# OVERVIEW OF PENSION ADVISORY GROUP

September 28, 2011

House Finance Committee

Senate Finance Committee

# 2011 PENSION ADVISORY GROUP

- Established by General Treasurer and Governor
- Made up of 11 members, including labor, business and other interests
- House and Senate Fiscal Advisors served in liaison capacity
- Not designed to issue *recommendations*

# 2011 PENSION ADVISORY GROUP

- Held four public meetings in different locations across the state from June to September
- Direct public input limited to website designed for that
- Extensive work done by members in addition to public meetings

# PENSION FUNDING STATUS

Funded status result of:

- Contribution levels
- Benefit policy / benefit growth
- Asset returns
- Updated experience studies

# PENSIONS – FUNDING RATIOS

- Funding Ratios: Value of actuarial assets vs. liability
- Plan design and earnings assumptions
- 80% funding is considered “healthy”

| | FY 2011 | FY 2012 | FY 2013 |
|---|---|---|---|
| State Employees | 62.3% | 59.0% | 48.4% |
| Teachers | 61.0% | 58.1% | 48.4% |
| Judges | 91.0% | 88.3% | 77.8% |
| State Police | 79.6% | 79.8% | 69.7% |

# POTENTIAL IMPACT OF INACTION

- Lack of retirement security for public employees
- Budget pressures become unsustainable and adversely impact resources for other priorities
- Burden on active state employees
- Adverse impact on costs of borrowing

