Michael A. Webb, AIF,® CEBS, Vice President, Cammack Retirement Group

Are States Migrating from Traditional Pensions? A State-by-State Review

Hardly a day passes without front-page headlines describing the pension troubles of one state or another. Almost as frequently, individual states make announcements of planned reductions to pension benefits. These cuts typically include elimination of cost-of-living increases for retirees or increases in employee contributions in order to close large funding gaps in traditional defined benefit plans.

A number of states have even gone a step beyond. They are moving away from a traditional pension arrangement to a hybrid plan, such as cash balance, a combined defined contribution/defined benefit arrangement, or even a defined contribution (DC) plan, limited to certain employees. Furthermore, some states have utilized nontraditional programs for several years now, and are thereby providing models to other states for implementing such strategies.

This article attempts to provide a state-by-state review of nontraditional alternatives to a defined benefit (DB) plan. One word of caution: conditions are in constant flux, as, for instance, states continue to deal with their pension deficits and new officials are elected, among other changes. Thus, it is possible this article may be out of date in a few respects by the time you are reading it! Moreover, though we have made every effort to provide an accurate assessment of nontraditional state pension provisions, it is possible that someone with more local knowledge may be aware of additional facts that we have missed. Hence we welcome reader input to enhance our effort to provide current and accurate information in all states.

As of this writing, 20 states, plus the District of Columbia, either currently sponsor, or plan to sponsor, alternatives to a traditional DB model, as follows:

States that Currently Maintain Defined Contribution Arrangements

ALASKA

All employees hired after 6/30/06 participate in a DC plan, while employees hired prior to that date participate in a DB plan. The DC option is a 401(a) plan with a mandatory 8% employee contribution and a 5% employer contribution (7% for teachers). Since it is a 401(a) plan, elective deferrals are not permitted, though there is a separate 457(b) plan available for such contributions. The DC plans are administered by a single third-party provider; the state self-administers the DB plan for pre-7/1/06 hires. See more: Alaska retirement system website.

COLORADO

All employees hired after 1/1/06 may choose between the state's DC and DB plans. Prior to 2006, there was only a DC option for elected officials, which was implemented in 1998. If employees fail to choose a plan, they are defaulted

into the DB plan, though they may switch from the DB to DC plan, and vice versa, up until the end of the fifth year of participation. The DC plan is a 401(a) plan with a mandatory 8% employee contribution (state troopers and Bureau of Investigation agents must contribute 10%). Employer contributions range from 10% to 13.6%. Again, elective deferrals are not permitted under the 401(a) plan, but both a 401(k) and 457(b) plan are available for such deferrals. However, not all employees are eligible for the 457(b) plan. A single third-party provider administers all the DC plans; the state self-administers the DB plan. See more: Colorado retirement system website.

DISTRICT OF COLUMBIA

The District was one of the first places to convert to a DC structure as the primary pension plan for its employees, since all employees (excluding police officers, firefighters, teachers, and civil service employees) hired on or after 9/30/87 were enrolled in the a DC plan. The DC plan is a 401(a) plan with a 5% employer contribution (5.5% for detention officers). In contrast to most public DC plans, there is no required employee contribution. There is only a 457(b) plan available for elective deferrals. There is a single third-party provider for both DC plans. See more: District of Columbia retirement system website.

FLORIDA

All employees hired 1/1/02 or later can choose between the state's DC and DB plans. A third hybrid option was introduced along with the DC plan in 2000, but that is now only available in limited circumstances. If employees fail to choose a plan, they are defaulted into the DB option, though they may switch from the DB to DC plan, and vice versa, at any time. It is a 401(a) plan with a 3% mandatory employee contribution and employer contributions that range from 3.3% to 11%. Again, there are no elective deferrals in the 401(a) plan, though there is a 457(b) plan available for such deferrals. A single third-party provider administers the 401(a) plan, while there are six different providers for the 457(b) plan and the state self-administers the DB plan. See more: Florida retirement system website.

