



California Retired Teachers Association

Defined Benefit and Defined Contribution Retirement Systems

Private industry, some public employers and the Social Security reform commission all have expressed interest in expanding the number of defined contribution retirement systems while decreasing the number of defined benefit retirement systems. What are the differences between such systems and what type of system is the California State Teachers Retirement System?

Defined Contribution Retirement Systems

The most common defined contribution systems are the 401 (k): 403 (b): and 457 retirement accounts. These types of accounts are employee owned and directed. Employees pay into the account (with an employer match in many cases) and have the full value of any earnings from the account. The defined contribution retirement account value is totally dependent on the amount of contribution and the individual's investment decisions. All liability for the retirement adequacy is with the individual. The employer has no liability for ensuring adequacy.

Defined Benefits System

A defined benefit system guarantees a retirement benefit based upon contribution, service, and age formulas. A common defined benefit system provides a percent of income (final compensation) for each year of service. An example is the safety retirement where a police or fire service employee receives 3% of final compensation for each year of service if they stay and retire after age 55.

Defined benefit retirement system also have service minimums for vesting (usually 5 years of service before being eligible for retirement allowance) minimum retirement ages, and minimum service requirements for supplemental benefits (for CalSTRS members the highest year compensation can be used as final compensation if the member has at least 25 years of credited service rather than the average of the three highest consecutive years for members with fewer than 25 years of credited service).

As long as the employee makes the employee contribution, the employer and retirement system are obligated to ensure the benefits guaranteed by the retirement formulas. The employee has no liability for ensuring full funding of the retirement benefits. The employer and retirement system have full liability.

Examples of a defined benefit system are Social Security (other than when Congress changes the rules) and the California Public Employees' Retirement System's standard benefits.

What is CalSTRS? Defined Benefit? Defined Contribution? Both?

The main benefit program for CalSTRS is the defined benefit where members are guaranteed formula benefits as defined in statute.

CalSTRS also is a defined contribution system for all members employed between 2001 and 2011. This is because part of the employee contribution during those years will be used for a supplemental benefit that is not guaranteed in amount. The supplemental benefit is depended on CalSTRS also is a defined contribution plan for members who have additional supplemental compensation (summer school, allowances, extra duty assignments etc.) that does not count towards the defined benefit plan.

Finally, CalSTRS also is a defined contribution plan for employees who make voluntary contributions for deferred compensation and tax sheltered annuities.

Consequently, CalSTRS is a blend of both defined contribution with employees' protections and defined contribution for employee optional supplemental retirement benefits.