



401(k)/Defined Contribution Research Report

Presented to the Finance Sub-Committee on Pensions

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Commissioner Bridget Gainer, Chair



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Defined Contribution Plans for a Public Workforce

Senate Bill 512, the pension bill debated in Springfield this year, contained a provision for a self-managed plan for all State, City of Chicago and Cook County employees. This was a new development, as 401(k) style plans are currently limited to the State University Retirement System (SURS) system. With funded ratios for public plans dropping and calls for budget cuts, nationally, the conversation has grown around switching from Defined Benefit (DB) retirement plans to Defined Contribution (DC).

These calls are countered by those uncomfortable with the increased risk for the employees of market volatility and longevity risk. Arguments have been put forward in support of maintaining the DB status quo, amending DB plans and moving toward DC. Recently, new 401(k) vehicles have been introduced that focus on maintaining the retirement income security within a DC plan.

For a public sector population without the guaranteed income of Social Security, the stability of the future retirement income stream is paramount. As the demand for 401(k) like vehicles grows for this population, plans with greater income security, investment decision support, employee education and annuity-like features have increased.

The following report details the results of national studies on the way employees use 401(k) plan assets, academic research or best practices and case studies from other public plans.

“Leakage of Participants’ DC Assets: How Loans, Withdrawals, and Cash outs Are Eroding Retirement Income”

Hewitt 2011

Examined: The behavior of 1.8 million employees in 110 large 401(k) plans nationally to assess their ability to provide sufficient retirement income

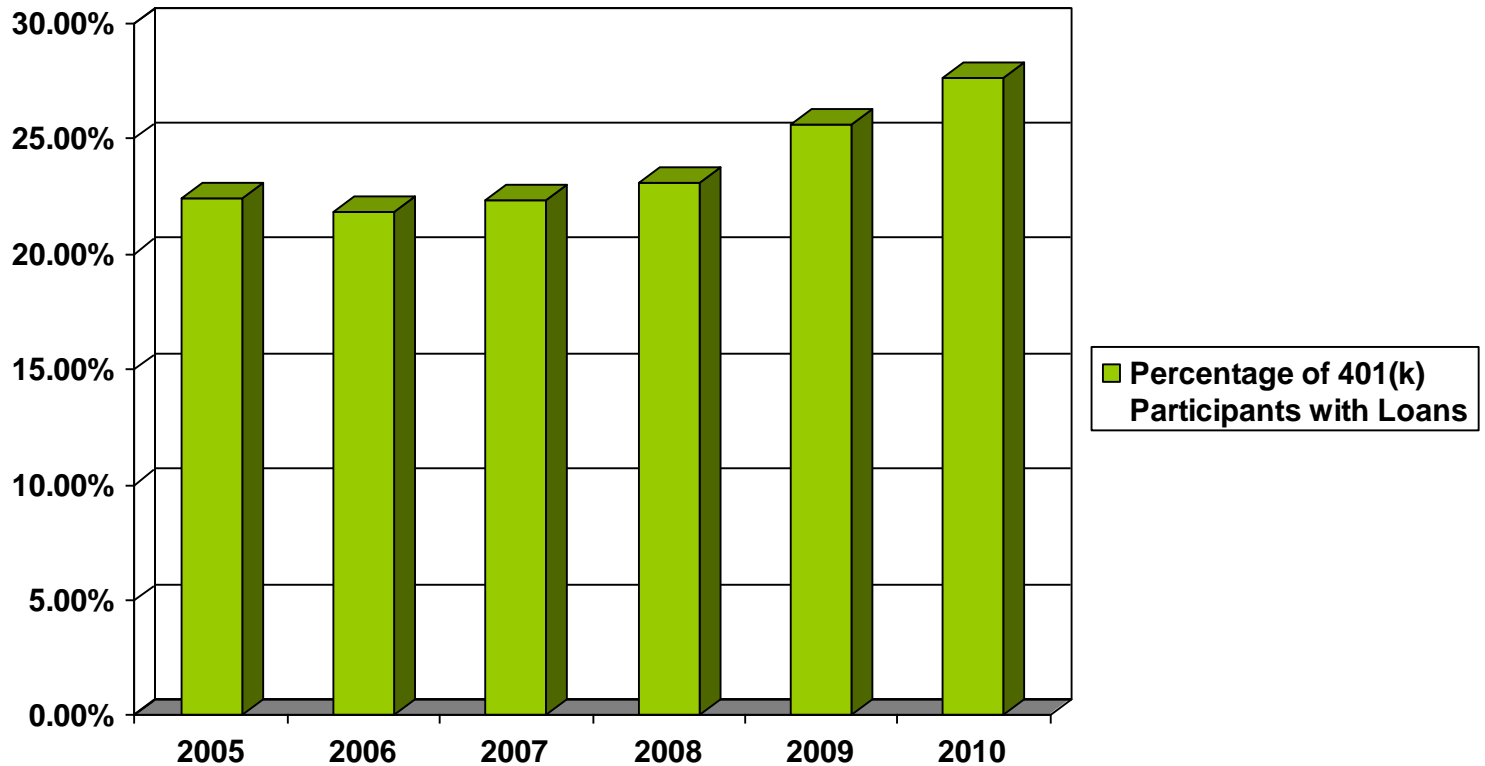
- 28% of all active participants had a loan outstanding.
- 70% of Employees that had loans outstanding at termination defaulted on the repayment.
- In 2010 over 6.9% of 401(k) participants took a withdrawal of funds.
- 401(k) members with lower salaries were more likely to take a withdrawal and more women were taking withdrawals than men.
- The majority of employees that took a withdrawal did so due to eviction or foreclosure.
- 42% of the workers that lost their jobs in 2010 took a cash out of their 401(k)
- Younger workers who change jobs are more likely to cash out their 401(k)
- Cashing out a 401(k) reduces future retirement income between 11% and 67%

