Hybrid plans have been in place in public sector retirement systems for decades. Currently, this plan design is receiving increased attention as states find that closing a traditional defined benefit pension plan to new employees could increase—rather than reduce—costs, and that providing only a 401(k)-type plan does not meet retirement security, human resource, or fiscal needs. While most states made the decision to retain their defined benefit plan by modifying required employer and employee contributions, restructuring benefits, or both, some have also looked to so-called “hybrid” plans that combine elements of traditional pensions and individual account plans.

This brief examines two types of hybrid plans in use in the public sector. The first is a cash balance plan, which marries elements of traditional pensions and individual accounts into a single plan (see Table 1). The second combines a smaller traditional defined benefit (DB) pension with an individual defined contribution (DC) retirement savings account, referred to in this brief as a “DB+DC plan” (see Table 2). Despite variability among these plans, most contain the core retirement plan elements known to promote retirement security: mandatory participation, shared financing between employers and employees, pooled assets invested by professionals, a benefit that cannot be outlived, and survivor and disability protections.

Mandatory Participation
In the private sector, just one-half of the workforce participates in an employer-sponsored retirement plan, a factor identified as a major cause of the nation’s growing retirement insecurity. By contrast, for nearly all employees of state and local government, retirement plan participation is mandatory. State hybrid plans are no exception, as employee participation remains mandatory in these programs. The Georgia Employees’ Retirement System (ERS) hybrid plan has a mandatory DB component. Its DC component has a default employee contribution of 1 percent with a matching employer contribution. However, employees may elect to increase or decrease participation or to opt out of the DC component altogether.

Most public employees also have access to a supplemental, voluntary individual retirement savings plan, such as a 401(k), 403(b) or 457 plan. In addition to mandatory participation in the primary plan, some public employers automatically enroll new hires in supplemental retirement savings plans, and participants may opt-out at any time.

Shared Financing among Employers and Employees
Nearly all traditional pensions in the public sector require employees to contribute toward the cost of their retirement benefit. In the wake of the Great Recession, many states have increased employees’ required contributions.

Hybrid plans also typically employ a shared financing approach to retirement benefits. State hybrid cash balance plans, which feature accruals on employee accounts (cash balances), are funded with mandatory contributions from both employees and employers. DB+DC plans vary regarding the level to which employees and employers are required to contribute toward the DB and DC components.
For the hybrid plans in Indiana, Ohio, Oregon, and Washington, the employer finances the DB component, and the DC component is funded by mandatory employee contributions (ranging from 3 percent to 15 percent of salary). The Michigan Public Schools hybrid plan requires employees to contribute to the DB component on a graduated scale based on pay, and employers finance the remainder; employees are also required to make a mandatory 2-percent-of-salary contribution to the DC component, which employers match at a 50 percent rate.

The Georgia ERS hybrid requires employees to contribute 1.25 percent of salary to the DB component with the remainder financed by the employer. There are no required employee contributions to the DC component, but employers match the first 1 percent of salary and one-half of the next 4 percent of salary voluntarily contributed by the employee.

The Utah retirement system requires employers to contribute 10 percent of salary (12 percent for public safety) toward the DB plan’s cost. If the cost is less than the employer’s 10 percent contribution rate, the difference goes into employees’ individual 401(k) savings account. If the cost of the DB plan exceeds the employer’s 10 percent contribution rate, employees must contribute the difference to the DB plan. In either instance, employees may elect to make additional contributions to the 401(k) plan.

### Pooled Assets
Retirement assets that are pooled and invested by professionals offer multiple advantages over individual, self-directed accounts. Combined portfolios have a longer investment horizon, which allows them to be better diversified and to sustain market volatility. In addition, the professional asset management and lower administrative and investment costs in pooled arrangements result in higher investment returns.

Assets for cash balance plans are pooled and invested by professionals and guaranteed annual returns are provided to plan participants. DB+DC plans pool assets in the DB component and management of assets in the DC component varies. Most plans provide a range of risk-based investment options: some are mutual funds available to the general public and others are maintained by the retirement system and available only to plan participants. Assets in the Oregon DC component are pooled and invested in a fund similar to the DB plan fund; similarly, Washington provides an option for employees to invest their DC assets in a fund that emulates the DB plan fund.

### Required Lifetime Benefit Payouts
An overarching objective of retirement plans is to provide income insurance in old age. Longevity risk is the danger that a participant could outlive their retirement assets. Most public sector plans require some or all of the pension benefit to be paid in the form of an annuity – installments over one’s retired lifetime – rather than allowing benefits to be distributed in a lump sum. This not only better ensures participants will not exhaust retirement assets, but it also reduces costs by distributing longevity risk across participants.

The two statewide hybrid cash balance plans in Texas require accounts to be paid in the form of a lifetime benefit, although employees may elect to receive a small portion of their benefit as a partial lump sum upon retirement. The Nebraska hybrid cash balance plan gives employees the option of receiving a lifetime benefit payout on some or all of their account balance, or to instead receive any portion of their retirement benefit as a lump sum.

