ebri.org
Employee Benefit
Research Institute

News from EBRI

1100 13th St. NW • Suite 878 • Washington, DC 20005
(202) 659-0670 • www.ebri.org • Fax: (202) 775-6312

FOR IMMEDIATE RELEASE: June 28, 2013

Contact: Stephen Blakely, EBRI: 202/775-6341, blakely@ebri.org
Jack VanDerhei, EBRI: 202/775-6327, vanderhei@ebri.org

New Research from EBRI:

401(k) or Pension: Which is Better for Retirement Readiness? No Simple Answer

WASHINGTON—Which type of retirement plan is likely to produce more money for retirement: A voluntary-enrollment 401(k), a traditional final-average defined benefit plan, or one of the newer cash balance plans?

A detailed analysis by the nonpartisan Employee Benefit Research Institute (EBRI) finds there is no single answer because a multitude of factors affect the ultimate outcome: interest rates and investment returns; the level and length of participation; an individual's age, job tenure, and remaining length of time in the work force; and the purchase price of an annuity, among other things.

"If historical rates of return are assumed, as well as annuity purchase prices reflecting average bond rates over the last 27 years, and real-life job tenure experience, EBRI's modeling results show a strong advantage for voluntary-enrollment 401(k) plans over both the final-average defined benefit plans and cash balance plans," said Jack VanDerhei, EBRI research director and author of the study.

"However, when subjected to various 'stress tests' by reducing the rate of return assumptions by 200 basis points and increasing the annuity purchase price to reflect today's bond rates, results show that in many cases the voluntary-enrollment 401(k) plans lose their comparative advantage to the final-average defined benefit plans (at least at the median) for lower-paid employees, though voluntary-enrollment 401(k) plans' median advantages over the stylized cash balance plans remain in force."

The baseline analysis uses the median level of employer generosity for both final average defined benefit plans and cash balance plans, but when the simulations are re-run with more generous provisions for the defined benefit plans, the relative advantages of the 401(k) plan decrease.

EBRI's analysis, using its unique Retirement Security Projection Model® (RSPM) to produce a wide range of simulations, provides a direct comparison of the likely benefits under specific types of defined contribution (DC) 401(k)-type plans and defined benefit (DB) retirement plans. The DC plans modeled in the analysis represent voluntary-enrollment 401(k) plans, while the DB plans are represented by two stylized plans: a high-three-year, final-average defined benefit plan and a cash balance plan.

VanDerhei said one additional factor that that should be taken into account when comparing the two different types of plans is that workers often contribute to 401(k) accounts, unlike traditional defined benefit pensions, which in the private sector are typically funded exclusively by the employer. He also noted that this particular research did not consider the impact of automatic-enrollment 401(k)s.

Full results are published in the June *EBRI Issue Brief*, "Reality Checks: A Comparative Analysis of Future Benefits from Private-Sector, Voluntary-Enrolment 401(k) Plans vs. Stylized, Final-Average-Pay Defined Benefit and Cash Balance Plans," available online at www.ebri.org

The Employee Benefit Research Institute is a private, nonpartisan, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. The work of EBRI is made possible by funding from its members and sponsors, which includes a broad range of public, private, for-profit and nonprofit organizations. For more information go to www.ebri.org or www.asec.org

###