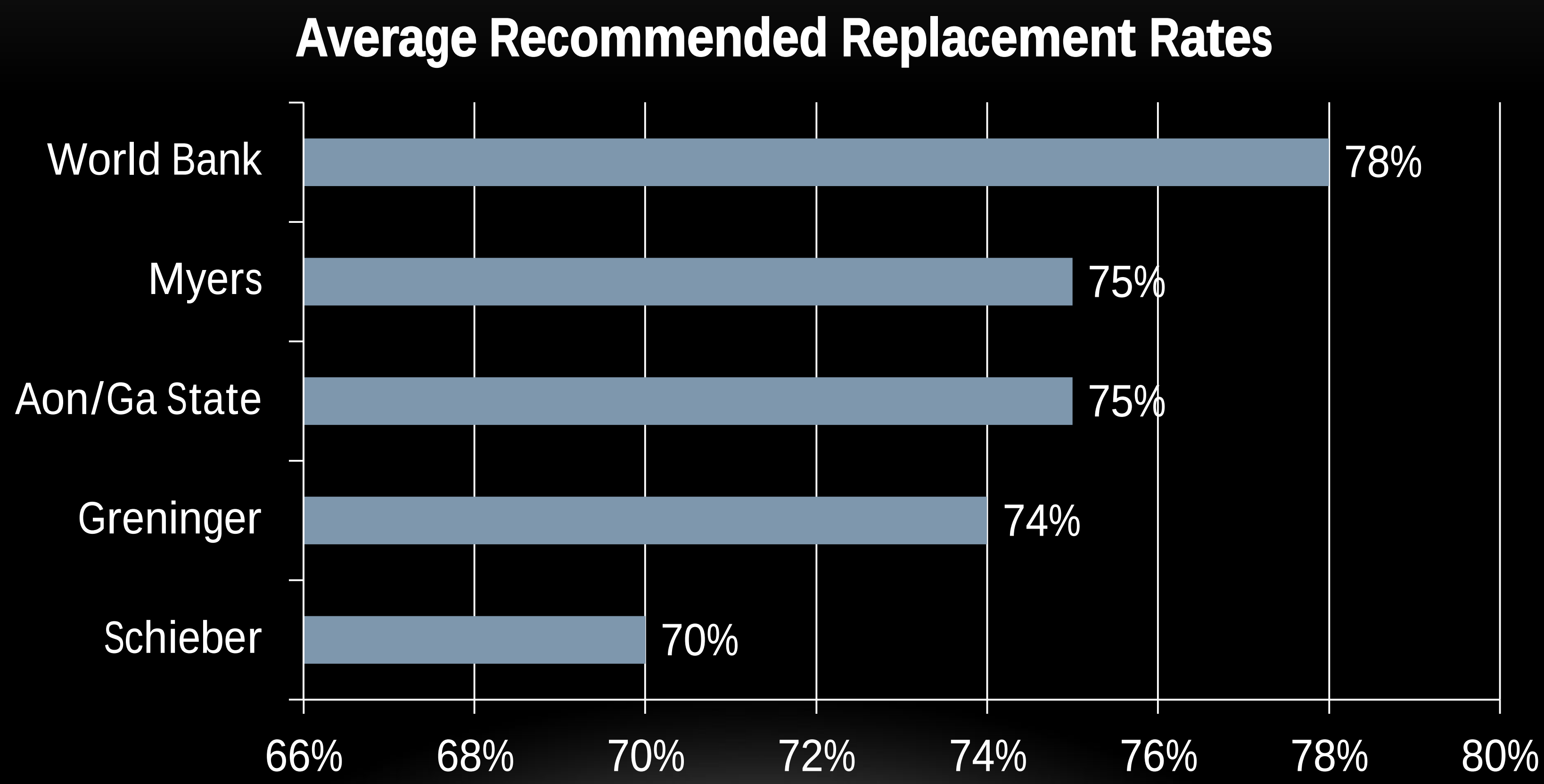
# ADVISORY GROUP – MAJOR PRINCIPLES

- Retirement security – Reliable and sustainable
- Affordable to taxpayers – Does not put undue pressure on budget
- Long term solution – Do not want to have to revisit solution

# WHAT IS A SECURE RETIREMENT?

- Focused on various reports to determine what income replacement should look like
- Generally agreed income replacement is in the range of 65-80% of income
- Agreed that there is a combination of sources to achieve this goal
- Sources range from a pension benefit, social security (for most employees) and other savings

# INCOME REPLACEMENT RANGE



# INCOME REPLACEMENT RATE FOR STATE EMPLOYEES AND TEACHERS

| Years of Service | Schedule A | Schedule B |
|---|---|---|
| | | |
| 10 | 17% | 16% |
| 20 | 36% | 34% |
| 25 | 51% | 44% |
| 30 | 66% | 55% |
| 35 | 80% | 68% |

# SOCIAL SECURITY

- Social security can replace 30% or more of a retirees' income
- However, nearly 50% of teachers in the state do not participate in social security (6,800 of nearly 14,000 teachers)
- Many public safety employees also do not participate in social security
- Raises the issue of how these employees will arrive at an income replacement target of 65-80%

# POTENTIAL PLAN DESIGN CONCEPTS

- Benefit provisions – eligibility, accruals, earning period and COLA
- Cost sharing, meaning increased employee contributions
- Tiering – creating new structure for new hires
- Self correcting mechanisms

# ALTERNATIVE FUNDING OPTIONS EXPLORED

- Reviewed State assets to see if there were opportunities to sell or lease state assets;

- Analyzed the potential for pension obligation bonds

- Reviewed the impact of re-amortization

# TYPES OF PLANS DISCUSSED

- Defined Benefit Plan
- Defined Contribution Plan
- Hybrid Plan

# DEFINED BENEFIT PLAN

- Plan provides guaranteed, predictable benefit that takes into account compensation, years of service and age

# DEFINED BENEFIT PLAN

***Pros***

- Predictable benefit for employees
- Limited risk to employees
- Efficient to operate and administer
- Encourages longer term employment

***Cons***

- Risk is on the employer/taxpayer
- Employer cost
- Lacks flexibility
- Encourages longer term employment

# DEFINED CONTRIBUTION PLAN

- Plan where contributions are made to an individual retirement account
- The retirement benefit is not pre-determined and is entirely dependent upon the account balance at retirement
- Account balance is based on the money that accumulates in an employee’s account, reflecting any employer/employee contributions and any investment gains or losses