DB+DC plans generally require the DB portion of the plan to be paid in the form of a lifetime benefit. The DC portion, however, generally may be paid out in various forms including a lifetime benefit, a lump sum or partial lump sum of the account balance, or installments over a certain term (e.g., 5, 10, 15 or 20 years).

### Social Security, Disability and Survivor Benefits
Approximately 25 percent of state and local government employees do not participate in Social Security. While most public sector retirement plan designs seek to replace a targeted percentage of income, they also account for the presence or absence of income from Social Security.
Benefits that provide for a form of insurance regarding death or disability are an important feature in the public sector, particularly as many jobs involve hazardous conditions. Most plans in the public sector—whether traditional or hybrid—integrate survivor and disability benefits into the pension, which is generally the most cost-effective way to do so.

**Conclusion**

The information in the tables below illustrates how states are using various combinations of retirement plan design to achieve their retirement plan objectives. This diversity in plan design reflects the fact that a one-size-fits-all solution does not meet different states’ human resource needs and fiscal conditions and frameworks. The critical factor in evaluating a retirement plan is the extent to which the plan contains the core elements of public pension plan design known to promote retirement security: mandatory participation, shared financing, pooled investments, benefit adequacy, and lifetime benefit payouts. These features are a proven means of delivering income security in retirement, retaining qualified workers who perform essential public services, and providing an important source of economic stability to every city, town, and state across the country.\(^8\)

**See Also**


National Conference of State Legislators, State Defined Contribution and Hybrid Pension Plans, [http://www.nasra.org/resources/NCSL_DC_Hybrid.pdf](http://www.nasra.org/resources/NCSL_DC_Hybrid.pdf)


**Contact**

Keith Brainard, Research Director
National Association of State Retirement Administrators
keithb@nasra.org
www.nasra.org

---

2. NASRA, “Selected Approved Changes to State Public Pensions to Restore or Preserve Plan Sustainability,” [http://www.nasra.org/resolutions.htm#200701](http://www.nasra.org/resolutions.htm#200701)
5. NASRA, “Selected Approved Changes,” supra
6. Employers are also required to contribute an additional five percent of salary to amortize the DB plan unfunded liability
<table>
<thead>
<tr>
<th>Year plan approved</th>
<th>Nebraska County and State</th>
<th>Texas Municipal</th>
<th>Texas County and District</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002</td>
<td>1947</td>
<td>1967</td>
</tr>
</tbody>
</table>

**Employee groups affected**
- Mandatory for county and state EEs* hired after 2002 and those hired previously who elected to switch from the DC plan
- Mandatory for EEs of 800+ cities that have elected to participate in the TMRS
- Mandatory for EEs of 600+ counties and special districts that have elected to participate in the TCDRS

**Contributions**
- State EEs contribute 4.8%, county EEs contribute 4.5%
- State contributes 156% of EE rate; counties contribute 150% of EE rate
- EEs pay 5%, 6%, or 7%, depending on ER* election
- ER pays 100%, 150%, or 200% of EE rate, also depending on ER election, and adjusted based on unfunded liability
- EEs pay 4%, 5%, 6%, or 7% depending on ER election
- ERs pay normal cost plus amount to amortize the unfunded liability within a 20-year closed period

**Rate of return applied to cash balances**
- Based on the federal mid-term rate plus 1.5%. When the mid-term rate falls below 3.5%, EEs receive a 5% minimum credit rate
- When favorable returns combine with an actuarial surplus, the governing board may approve a dividend payment to EE accounts
- 5% (set by statute): The TMRS Board determines the allocation of any excess amounts
- The board is authorized to distribute such amounts a) to reduce cities’ unfunded liabilities; b) to EEs’ individual accounts, and/or c) to a reserve to help offset future investment losses
- 7% (set by statute): Used to reduce ERs’ unfunded liabilities and accumulated in a reserve account to offset future losses

**Benefit payment options**
- Rollover, lump sum or annuity
- Annuity with or without a partial lump sum, depending on EE election
- Annuity based on final savings balance and ER matching with or without a partial lump sum, depending on EE election

**Info online**
- [www.npers.ne.gov](http://www.npers.ne.gov)
- [http://www.tcdrs.org](http://www.tcdrs.org)

* EE = employee; ER = employer
Table 2: Overview of Hybrid Plans: Smaller Defined Benefit + Defined Contribution (DB+DC)

