Should the Connecticut move from its Defined Benefit (DB) Plan to a mandatory Defined Contribution (DC) Plan

The Commission examined the possibility of moving existing and future retirement plan participants from the existing DB Plan to a DC Plan. Currently, the State offers an optional DC plan or Alternative Retirement Program where the State deposits 8% of salary into an employee's account and the employee contributes up to 5% of his or her salary into such account. This program is in lieu of the traditional DB plan. The employee makes an irrevocable choice to enter this Plan upon the start of employment. This option has not been widely accepted by state workers and those who have chosen it have generally have had second thoughts given the poor equity results of recent years. It is however a choice and provides a portable benefit that appeals to certain employees. The question is to make a DC Plan for either new employees and/or existing workers mandatory.

The primary benefit for Connecticut in transitioning its workers and future workers into a DC Plan would be to cap the State's annual and future retirement costs. It would accomplish this by transferring 100% of existing investment risk from the State to the employee. As such the DC retirement plan would also be similar to most plans offered in the private sector. Although attractive from a budgetary point of view, there are reasons of fairness, social benefits and economics to maintain most, if not, all aspects of the current DB Plan for both the state and its workers.

First, the Plan's current unfunded actuarially accrued liability (UAAL) is largely attributable to the State not funding pension liabilities until the mid-1980's, early retirement incentives or RIPs and below plan investment performance. The UAAL associated with Tier II and Tier IIA workers is only a one-third of the overall UAAL due to plan modifications applicable to newer workers. It seems unfair to take away a valuable benefit from current workers due to a State decision not to fund prior obligations to Tier I employees. Why should recent employees subsidize a funding error made by the State?

Second, the existing DB Plan provides significant benefits to both the State and its employees including:

- Attracting and maintaining workers – in order to receive benefits significant service time is required and benefits build over time;
- Automatic Coverage – DB Plans do not require an employee to opt in;
- Protected Money – DB Plans maintain monies in a block and do not permit individual loans. DC Plans permit loans and hardship withdrawals;
- Professional Management – DB management protects against bad individual investment decisions and generally produce better outcomes at a lower cost for DB Plan participants. **Employees focusing on their jobs not their investment choices**;
- Lifetime Income – DB benefit plans provide retirees lifetime income without the possible financial risk of large individual withdrawals associated DC Plans;
- Special Protection for Spouses – ERISA requires that a joint life annuity be the default benefit option.

The Commission recommends that the existing DB Plan with the employee option of DC Plan be retained. We do however recommend that adjustments to the existing DB be considered to reduce the growing UAAL, which threatens the State's overall credit quality and crowds out discretionary spending. These adjustments include considering increasing employee contributions, identifying new funding sources, creating a new less generous Tier for future employees and work rule changes to control unintended pension benefits. The State's Actuarially Required Contribution (ARC) to the Plan is the fastest growing component of the State budget. The ARC was $807 million for FY 2010 and is on track for rapid growth in future years as weaker investment performance is factored in - absent any Plan changes.