# DEFINED CONTRIBUTION PLAN

***Pros***

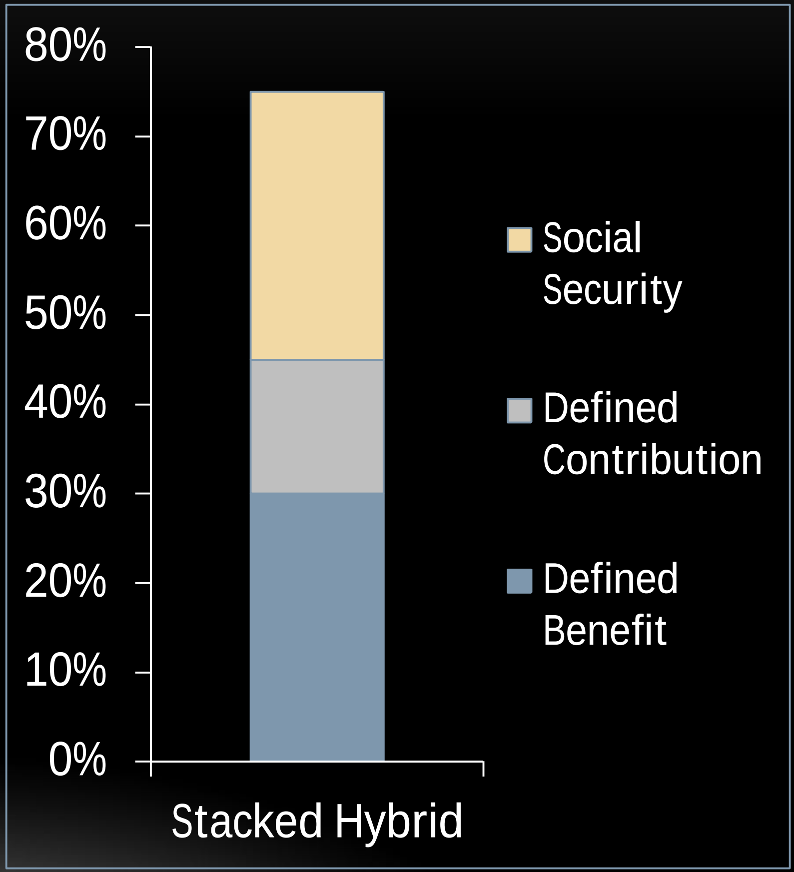
- Sense of control
- By definition, fully funded
- Permits employee mobility

***Cons***

- Past indicates low participation rate
- Individuals tend to not invest/plan well
- Risk is on the employee

# POTENTIAL FOR HYBRID PLAN

- Stacking the two plans intended to maximize advantages of DB and DC plans, while minimizing risks
- Enables risk sharing



# POSSIBLE ALTERNATE SCENARIOS

- Actuary (GRS) presented different options for changes and their impact
- Separated current retirees and those eligible to retire from current active employees
- Illustrations used state employees only for simplicity

# CURRENT VALUATION RESULTS: *STATE EMPLOYEES*

| (in millions) | Current Retirees & Eligible to Retire | Current Actives | Total |
|---|---|---|---|
| Unfunded Liability | $2,078.3 | $593.7 | $2,672.0 |
| Funded Ratio | 51.49% | 35.45% | 48.66% |
| | | | |
| Employer Normal Cost | $4.9 | $20.4 | $25.3 |
| Employer Amortization Cost | $172.1 | $49.2 | $221.2 |
| Total Employer Cost | $185.8 | $60.7 | $246.5 |
| Employer Cost as % of Payroll | 27.78% | 9.07% | 36.85% |