<table>
<thead>
<tr>
<th>Georgia Employees' RS</th>
<th>Indiana Public RS</th>
<th>Michigan Public Schools RS</th>
<th>Ohio Public Employees' RS</th>
<th>Ohio State Teachers' RS</th>
<th>Oregon PERS</th>
<th>Washington Dept of RS</th>
<th>Utah RS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee groups affected</strong></td>
<td>Mandatory for new hires since 2009; optional for those hired before 2009 (EE* may opt-out of DC component within 90 days)</td>
<td>Mandatory except for EE hired after 2011 who may elect a DC plan only</td>
<td>Mandatory for all new hires after 06/30/2010</td>
<td>Optional for new hires and non-vested workers since 12/31/02</td>
<td>Optional for new hires and non-vested workers since 2001</td>
<td>Mandatory for all EEs (existing and new) since 2004</td>
<td>Optional for most employee groups</td>
</tr>
<tr>
<td><strong>Defined Benefit Portion</strong></td>
<td>1.0% x years of service x final average salary = annual benefit</td>
<td>1.1% x years of service x final average salary = annual benefit</td>
<td>1.5% x years of service x final average salary = annual benefit</td>
<td>1.0% x up to 30 years of service x final average salary + 1.25% x years in excess of 30 x final average salary = annual benefit</td>
<td>1.0% x years of service x final average salary = annual benefit</td>
<td>Varies depending upon date of hire and which one of three DB plans EE is enrolled</td>
<td>1.0% x years of service x final average salary = annual benefit</td>
</tr>
<tr>
<td><strong>DB benefit formula (having met age/service requirements)</strong></td>
<td>EE contributes 1.25% and ER* contributes remainder</td>
<td>ER funds the DB benefit</td>
<td>EE contributes on a graduated scale based on pay; ER contributes remainder</td>
<td>ER funds DB benefit</td>
<td>ER funds DB benefit</td>
<td>ER funds DB benefit</td>
<td>ER funds DB benefit</td>
</tr>
<tr>
<td><strong>DB plan contributions</strong></td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Defined Contribution Portion</strong></td>
<td>None</td>
<td>ER contributes 1% of salary</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Employer DC plan contributions</strong></td>
<td>100% ER match on EE’s 1st 1% of salary and 50% match on next 4% of salary for a maximum ER contribution of 3%</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

*ER*: Employer Retirement; *EE*: Employee Retirement; *DB*: Defined Benefit; *DC*: Defined Contribution

November 22, 2011   |   NASRA ISSUE BRIEF: State Hybrid Retirement Plans   |   Page 5
Table 2: Overview of Hybrid Plans: Smaller Defined Benefit + Defined Contribution (DB+DC)

<table>
<thead>
<tr>
<th>Georgia Employees’ RS</th>
<th>Indiana Public RS</th>
<th>Michigan Public Schools RS</th>
<th>Ohio Public Employees’ RS</th>
<th>Ohio State Teachers’ RS</th>
<th>Oregon PERS</th>
<th>Washington Dept of RS</th>
<th>Utah RS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee DC plan contributions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EE auto enroll at 1.0% of salary contribution but may vary contribution rate up or down</td>
<td>3.0% of salary</td>
<td>2.0% of salary</td>
<td>10.0% of salary</td>
<td>10.0% of salary</td>
<td>6.0% of salary</td>
<td>5% to 15% of salary depending on EE</td>
<td>EE contributions optional</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>DC plan investment options</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 options ranging from conservative to aggressive, plus 5 lifecycle funds</td>
<td>7 options ranging from conservative to aggressive, and 10 target date funds, all administered by the retirement system</td>
<td>Choice of active and passive investment options, target date funds, and a brokerage window</td>
<td>16 OPERS-sponsored funds including core and target date funds, plus a brokerage window</td>
<td>8 options ranging from conservative to aggressive including a guaranteed return option</td>
<td>All DC plan contributions are invested in a single, pooled fund that mirrors the DB plan fund</td>
<td>Either the total allocation portfolio, which mirrors DB plan fund, or 7 self-directed funds ranging from conservative to aggressive, plus target date funds</td>
<td>12 risk-based options</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Default DC plan investment options</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lifecycle funds based on age</td>
<td>The Guaranteed Fund, which earns a fixed rate established annually by the Board</td>
<td>Target Retirement Fund that matches the year the participant will be eligible to retire</td>
<td>Target Date Fund closest to the year the participant turns 65</td>
<td>Money market fund</td>
<td>DB plan fund</td>
<td>Target Date Funds</td>
<td>Medium Horizon Fund, which features a diversified investment portfolio</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>DC plan withdrawal options</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rollover, annuity, lump sum, partial lump sum, installments</td>
<td>Annuity, rollover, partial lump sum and annuity, deferral until age 70%</td>
<td>Lump sum, consolidation from other plans, direct rollover to an IRA, periodic distribution</td>
<td>Annuity, including partial lump sum option plan; deferral until age 70%</td>
<td>Annuity including partial lump sum lump sum, or rollover</td>
<td>Lump sum payment or in installments over a 5-, 10-, 15-, or 20-year period or the EE’s anticipated lifespan</td>
<td>Lump sum, direct rollover, scheduled payments, personalized payment schedule, and annuity purchase</td>
<td>After 4-year vesting period: lump sum, partial balance, periodic distribution, direct rollover, direct rollover to an IRA</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Info online</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The National Association of State Retirement Administrators is a nonprofit, nonpartisan association for the directors of the nation’s largest public retirement systems. NASRA members oversee systems holding over $2 trillion in assets to fund pension and other benefits for nearly two-thirds of the state and local government workforce. To learn more, visit www.nasra.org