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Hybrid and Cash Balance Plan Designs in State Pensions

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Overview

- “Hybrid” typically refers to a retirement plan that combines elements of a traditional defined benefit (DB) plan and a defined contribution (DC) plan.

- The most common model is a “side-by-side” hybrid plan which combines a DB component with a separate DC retirement savings account.

- A broader definition of hybrid can also include cash balance plans which offer workers an individual retirement account paired with some of the basic protections of a defined benefit plan.

Definitions

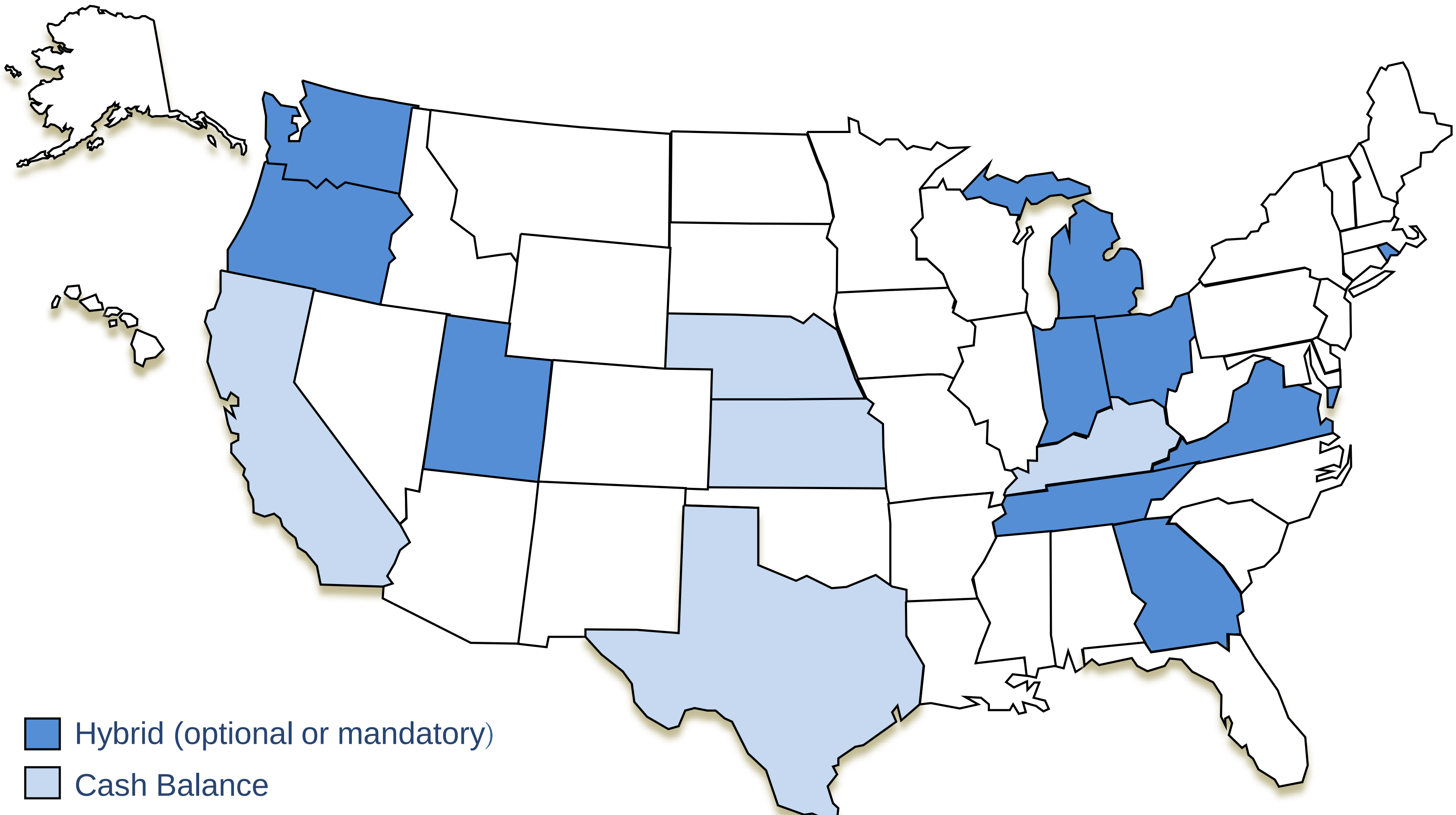
- **Defined Benefit Plan (DB):** A plan in which the employer promises a specific amount of monthly retirement income based on a formula that typically takes into account the employee's salary, years of service, and age.