Suggestions: Enact measures that reduce loans, withdrawals and cash outs

- Restrict the number of loans allowed and the amount an employee can borrow or withdraw
- Limit the reasons for hardship withdrawals
- Simplify rollover process for those who are leaving employment for a new position

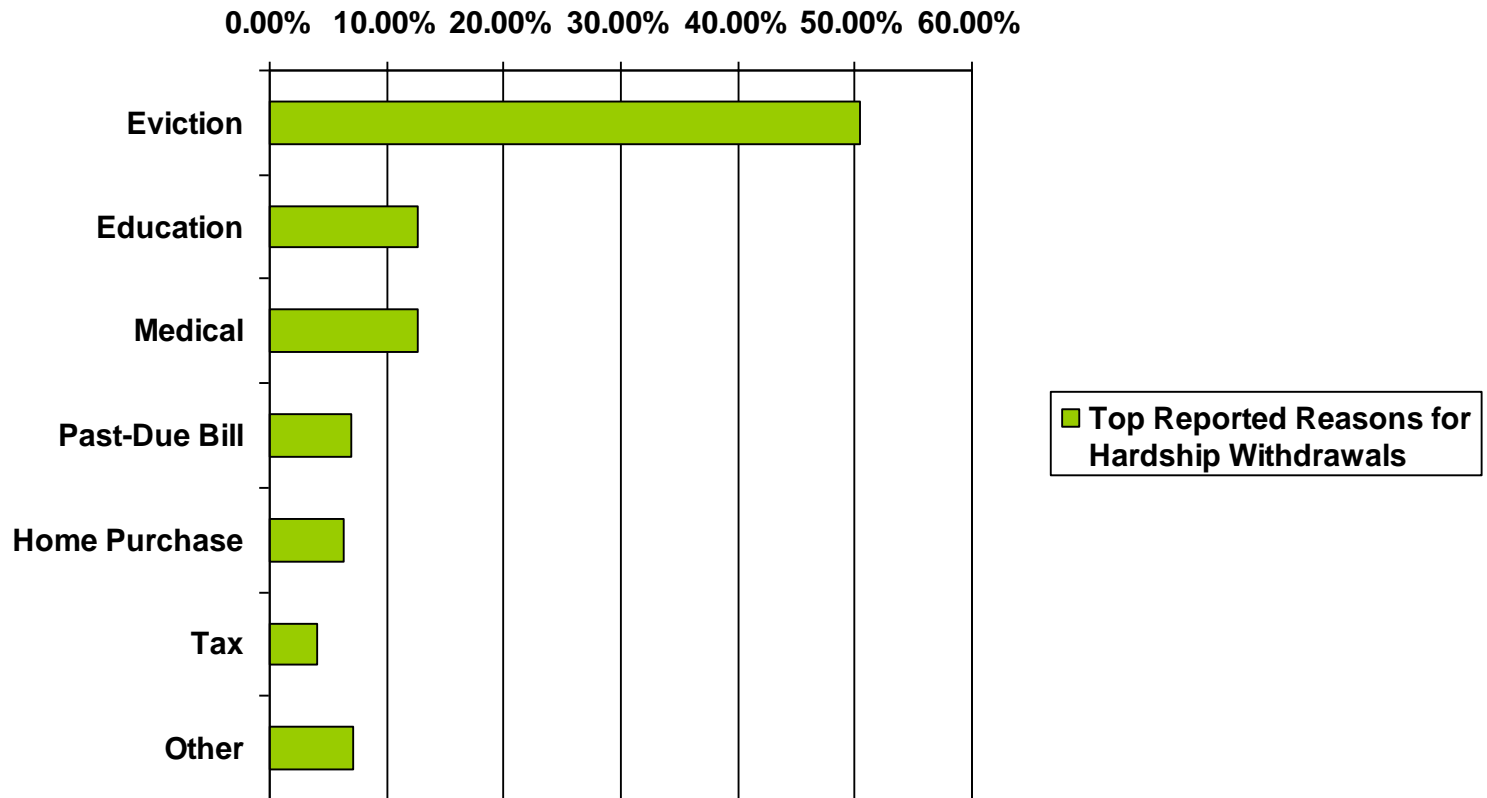
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“401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups”

