



# fact sheet

## Defined Benefit Plan vs. Defined Contribution Plan

In December 2009, the Commission on Streamlining Government released a recommendation that would require that the retirement plan benefit structure for the four state retirement systems be changed to a Defined Contribution Plan for all new employees hired after July 1, 2010. Currently, members of the Teachers Retirement System of Louisiana (TRSL) receive their primary retirement benefit through a Defined **Benefit** Plan (DB) rather than a Defined **Contribution** Plan (DC). A+PEL believes that it is critically important that our members understand the fundamental differences between a Defined Benefit Plan and a Defined Contribution Plan.

**DEFINED BENEFIT PLAN (DB)** – A retirement plan, such as a pension plan, in which an employee upon retirement receives a specific monthly benefit based on salary history and years of service. DB Plans are structured to allow investment gains and losses to be spread across a large number of individuals of different ages and over different time horizons. The State of Louisiana bears the investment risk. Benefits are calculated through a plan formula. Below is the formula used by the Teachers Retirement System of Louisiana.

DB Plan Formula:

years of service x final average compensation (highest 3 years of consecutive earnings) x 2% or 2.5% = benefit \$

Example:

30 years of service x average salary of \$45,000 x 2.5% = \$33,750 or 75% of average salary per year

**DEFINED CONTRIBUTION PLAN (DC)** – A retirement plan in which the employee elects to defer some amount of his/her salary into the plan. Portions of a salary deferral may be matched by the employer. Options are provided to the employee for investing their individual funds. Thus, the employee bears the investment risk. This type of plan does not promise a specific monthly benefit at retirement. It is a plan in which an employee's retirement funds depend on the contributions made to and the investment performance of the assets of his or her account, rather than an employee's years of service and earnings history.

In DC Plans, the employee or the employer (or both) contribute to the employee's individual retirement account, usually at a set rate, such as 5 percent of earnings annually. The employee will ultimately receive, at retirement, the balance in their account, which is based on contributions plus or minus investment gains or losses. The value of the account will fluctuate due to the changes in the value of the investments. Unlike with a Defined Benefit Plan, employees have substantial control over how the contributions to their plan are invested and may generally choose from an assortment of stocks, bonds, mutual funds, and other investment vehicles. Examples of Defined Contribution Plans include 401(k) plans, 403(b) plans, all of which share similar characteristics.

## **WHY DOES A+PEL OPPOSE A DEFINED CONTRIBUTION PLAN...**

- In a Defined Benefit Plan the benefit is paid for the life of the employee. The benefits are guaranteed by the State of Louisiana for the life of the employee; therefore, there is no risk of outliving your retirement benefits. With a Defined Contribution Plan, the mortality risk rests solely with the employee, which means that the employee must prepare for the possibility of living longer than planned and running out of funds to live on, which potentially increases the need for public assistance such as welfare.
- By providing a predictable, guaranteed benefit at retirement that is valued by workers, a defined benefit plan can promote worker loyalty and help retain valuable workers.
- In a Defined Benefit Plan, the employees are entitled to a lifetime benefit at the time they meet all of the eligibility criteria, but have no involvement in the investing or managing of the assets that one day will pay for their benefit. The money is managed and invested by a professional investment staff. In a Defined Contribution Plan, the employee is responsible for making all investment decisions, within the framework of the Defined Contribution Plan structure.
- With a Defined Benefit Plan, very little responsibility is placed on the employee. The employer is responsible for ensuring that there are enough funds to pay for a member's lifetime retirement benefit. Defined Contribution plans place significant responsibility on the employee, because the employee bears the investment risk and the risk that the employee will outlive the retirement fund. In a Defined Contribution Plan, the employee is responsible for ensuring that there is enough money in their account to support them during their lifetime.
- It is unknown how switching to a Defined Contribution Plan will affect teachers coming into the profession. Will the lack of a Defined Benefit Plan sway some potential educators from becoming teachers? Will potential educators choose other professions with better benefits?
- Defined Benefit Plans attract longer tenured and/or older employees because employees receive the greatest benefit accruals at the end of their long-time service. Defined Contribution Plans attract shorter tenured and/or younger employees. DC Plans are portable and employees are immediately vested.
- Switching to a Defined Contribution Plan will not reduce the state's obligation to reduce the unfunded accrued liabilities currently owed by the retirement systems.
- The average investment returns of a Defined Contribution Plan are typically lower than those of a Defined Benefit Plan, even when the same dollars are invested.