INDIANA

This state is anomalous in that it has had a combination DB/DC plan since 1955(!), but recently new hires (as of 3/1/13) have been permitted to join a DC plan only. If a new hire fails to make an election within 60 days of employment, he/she is defaulted into the hybrid DB/DC plan. In addition, existing hybrid plan participants may not switch to the DC plan. The DC plan is a 401(a) with a 3% mandatory employee contribution (note that employers can choose to contribute some or all of this 3% amount on behalf of the employee) and a discretionary employer contribution of 4.7% in 2014. In addition, unlike 401(a) plans in other states, the plan allows for "pick-up" voluntary pretax contributions of up to 10%, pursuant to a one-time irrevocable election under 414(h). There is also a separate 457(b) plan for elective deferrals. Both DC

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plans are administered by a single third-party provider, as is the DC portion of the combination plan; the DB portion of the combination plan is self-administered. See more: Indiana retirement system website.

MICHIGAN

This state's primary plan has been DC for some time, as the DB plan has been closed to new hires since 3/31/97 (except for teachers, who were switched to a hybrid plan in 2010, with an additional option of a DC plan for 9/4/12 and later hires). In addition, existing DB plan participants could have switched to the DC plan in 1998, and in 2012 were required either to commence a 4% contribution to the DB plan or switch to the DC plan. (As an aside, a lower court ruling has stated that the 4% contribution is unconstitutional, but the case is still under appeal, and the 4% continues to be deducted.) Those who did not make an election were automatically converted to the DC plan. At present, DB plan participants may not switch to the DC plan. Unusually, the DC plan is a 401(k) plan rather than a 401(a) plan, with a 4% base contribution and a dollar-for-dollar match, up to 3% (total employer contribution of 7%). Employees are automatically enrolled in the 401(k) at a 3% deferral level. Additional elective deferrals may be made either into the 401(k) or a 457(b) plan. The DC plans are administered by a single third-party provider; the old DB plan is self-administered. See more: Michigan retirement system website.

MONTANA

Since 2002, all employees (except teachers, who are covered under their own retirement system) have had the option to elect a DB or a DC plan. If an employee does not choose a plan within 12 months, he/she is defaulted into the DB plan. The DC plan is a 401(a) plan, with a required 7.9% employee contribution, and a 4.19% employer contribution. Again, elective deferrals may not be made to the 401(a), but there is a 457(b) plan available for such deferrals. Both DC plans are administered by a single third-party provider; the DB plan is self-administered. See more: Montana retirement system website.

NORTH DAKOTA

Employees hired on 10/1/13 or later (except teachers and highway patrol, who are covered under their own retirement systems) have the option to elect a DB or a DC plan. If an employee does not choose a plan within six months, he/she is defaulted into the DB plan. The DC option is a 401(a) plan, with a required 7% employee contribution (state employers have the option to "pick-up" these contributions under 414(h); see Indiana description, above), and a 7.12% employer contribution. Additional deferrals may be made to a 457(b) plan. The 401(a) plan is administered by a single third-party provider, while the 457(b) plan utilizes eight vendors. The DB plan is self-administered. See more: North Dakota retirement system website.

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OHIO

Since 2002, new Ohio employees have had a choice among three plans: a DB plan, a DC plan, or a combination plan whereby employer contributions go into the DB plan, while employees' money goes into the DC plan. If an employee does not choose a plan within six months, he/she is defaulted to the DB plan. Employees can change from one plan to another, with certain restrictions (see links below). There is a required 10% employee contribution (11% for teachers, 13% for law enforcement) and a 14% employer contribution (9.5% for teachers, 18.1% for law enforcement and public safety employees) for all three plans. The DC option is a 401(a) plan which cannot accommodate elective deferrals, but there is a 457(b) plan available for such deferrals. All plans are self-administered, except for the DC components of the teachers' plan, which are administered by a single third-party provider. See more: Ohio retirement system website; Ohio teachers' retirement system website; Rules for changing from one plan to another; Rules for teachers (see "Choosing a Plan").

SOUTH CAROLINA

Certain segments of the state workforce have been provided the option to select between a DB and a DC plan since 1987. Currently, all employees can choose between the two options, except for local government employees, who can only have a DB plan. If an employee does not choose a plan within 30 days, he/she is defaulted to the DB plan. Employees can change from the DC plan to the DB plan during the first five years of employment, but not from the DB plan to the DC plan. The DC option is a 401(a) plan, with a required 7.5% employee contribution (increasing to 8% on 7/1/14), and a 5% employer contribution. The state also offers 457(b) and 401(k) plans for elective deferrals, since the 401(a) cannot accommodate such deferrals. There is a single third-party provider for the 401(k)/457(b), while there are four providers for the 401(a) plan. The DB plan is self-administered. See more: South Carolina retirement system website.