- **Defined Contribution Plan (DC):** A plan in which retirement savings are based on accumulated employer and employee contributions and the investment returns on those contributions.

- **Hybrid Plan:** Combines elements of DB and DC plans
  - Side-by-Side Hybrid: Plan combines a DB component with a separate DC retirement savings account
  - Stacked Hybrid: DB plan is the primary benefit up to specified income level, then DC covers additional higher income for employees above the threshold

- **Cash Balance Plan (CB):** Pooled and professionally-managed employee savings accounts with a guaranteed minimum annual investment return and an option for lifetime, guaranteed benefit

States with Hybrid Plans and Cash Balance Plans



Principles for Plan Design

- A commitment to fully funding retirement promises.
- A combined benefit and savings rate that helps put workers on the path to a secure retirement.
- Professionally managed, low-fee, pooled investments with appropriate asset allocations.
- Access to lifetime income in the form of annuities.

Key Considerations for Hybrid Plan Design

- Defined Benefit
  - Benefit multiplier – most common is 1%
  - Consideration of other benefit provisions (retirement eligibility, COLAs, funding)

- Defined Contribution
  - Contribution rates – mandatory/matching
  - Investment options –
    - Thrift Savings Plan Model—Limited, diversified options with low fees
    - Oregon Model—DC accounts are invested alongside DB plan assets.
  - Access to lifetime income

Hybrid Plan Key Provisions

	DB Multiplier	Employee cont. to DB	Employer cont. to DC	Default employee cont. to DC	Number of investment options	Annuity offered for the DC*
Georgia Employee's Retirement System	1%	1.25%	3% (3% matching, 0% mandatory)	5% (optional)	21	No
TN Consolidated Retirement System	1%	5%	5% (0% matching, 5% mandatory)	2% (optional)	26	No
Rhode Island Employee Retirement System (state and teachers)	1%	3.75%	1% (0% matching, 1% mandatory)	5% (mandatory)	23	Yes
Virginia Retirement System	1%	4%	3.5% (2.5% matching, 1% mandatory)	1% (mandatory)	21	Yes
Washington Department of Retirement Services	1%	None	None	5% (mandatory)	13	Yes
Federal Government Retirement System	1%	0.8%	5% (4% matching, 1% mandatory)	3% (optional)	10	Yes

*Many plans that do not offer annuities to participants provide information on options to purchase annuities externally at retirement.

Source: The Pew Charitable Trusts, "Hybrid Public Pension Plans: A primer"

Key Considerations for Cash Balance Plan Design

- Pay Credit
  - Amount as a percent of salary added to workers' cash balance accounts each year.

- Interest Credit
  - Rules by which account balances grow annually.
  - Can be a fixed rate or based on plan investment returns.
  - Accounts can never lose money.

- Annuity Conversion
  - Cash balance plans need to enable retiring workers to convert account balances into an annuity.

Cash Balance Plan Key Provisions

	Employee Contribution	Employer Pay Credit	Guaranteed Return	Gain Sharing
Kansas Public Employees Retirement System	6%	3% to 6% depending on length of service	4%	If the 5-year average of actual returns is greater than 6%, employees get 75% of the excess
Kentucky Retirement System	5% for regular members, 8% for public safety	4% for regular members, 7.5% for public safety	4%	If the 5-year average of actual returns is greater than 4%, employees get 75% of the excess
Nebraska State Employees and County Employees Pension Plan	4.5% for county members, 4.8% for state members	6.8% for county members, 7.5% for state members	Greater of 5% or the federal mid-term rate plus 1.5%	Granted depending on plan's funding level and board approval.
Texas County and District Retirement System	4 to 7%, depending of employer election	Between 100 and 250% of the member's contribution	7%	None
Texas Municipal Retirement System	5 to 7%, depending on employer election	Between 100 and 200% of the member's contribution	Member contributions earn 5%; employer contributions earn actual plan return.	Granted based on board approval

Source: The Pew Charitable Trusts, "Public Pension Cash Plans: A primer"

Key Takeaways

- There are proven hybrid pension plans in states. Side by side hybrid plans have been in use in states since the mid-90's; cash balance plans in Texas were first implemented in 1947.

- Hybrid plans allow employers to increase the predictability of retirement costs and provide more flexible benefits for shorter term workers while keeping key defined benefit protections for employees.

- No one size fits all in retirement plan design
  - Measure impacts on retirement security and cost predictability
  - Consider common principles for any plan design

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States' Public Sector Retirement Systems

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