Ariel Investments July 2009

Examined: The results of an analysis of private sector 401k plans broken down by participant race.

- African Americans are 167% more likely to take a hardship withdrawal than other participants.
- Hispanics borrow from their 401(k) plans at a higher rate than whites, but a lower rate than African Americans.
- Asian workers are the least likely to borrow against their 401(k)

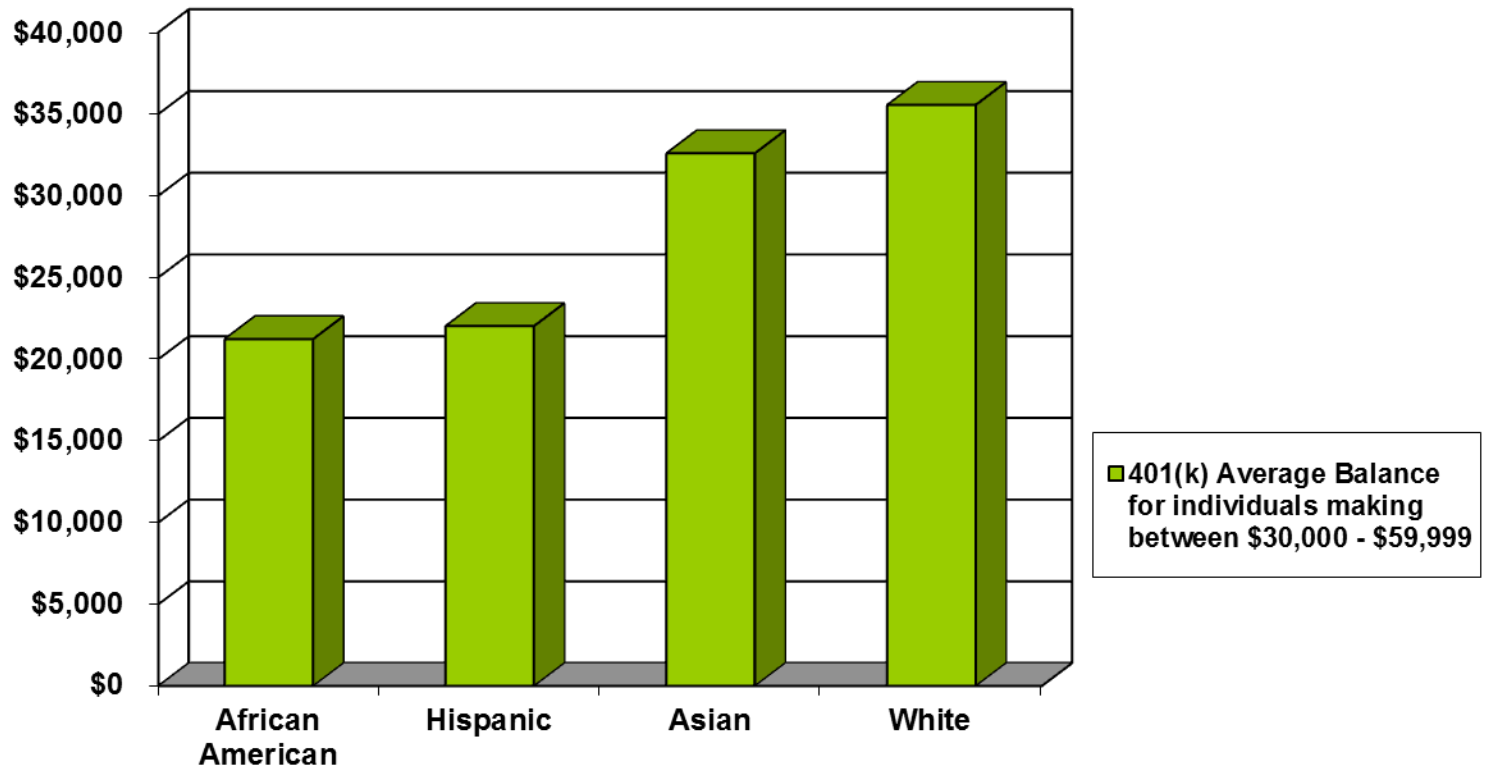
Suggestions: Implement best practices to increase retirement income security