UTAH

All employees hired 7/1/11 or later may choose between a DC plan and a combination DB and DC plan; in the latter case, employer contributions are split between the two plans. Prior to 7/1/11, only a traditional DB pension plan existed. If an employee does not choose a plan within one year, he/she is defaulted to the hybrid plan. Employees cannot change from one plan to another. The DC plan is a 401(k) structure, with no required employee contribution, and a 10% employer contribution (12% for police and fire). Additional elective deferrals may be made to the DC plan, as well as 457(b) plan, and an IRA option. All of the plans are self-administered. See more: Utah retirement system website.

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Note that, in addition to the above states, West Virginia maintained a DC plan between 1991 and 2005, but returned to a traditional DB in 2005.

States that Currently Maintain Only Combined DB/DC Arrangements

Indiana, Ohio, and Utah are not included here, as they have standalone DC plan options as well, and are thus listed above.

GEORGIA

As of 7/1/2009, the state converted from a traditional DB plan to a combination DB/DC plan, except for teachers, who are covered under their own retirement system. Those hired on or after 7/1/2009 were enrolled in the hybrid plan, with those employed prior to that date given the option to convert to the hybrid plan or remain with the traditional DB plan. Employees must contribute 1.25% to the DB plan. The DC plan is a 401(k) with no required contribution; there is a match of 3% of the first 5% of elective deferrals. Though there is no required contribution to the DC plan, new hires are automatically enrolled at an elective deferral level of 1%, or 5% for employees hired after 7/1/14. Additional elective deferrals may be made to the 401(k) or to a 457(b) plan. The DC plans are administered by a single provider; the DB plan is self-administered. See more: Georgia retirement system website.

OREGON

Beginning 1/1/2004, all employees transitioned from a traditional DB plan to a combination DB/DC plan, where employer contributions go into the DB plan while employees' money goes into the DC plan. The DC plan is of an unknown type (likely a 401(a), but nothing on the website states the plan type explicitly) with a 6% mandatory employee contribution. Unusually, investments in the DC plan are state-directed rather than participant-directed. A 457(b) plan is provided for additional elective deferrals. Both the DC plan and 457(b) plan are administered by the same third-party provider; the DB plan is self-administered. See more: Oregon retirement system website.

VIRGINIA

This state introduced a combination DB/DC plan for those hired 1/1/14 or later, whereby employer and employee contributions are split between the two plans. Existing traditional DB plan participants were permitted to opt into the new plan, but only until 4/30/14. The DB plan requires a 4% employee contribution. The DC plan is a 401(a) plan, which consists of a 1% mandatory employee contribution as well as a 1% employer contribution. Employees may make additional elective deferrals of up to 4% and receive an additional 2.5% in employer matching contributions, for a total employer match of 3.5% (all matching contributions are directed to the 401(a)). A 457(b) plan is provided for the elective deferrals of up to 4%, since the 401(a) cannot accommodate such deferrals, as well as any additional elective

deferrals. In an unusual arrangement, all plans are administered jointly by the state and a third-party provider. See more: Virginia retirement system website.

WASHINGTON

Since 2000 (1996 for teachers), employees have had the option of choosing between a traditional DB plan and a combination DB/DC plan whereby employer contributions are allocated to the DB plan and employee contributions to the DC plan. Employees who do not make an election within 90 days are defaulted to the hybrid DB/DC plan. Certain employees have the ability to transfer from the DB to hybrid DB/DC plan once a year, but cannot transfer back to the DB plan. The DC plan is a 401(a) structure with a minimum mandatory employee contribution of 5%, though employees can choose from among a menu of higher mandatory rates (up to 15%), some of which automatically escalate at certain ages. A 457(b) plan is provided for elective deferrals. The 401(a) plan is administered by a single third-party provider, while the 457(b) plan is administered by a different third-party provider. The DB plan is self-administered. See more: Washington retirement system website.