FROM GRS- 9/12/11 MEETING

# IMPACT COLA CHANGES: CURRENT RETIREES AND ELIGIBLE TO RETIRE

| Description | UAAL | Diff | Employer Cost – FY 2013 | Diff |
|---|---|---|---|---|
| **Current 3%** | **$2,078** | **n/a** | **$177** | **n/a** |
| - Suspension for 5 yrs. | $1,704 | $374 | $143 | $34 |
| - Re-amortization, 25 yrs. | $2,078 | - | $126 | $51 |
| **Schedule B for All** | **$1,746** | **$332** | **$145** | **$32** |
| - Suspension for 5 yrs. | $1,544 | $534 | $131 | $46 |
| - Re-amortization, 25 yrs. | $1,746 | $332 | $109 | $68 |
| **2% on first $12,000** | **$1,444** | **$634** | **$116** | **$61** |
| - Suspension for 5 yrs. | $1,373 | $705 | $110 | $67 |
| - Re-amortization, 25 yrs. | $1,444 | $634 | $86 | $91 |
| **Elimination of COLA** | **$1,153** | **$925** | **$90** | **$87** |

FROM GRS- 9/12/11 MEETING

# POSSIBLE FRAMEWORK

| Provision | Current Plan | New Plan |
|---|---|---|
| Member Contribution Rate | 8.75% | 3% |
| Replacement Accrual at 40 Yrs. | 75% capped at 38 yrs. | 40% + DC balance |
| Replacement Income at 26 Yrs. | 46% | 26% +DC balance |
| Unreduced Retirement Eligibility | Age 65 w/ 10 yrs. or Age 62 w/29 yrs. | SS NRA |
| Reduced Retirement Eligibility | Age 62 w/ 20 yrs. | Age 62 w/ 20 yrs. |
| COLA – all members, including current retirees | CPI capped at 3% on first $35,000 | Investment related w/ 2% target at 7.5% return on first $12,000 |
| Average Salary Period | 5 years | 5 years |
| Vesting | 10 years | 5 years |
| DC Member Contribution | n/a | 5.75% |

FROM GRS- 9/12/11 MEETING

# FISCAL IMPACT: *STATE EMPLOYEES*

| Valuation Results | Baseline (Current) | Alternative Scenario | Change |
|---|---|---|---|
| FY 2013 Contribution Rate | 36.85% | 21.41% | (15.44%) |
| Normal Cost Percentage | 12.17% | 7.67% | (4.5%) |
| Unfunded Liability (in millions) | $2,672.0 | $1,785.7 | ($886.3) |
| Funded Ratio | 48.66% | 58.64% | 9.99% |
| Long Term Normal Cost | 11.45% | 5.33% | (6.12%) |
| FY 2013 Contribution (in millions) | $246.5 | $153.8 | ($92.7) |
| ***Out-years*** | | | |
| *FY 2014 Contribution Rate* | *38.92%* | *23.00%* | *(15.92%)* |
| *FY 2015 Contribution Rate* | *41.23%* | *23.00%* | *(18.23%)* |
| *FY 2016 Contribution Rate* | *42.35%* | *23.00%* | *(19.35%)* |

