Are California Teachers Better Off with a Pension or a 401(k)?

Not only are California's educators better off with the CalSTRS Defined Benefit Program, but schools greatly benefit from the reduced workforce turnover. Created in 1913, the CalSTRS pension benefit structure was designed as a retention tool to reward full-career educators, as well as to provide retirement security to program participants. This superior design stands the test of time and complements the career trajectories of California's educators.

A recent UC Berkeley study, *Are California Teachers Better Off with a Pension or a 401(k)?*, shows the existing CalSTRS pension structure—which is designed to benefit teachers who stay until at least early retirement age—is better matched to meet the retirement needs of the teaching workforce than either a 401(k)-style or cash balance plan.

Study's Key Findings Show Pensions Benefit a Long-Term Educator Workforce

Three-quarters of classroom teaching in California is performed by long-term teachers

61
age at retirement with around 29 years of service

75%
of active educators will have worked at least 20 years

49%
of educators will retire with 30 or more years of service

26%
will have been covered by CalSTRS for 20–29 years

Misleading Information on Teacher Tenure Dominates Pension Studies

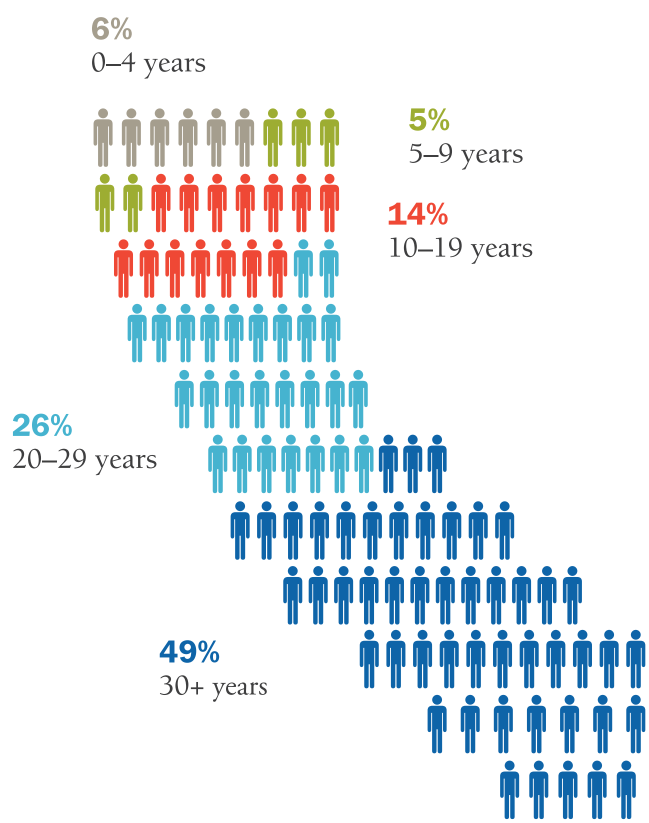
Several studies on 401(k) and cash balance plans for teachers wrongly suggest that new-hire attrition rates, or teacher turnover, should drive retirement plan design. While it is true that account-based retirement plans reward those who leave the education profession early, restructuring retirement benefits to advantage temporary teachers, at the expense of a large majority of educators, makes little sense. **Further, it is misleading to use young, new-hire turnover to represent the majority of the educational workforce as a whole.**

Similar to other professions, turnover is highest in the early years of teaching, with four out of 10 new hires leaving CalSTRS before the five-year vesting period in any given year. Many studies focus on this specific turnover rate to drive their recommendations; however, this misrepresents the active teaching workforce. In practice, the workforce population who leave during the five-year vesting period, represents only 6 percent of educators in California's classrooms today.

The vast majority of teaching in California is performed by educators who have remained, or will remain beyond the initial high-attrition years.

Once vested, few teachers leave before retirement age. Three-quarters earn 20 or more years of service.

Projected Tenure of Current California Teachers



Defined Benefit Pensions Aid Workforce Management

401(k) plans create stark inequalities between retirement cohorts because retirement income varies wildly with volatile financial markets.

Educators caught in this situation have a 50 percent chance of either exceeding their expected defined contribution outcomes by one-third or falling short by one-third.

- In contrast, the CalSTRS Defined Benefit pension provides guaranteed retirement income for vested members.
- Defined benefit pensions aid in retaining educators for the long haul, while encouraging them to exit in their 60s.
- Account based retirement plans however, would increase the incentive for young and mid-career teachers to leave and decrease the ability of older educators to retire.

Defined Benefit Pensions Reward California's Educators

Overall, the CalSTRS pension benefit structure is better matched to the needs of the active teaching workforce than 401(k) or cash balance plans. Under benefit models used in the study:

- For six out of seven teachers in California the CalSTRS Defined Benefit pension provides a greater, more secure retirement income compared to a 401(k)-style plan.
- The CalSTRS Defined Benefit pension becomes greater than an idealized 401(k) defined contribution account at age 51 and 86 percent of active educators stay in California schools until at least age 51.
- The CalSTRS Defined Benefit pension becomes greater than a generously structured cash balance plan at age 56, and 79 percent of active educators will stay on the job until age 56.

For those who commit to teaching as a profession, the CalSTRS defined benefit plan is a powerful retention tool that serves their retirement needs well, while offering portability throughout the largest education labor market in the US.

Age When Value of CalSTRS Defined Benefit Pension Exceeds Value of Alternative Plans for Female Teachers, by Entry Age

	ENTRY AGE				
	25	30	35	40	45
DC Plan					
Baseline	51	51	49	49	50
Realistic (1% drag on returns from individual investor behavior)	47	48	46	49	50
DC Plan—Employee Contributions Only					
Baseline	43	43	42	45	50
Realistic (1% drag on returns from individual investor behavior)	38	39	40	45	50
CB Plan	56	55	54	53	52

Note: *Women make up 72% of CalSTRS active membership. For entry ages 25, 30, and 35, DB value exceeds DC and CB values one year later for male teachers than for female teachers. For entry ages 40 and older, the crossover point is the same for both genders.*

Source: *Are California Teachers Better Off With a Pension or a 401(k)?, conducted by Nari Rhee, PhD, of the UC Berkeley Center for Labor Research and Education and William Fornia, FSA of Pension Trustee Advisors.*