

The difference is what's defined

There's a lot of information out there regarding the New Hampshire Retirement System, some of it fact, some of it fiction. This document, along with others in the "NHRS ... Now You Know" series, is designed to provide you with straight talk about the retirement system.

Most people are familiar with Defined Contribution (DC) plans, such as a 401(k). When public employees in New Hampshire begin working in a position covered by NHRS, they become part of a Defined *Benefit* (DB) plan, also referred to as a pension plan. So, what are the major differences between the two?

DB plans, which have been around much longer, provide a guaranteed lifetime benefit based on a pre-determined formula. While DB plans are typically designed so that the combination of member and employer contributions and investment income pre-fund future benefits, the employer is ultimately responsible for ensuring the benefit is paid.

DC plans are common among employer-sponsored retirement plans in the private sector. With these plans, the amounts contributed are what is defined, not the benefit. Employees contribute a set amount from their

paychecks toward their retirement. Some employers may also contribute to their employees' retirement accounts, often matching the employee's contribution up to a certain level.

At one point, DB plans were the "norm" in terms of retirement benefits in both the public and private sectors. Today, the number of DB plans has decreased as more and more private employers have switched to a DC model over the past 35 years. A key reason for the switchover comes down to risk. With a DC plan, there is no ongoing financial obligation to the employer if a former employee outlives his or her retirement savings. DC plans are also less complex to administer. DB plans are now primarily seen only in the public sector.

Though both types of plans ultimately provide a retirement benefit to the employee, there are key differences between the two.

In a DC plan, employees may adjust the amount they contribute toward retirement within limits set in the tax code. Employees also have more freedom in choosing where to invest their contributions, which may or may not be a good thing depending on how well-informed – or lucky – the individual employee is. DB plans are a bit more rigid, typically having a set contribution amount for employees and variable rates for employers. With these plans, employees do not have a choice in where their contributions are invested, as all assets are typically pooled and

professionally managed in a trust. Pooled assets in a DB plan have historically outperformed individual DC accounts and tend to pay lower investment fees.

There are different rules as to when members may collect their funds. DC plans typically require members to reach age 59½ to collect without an early withdrawal penalty, though different plans may have different guidelines. Most DB plans require members to work a certain number of years before they become eligible for a pension in retirement, known as “vesting,” and require members to reach a specific age before they can collect (the “normal retirement age”).

Most DB plans also include death and disability benefits. In DC plans, the member's account balance is usually all that is payable at death or disability.

Perhaps the biggest difference comes when it's time to retire. Contributions from a DC plan are finite, meaning that the contributions plus investment earnings can one day run out. Recipients must be strategic in how they budget and plan to ensure their DC account will last throughout their retirement. DC plans are also subject to stock market swings, meaning an account's value can fluctuate depending on the state of the economy. Members will want to keep an eye on their investments and strategize accordingly.

This is not the case with a DB plan. Benefits are paid for the remainder of a retiree's life, as well as a survivorship benefit if they so choose. These benefits are typically determined at retirement based on determinable factors, such as how many years the member worked, the member's salary in the position(s) held, and a benefit multiplier outlined in statute. The benefit multiplier is the calculation of a member's Average Final Compensation and Creditable Service. Group I (Employee and Teacher) and Group II (Police and Fire) have distinct benefit multipliers. Once the benefit amount is calculated, retirees will first receive their contributed funds back in the form of a monthly benefit. When those funds are exhausted, the pension trust fund continues to fund the benefit. DB plans may also provide periodic cost-of-living adjustments at the discretion of the plan sponsor. In New Hampshire, the Legislature is the plan sponsor.

There are arguments for and against each type of plan, and each comes with its own set of pros and cons. While DC plans provide more flexibility in contributions and investments, DB plans provide a guaranteed lifetime income that is not subject to investment risk. Having financial security in retirement is invaluable, and with the NHRS DB plan, retirees are secure in knowing they will receive their monthly benefits for life.