FROM GRS- 9/12/11 MEETING

# DISTRIBUTION OF CHANGES ACROSS GENERATIONS

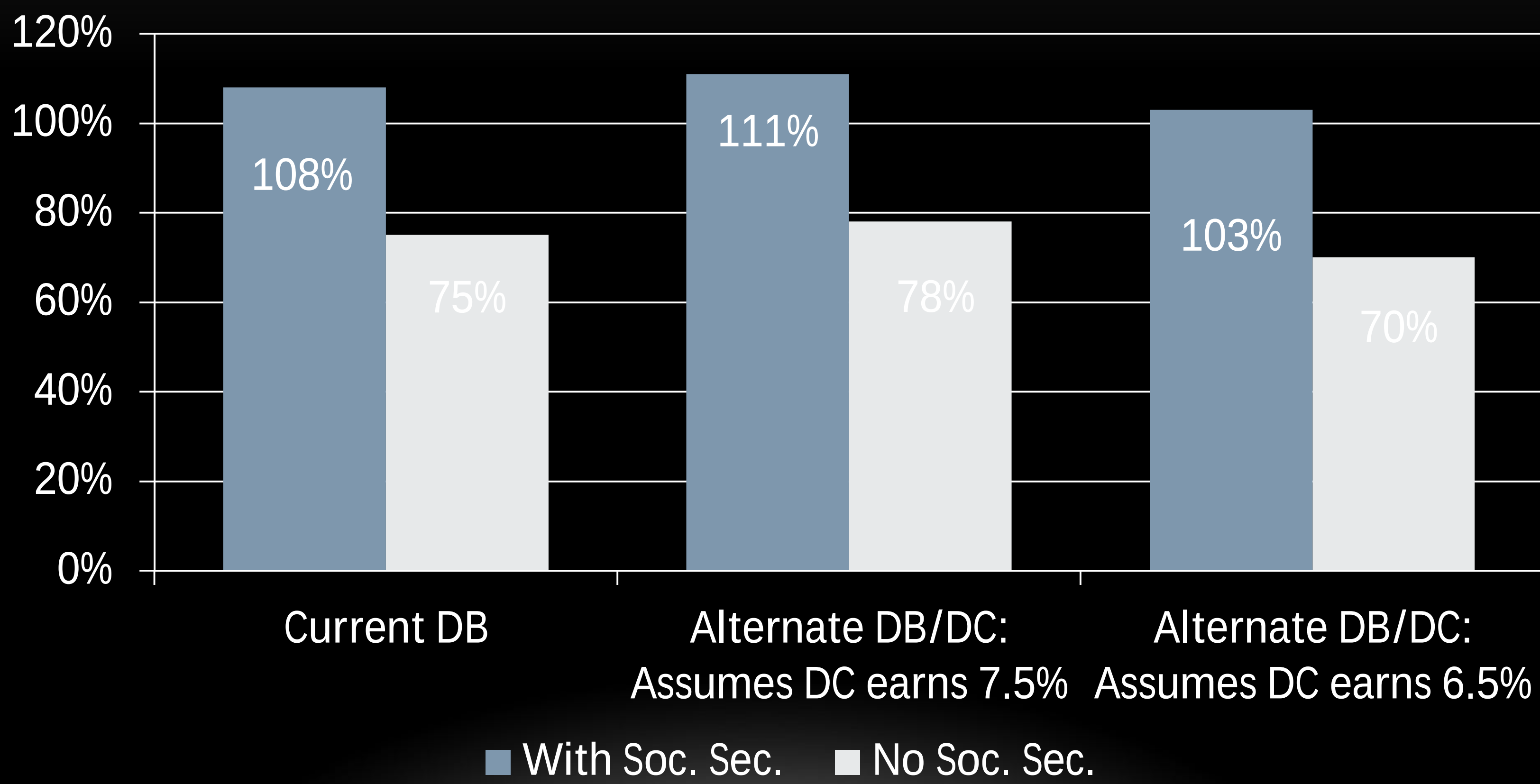
| | Current Retirees/ Eligible to Retire | Current Vested | Non-Vested & New Hires |
|---|---|---|---|
| Relative Value of Current Benefits: DB Plan | 100 | 81 | 76 |
| Alternative Chg. to Current | (19%) | (24%) | (50%) |
| Relative Value of Alt. DB Plan | 81 | 61 | 38 |
| Value Replaced by Alt. DC Plan | NA | 17 | 38 |
| Relative Value of Combined Illustrated Plan | 81 | 78 | 76 |
| Risk Sharing | 75 State/ 6 Self* | 55 State/ 23 Self | 38 State/ 28 Self |

**future COLAs tied to funding level and investment performance*

FROM GRS- 9/12/11 MEETING

# REPLACEMENT VALUE COMPARISON

## *NEW HIRE AT AGE 27, CONTINUOUS EMPLOYMENT UNTIL RETIREMENT AGE OF 67*




FROM GRS- 9/12/11 MEETING

# MEANINGFUL LEVERS

Solutions must balance the following items:

- Employer contribution
- Employee contribution rate transition
- Size of COLA, COLA deferral
- Amortization period, timeframe until 80% funded

