pension program" funded by employer contributions and a defined contribution program called the "individual account program," funded by employee contributions.

Rhode Island. Legislation enacted in 2011 provided for closing the defined benefit plan of the Rhode Island Employee Retirement System (ERS) on July 1, 2012, and created a hybrid plan for all existing members of ERS as of that date as well as new members of the system, except for judges and some public safety members. The hybrid plan will consist of a reduced defined benefit plan and an individual account for each members.

Members are required to contribution to the defined contribution component and may not opt out of it. For most members, contributions are unchanged from the total amount required for the former DB plan, although the allocation of the contributions has been changed.

See Chapter 408, Public Laws of 2011 (Senate Bill 1111) and the website of the Rhode Island Employee Retirement System:
http://www.treasury.ri.gov/secure-path-ri/legislation.php

Virginia. Act 702 of 2012 provided a hybrid retirement plan for state and local employees and teachers, other than law enforcement personnel, who enter the Virginia Retirement

System on or after January 1, 2014. It includes mandatory defined benefit and defined contribution components.

- For the DB component of the hybrid plan, the vesting, age and service requirements for normal and early retirement and calculation of average final compensation are the same as for Plan 2 DB members. Vesting is at five years; normal retirement is at a person's Social Security age with five years of service or at the Rule of 90. Early retirement is available at the age of 60 with five years of service. Average final compensation is the average of the highest 60 months.
- The hybrid plan DB multiplier will be 1.0%
- Each member of the hybrid plan will be required to make contributions to both the DB and DC component. The employee contribution to the DB component will be 4%. The mandatory employee contribution to the DC component will be 1%, and employees may contribute up to 5% of salary to earn an additional partial employer match.
- The legislation includes a provision to increase an employee's contribution automatically by 0.5% of compensation every three years until members reach the maximum contribution rate. Matches will apply to the increased contribution as described below. Employees may opt out of the automatic increase in the employee contribution rate.
- Employer contributions for the DB plan will be actuarially determined at the rate set for the legacy defined benefit plans. Employer contributions to each employee's DC account will be as follows:
    - For the 1% mandatory employee contribution, 1% of salary.
    - For the first 1% voluntary employee contribution, 1%.
    - 0.5% for each additional 1% voluntary contribution, up to the full 5% that is subject to match.
    - The total possible employer contribution would be 3.5% on a 5% employee contribution.
- Vesting of employer contributions will begin at 25% after an employee has participated continuously in the program for one year, increasing at 25% a year until the employee is fully vested in the employer contribution after four years of continuous membership.

See Chapter 702, Laws of 2012 (House Bill 1130)
http://leg1.state.va.us/cgi-bin/legp504.exe?ses=121&typ=bil&val=hb1130

Utah. Legislation enacted in 2010 provided a hybrid retirement plan as one option available to state and local government employees hired on or after July 1, 2011. The other option is a defined contribution plan described earlier in this report.

The hybrid plan (§29) includes a defined benefit and a defined contribution component.

- For the DB component, employers will pay up to 10 percentage points of an employee's compensation toward the amount that is required to keep the plan actuarially sound. The employee will contribute any additional amount required to make up the actuarial requirement.

- For the DC component, employers will contribute 10% of employee compensation less the amount the employer contributes to the DB component. The employer contribution will be deposited in a 401(k) plan to which the member may choose, but is not required, to make additional contributions. Employer contributions will vest after four years' membership in the plan; employee contributions vest immediately. The member may direct the investment of his or her contributions immediately, and those of the employer after they are vested.

See Senate Bill 63 of the 2010 Utah legislative session.

Washington. The 1998 Teachers' Retirement Plan Tier 3 consists of defined contribution and defined benefit elements, funded respectively by employee and employer contributions. This plan is mandatory for teachers hired since the plan's inception. Legislation in 2000 created a similar but optional Public Employee Retirement System Plan 3 for state and local government and higher education employees. State and local employees who do not select the hybrid plan are enrolled in a defined benefit plan.

Sources

In addition to the sources listed in the text, this report is based on NCSL's series of annual summaries of state legislation concerning state pension and retirement plans. The summaries are available on the NCSL website at http://www.ncsl.org/default.aspx?tabid=13399 Other information has been taken from the websites of the retirement systems mentioned in the text.