- Encourage employers to collect and report their 401k data by race and ethnicity
- Change loan features to facilitate retirement income stability



401(k) Plans in Living Color: A Study of 401(k) Savings Disparities Across Racial and Ethnic Groups”

Ariel Investments July 2009



“Defined Contribution Pension Plans in the Public Sector: A Benchmark Analysis”

Wharton School, University of Pennsylvania 2008

- The University of Pennsylvania Wharton School comprised a list of best practices for 401(k)/Defined Contribution Pension Plans that will help provide an adequate and secure retirement income.

Eligibility and Participation	Mandatory Enrollment/Opt Out Waiting period of a year or less for participation
Vesting	100% Vested after one year of employment
Contributions (Employer and Employee)	12% of pay if covered by Social Security 18 to 20% of pay if not covered by Social Security
Investments	Mandatory/default investment into lifecycle target-date funds Limited menu of options of major asset classes
Distributions	Pre-retirement: No lump sum distributions at job change No hardship withdrawals No plan loans Retirement: Level of mandatory annuitization with inflation-protected income Limited lump-sum distribution
Administrative Structure and Fees	Single vendor recordkeeping structure Single point of contact for participants Larger plans standard: total administrative and investment costs not to exceed 100 basis points
Other Participant Services	Broad-based employee investment education Individual-specific investment advice Services delivered through multiple modes: call center, internet and in-person

“Look Before You Leap; The Unintended Consequences of Pension Freezes”

National Institute on Retirement Security Oct. 2008

West Virginia Case Study:

- In 1991, the West Virginia Teacher’s Retirement System (TRS), a DB plan, was frozen, and all newly hired teachers were put into a new plan, the Teachers Defined Contribution Retirement System (TDC).
- In 2004 the State conducted a study of teacher’s retirement 401(k) plans and determined that the average balance was \$41,478 with only 6% of participants accumulating over \$100,000.
- The State decided that allowing teachers to invest themselves was too risky and passed a law in 2005 that moved all new teachers into a DB plan.
- When given the opportunity to move from the DC plan back to the DB plan over 75% of West Virginia teachers under 40 switched into the DB.



“Minnesota Retirement Plan Design Study”

Minnesota Statewide Retirement System June 2011

- The Minnesota Legislature conducted a study to determine the cost of switching from a DB plan to a DC plan.
- The DC Plan was designed to have a 5 percent employee contribution with a 5% employer match.
- For all three retirement systems to transfer from a DB to a DC total costs would increase by \$2.76 Billion over the next 10 years.
- The higher cost is mainly due to the increased cost of operating two systems concurrently.
- The study also reported that the normal cost of the DB plan would be less than the proposed DC plan over time.



“SEAL ACT; Savings Enhanced by Alleviating Leakage in 401(k) Savings”

US Senator Kohl (WI) and US Senator Enzi (WY)

- This bill was introduced in May 2011 by US Senator Kohl (D-WI) and US Senator Enzi (R-WY) and is being heard in the Finance Committee

- The Bill would make the following changes to all 401(k) systems:
 - Restrict the number of loans allowed at any one time to 3 loans
 - Ban debit/credit cards that withdraw funds directly from a 401(k) account
 - Extends the deadline for paying back loans against a 401(k) after separation from employment
 - Eliminate the restriction on contributions following a hardship withdrawal

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