# POSSIBLE COMBINATION OF LEVERS

| Alt | Aggregate 25 Yr. Cost Employer | Target 80% Funding Date | COLA Deferral | Member Rate Transition | Employer Rate | Other Chgs. |
|---|---|---|---|---|---|---|
| 1 | $3.94B | 2024 | 13 years | 0.5% per year | 23% | |
| 2 | $4.99B | 2029 | None | Immediate 3% | 23% | |
| 3 | $4.37B | 2024 | None | Immediate 3% | 28% | |
| 4 | $4.47B | 2027 | None | Immediate 3% | 23% | 0.75% multi-plier |
| 5 | $4.32B | 2026 | 5 years | 5% for 5 years | 23% | |
| 6 | $4.12B | 2024 | 5 years | 5% for 5 years | 25% | |

FROM GRS- 9/12/11 MEETING

# POSSIBLE ALTERNATE: *MERS POLICE & FIRE PLAN*

| Provision | Current Plan | New Plan |
|---|---|---|
| Member Contribution Rate | 9% | 9%, perhaps eventually less |
| Target Replacement Accrual | 50% (20 yrs.) | 50% (25 yrs.) |
| Unreduced Retirement Eligibility | 20 and out | Age 55 with 25 yrs. |
| Reduced Retirement Eligibility | NA | Age 55 with 20 yrs., reduced from 55 |
| COLA – all members including current retirees | 3% simple | Dynamic with 2% target at 7.5% investment return on first $12,000 |
| Average Salary Period | 3 years | 5 years |
| Vesting | 10 years | 5 years |
| DC Contribution with Soc. Sec | n/a | Initially 0%, eventually more |
| DC Contribution w/out Soc. Sec | n/a | 3% Employee & Employer |

FROM GRS- 9/12/11 MEETING

# PENSION ADMINISTRATION – DEFINED CONTRIBUTION PLANS

| 100% State Administered | Administration outsourced, range of investment options | 100% Outsourced |
| --- | --- | --- |
| • State responsible for administration and investment of individual plans<br>• Limited resources and expertise could impact ability to provide these services | • Outsource administration<br>• State could manage individual accounts or set parameters to individual investments | • Outsource administration and investment management<br>• State has little role in program, employees |

FROM GRS- 9/12/11 MEETING

# SELF CORRECTING CONCEPT

- Consideration was given to mechanisms to effectuate shared risk if pension systems fail to meet pre-determined benchmarks
- Discussion of potential triggers to move the system to a pre-determined reform schedule if system fails to meet benchmarks
- Potential to design triggers for a shared benefit should pension systems exceed pre-determined benchmarks

# MUNICIPAL PENSIONS - ISSUES

- Advisory Group discussed the non-MERS plans
- Cover general municipal, police and fire
- Combined total assets of $1.4 billion as of June 30, 2010
- Combined Unfunded Actuarial Accrued Liability of $2.1 billion as of June 30, 2010
- Overall funded ratio of 40.3% as of June 30, 2010

# MUNICIPAL PENSIONS - ISSUES

- Participation in Social Security
- Differences in who administers plans and benefits
- Variance in plan design among communities
- Disability pension provisions
- Second careers after retiring
- Variance in local fiscal capacity
- Size and severity of unfunded liabilities

# MUNICIPAL PENSION IDEAS

- Move troubled local plans into MERS
- Manage benefit changes until funded at target ratios
- Establish permanent benefit limits
- Abolish selected features of local plans
- Consider buyouts for poorly funded plans
- Conduct audits on non-MERS plans

# OTHER PENSION ISSUES DISCUSSED

- Vesting – Consider shorter vesting period for shorter term employees
- Disability pensions – Options for partial disability
- Service credits purchases – Limit to military service
- Part time work – Prohibit part time work from counting toward years of service
- Lower income earners – Discussion regarding additional provisions to protect lower income earners

# PENSION ISSUES NOT DISCUSSED OR LITTLE DISCUSSION

- Transition issues from current plans to new plans
- Impact on current workforce – minimize loss of existing talent and institutional knowledge
- Other aspects of benefit provisions, such as current age and years of service
- Other pension systems such as nurses, correctional officers, state police and judges