States that Currently Maintain Cash Balance or Similar Pension Plan Designs

KENTUCKY

New hires on or after 1/1/2014 were enrolled in a cash balance plan, while employees hired prior to that date continue participation in a traditional DB plan. Employees must contribute 5% to the plan (8% for police/fire), and the employer contribution is 4% (7.25% for police/fire). An additional 1% must be contributed by the employee to a health insurance fund for retiree medical benefits. The minimum interest credit is a 4%, with additional interest credited at the rate of 75% of any excess average actual return above 4% over the previous 5-year period. There are 401(k) and 457(b) plans for additional elective deferrals. The DC plans are both administered by a single third-party provider; the cash balance and DB plans are self-administered. See more: Kentucky retirement system website

NEBRASKA

This state took the unusual step of transitioning from a DC plan to a cash balance plan in 2003. Teachers and other public school employees, however, as well as judges and state police, are covered in traditional DB plans. New hires on or after 1/1/2003 were enrolled in the cash balance plan, and DC plan employees have been provided with periodic opportunities since that time to transfer to the cash balance plan. Employees must contribute 4.8% to the plan, and the employer contribution is 7.5%. There is an interest credit based on the federal mid-term rate plus 1.5%. The minimum credit is 5%, which is the current level since interest rates are so low. There is a 457(b) plan for additional elective deferrals. Unusually, a single third-party provider administers both the

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DC and the cash balance plan. See more: Nebraska retirement system website

States that Currently Have Traditional DB Plans But Plan to Transition to an Alternative Model

KANSAS

The state has enacted legislation to transition from a traditional DB to a cash balance plan for most of its employees hired 1/1/2015 or later. There was a bill in the legislature to implement a DC plan instead of a cash balance plan for such hires, and to replace the cash balance plan legislation, but that bill did not make it out of committee.

ILLINOIS

The state has enacted legislation that includes, among other major pension changes, an option for employees (capped at 5% of all pre 1/1/2011 plan participants) to make an irrevocable election to switch from the existing DB plan to a new DC plan. The effective date for these changes was to have been June 1, 2014, but the implementation has been delayed by the courts.

RHODE ISLAND

Legislation was enacted to transition all employees from the current traditional DB plan to a combination DB/DC plan, effective July 1, 2012, but litigation has repeatedly delayed implementation.

TENNESSEE

Legislation has been enacted, mandating that all employees hired on or after July 1, 2014 participate in a combination DB/DC plan. Existing employees, who participate in a traditional DB plan, are unaffected by this legislation.

The remaining 30 states currently sponsor a traditional DB plan and have not enacted any legislation to transition to an alternative model, despite discussions in almost every state to reform traditional pension plans in some manner, to address funding shortfalls. These states are, as follows:

Alabama	Idaho	Mississippi	North Carolina	Wisconsin
Arizona	Iowa	Missouri	Oklahoma*	Wyoming
Arkansas	Louisiana	Nevada	Pennsylvania	
California	Maine	New Hampshire	South Dakota	
Connecticut	Maryland	New Jersey	Texas**	
Delaware	Massachusetts	New Mexico	Vermont	
Hawaii	Minnesota	New York	West Virginia	

* 2015 budget includes a DC plan for new hires, but legislation has yet to be enacted (though a bill has passed in one branch of state government, the House of Representatives).

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** Texas is composed of several retirement systems. Two systems—The Texas County & District Retirement System and the Texas Municipal Retirement System—offer cash balance plans for counties, municipalities and some local agencies such as public utilities.

Note that some of these states do provide a nontraditional option for small segments of their populations; for example, California offers a cash balance plan for part-time employees and adjunct faculty. Such plans are disregarded for purposes of this review.

In addition, public university system employees in most states have the option to choose a DC plan as well, often a 401(a) and/or 403(b) plan sponsored by the university. Of course, school district employees often have a 403(b) plan as an elective deferral option, in addition to the state 401(k)/457(b) options described above.

Conclusion

The most direct impact of the migration from traditional DB plans to alternative models is on those employers and employees in the state systems who participate in such plans. However, even entities that may not employ individuals from the public sector may still be affected, if they compete with public institutions for employees, including public hospitals, colleges and universities. Those who sponsor a traditional DB plan should be aware of the continued shrinkage of the overall DB plan market, recognizing that states sponsor some of the largest DB plans in the U.S. On the flip side, continued expansion of the DC arena would likely increase competition among service providers to that market, further enhancing the service/fee equation for DC plan sponsors.

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