



## NATIONAL CONFERENCE *of* STATE LEGISLATURES

*The Forum for America's Ideas*

### STATE PENSION POLICY OPTIONS IN 2010

Ron Snell

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In 2010, states are considering more far-reaching change to state defined benefit retirement plans than any other time since those plans became the usual state practice in the middle of the 20<sup>th</sup> century. Legislatures are reviewing a wide variety of innovations to deal with unfunded liabilities and benefits costs, but one theme recurs across the country. Public employees will probably have to assume more of the burden of their retirement security than they have in the past.

This report draws examples from eight states to demonstrate the variety of policy options that have been enacted since the beginning of 2010 or are under legislative review. The sources for this report are legislation enacted or on governors' desks in three states, bills that have made their way through one chamber in two more states, and proposals from governors or retirement systems in the other three states. These are proposals made on the premise that they are politically acceptable, as well as fiscally essential, policies. The measures included here may not be representative of all 50 states' 2010 legislation, but they clearly illustrate the breadth and depth of state governments' anxiety over the sustainability of their public retirement programs.

Nineteen states enacted pension reform from 2005 through 2009. Most of those reforms were conservative in the sense of preserving existing institutional arrangements, and revising no commitments made to employees earlier. As a rule, those revisions preserved traditional defined benefit plans and adjusted a wide range of eligibility and benefit provisions with restraint. Among the 19 states, only Alaska and Georgia closed

traditional pension plans to new members and created alternatives, a defined contribution plan for Alaska in 2005, and a hybrid plan for Georgia in 2008.

The outlook for 2010 is more in the style of Alaska in 2005 and Georgia in 2008 than of those other 17 states. Already in 2010, Colorado has cut benefits for existing retirees, Utah has replaced its defined statewide benefit plans with a defined contribution plan and a hybrid plan, and Virginia has converted a non-contributory plan to one that requires state employee contributions.

In those three states, as in the other states discussed below, one issue is paramount: public employees will have to provide a greater share of their own future retirement security. It is unlikely that all the proposals listed here will become law. But what this report does show is that in 2010, states are considering more far-reaching changes to traditional state plans than have been seen since defined benefit plans became the state retirement model.

This report draws its examples from Colorado, Iowa, Michigan, Minnesota, New Jersey, Utah, Virginia and Vermont. They were chosen because they had enacted legislation, had legislation well into the process of enactment, or had substantial policy recommendations from authoritative sources in the state.

The report excludes requirements for increases in employer contributions in 2010, because those will be widespread. It excludes the issues of pension spiking and of double-dipping, which are receiving attention in many states. These are the policy changes covered in the state examples in this report:

<b>2010 Policy Proposal or Enactment</b>	<b>Found in These States</b>
Move employees from defined benefit to defined contribution or hybrid plans	Michigan, Utah
Convert non-contributory retirement plans to contributory plans.	Michigan, Utah, Virginia
Increase current state employees' required contributions.	Colorado, Iowa, Michigan, Minnesota

Provide for adjusting employee contributions or benefits as actuarially required in the future.	Colorado, Iowa, Minnesota, Utah, Vermont
Divert future funding for salary increases to a pension system instead.	Colorado
Increase vesting requirements.	Iowa, Michigan, Minnesota, New Jersey
Extend the period over which final average salary is calculated or capping credited service.	Iowa, Michigan, New Jersey
Increase the age and service requirements for normal retirement.	Colorado, Iowa, Michigan, Utah, Virginia, Vermont
Extend the period over which final average salary is calculated.	Michigan, New Jersey, Utah, Virginia, Vermont
Increase the actuarial reduction for early retirement.	Iowa, Utah
Reduce COLAs promised to current retirees or future retirees.	Current retirees: Colorado, Minnesota Future retirees: Michigan, Utah, Virginia

**COLORADO SB 1, SIGNED ON FEBRUARY 21.**

- Increases employee contributions through a mechanism of diverting funds that otherwise would be used for increases in salary and wages for current employees in state and local government to PERA.
- Eliminates a cost of living adjustment for current retirees in 2010 and limits it to 2 percent or less in future years (a reduction from existing law).

- Creates higher age and service requirements for members' normal retirement, including the Rule of 88 and the Rule of 90.
- Caps the amount of annual salary increases that can be used to calculate final average salary, reduces the interest paid on refunds to members who leave active service, and imposes contribution requirements on members who return to active service.
- Specifies that the General Assembly can modify benefits in the future.

#### IOWA PUBLIC EMPLOYEE RETIREMENT SYSTEM 2010 LEGISLATIVE PROPOSALS

- Increase employee and employer annual contributions. The combined rate is slowly rising to a previously-scheduled 12 percent for fiscal year 2011 (split 60-40 between employers and employees). This legislation would increase the combined FY 2012 rate to 13.45 percent. The retirement system would be empowered to increase the rate by up to 1 percentage point a year after June 2012.
- Increase the vesting requirement from four years to seven years for those not vested on June 30, 2012; increase the automatic vesting age from 55 to 65 (regardless of length of service).
- Increase the period for calculating final average salary from three years to five years for members not vested on June 30, 2012.
- Increase the actuarial reduction for taking early retirement from 3 percent a year to 6 percent a year, effective July 1, 2012, on the portion of the benefit earned after that date.

## MICHIGAN GOVERNOR JENNIFER GRANHOLM'S LEGISLATIVE PROPOSALS

### *State Employees Retirement System*

This is the state defined benefit (DB) plan). Although this plan was closed to new enrollment in 1997, it still has more than 27,000 active members.

- Increase employee contributions. The plan is currently noncontributory. Members would be required to make a contribution of 3 percent of salary.
- Cap service accumulations at 30 years. Members who remain employed after 30 years of service will be transferred to the state employee defined contribution (DC) plan. Active members who have served 30 years or more will be transferred to the DC plan when the legislation goes into effect. Those with more than 30 years of service may retain that service but may not accumulate additional service time in the DB plan.
- Allow members who are 60 and older to draw retirement benefits while working up to 50 percent of full time, at the discretion of employers, for a maximum of three years.
- Provide an early retirement incentive.

### *Public School Employees Retirement System*

This system includes teaching staff and other public school employees. It is a DB plan.

- Increase employee contributions. Members of a non-contributory tier would be required to contribute 3 percent; those in a tier that contributes 4.3 percent and those in a tier that contributes 6.5 percent would increase their contributions to 7.3 percent.
- Cap service accumulations at 30 years. Members who remain employed after 30 years of service will be transferred to a new defined contribution (DC) plan that will mirror the DC plan for state employees. Service would be capped and transferred as described for state employees above.
- New hires as of October 1, 2010, would be placed in a new hybrid plan with DB and DC components. The DB component

would set retirement eligibility at age 65 (60 in the existing DB plan for school employees), provide no COLA, and calculate final average salary over nine-years (now five years). The employee contribution rate would be 7.3 percent (now zero to 6.4 percent depending on tier). Contributions to the DC component would be voluntary but would be encouraged by a state match of 1 percent of salary if the employee contributes 2 percent.

- Provide for return to part-time employment and an early retirement incentive similar to those described for state employees above.

#### MINNESOTA PENSION SYSTEMS' 2010 LEGISLATIVE PROPOSALS

The proposals are summarized from those of two separate systems: the Public Employee Retirement Association and Teachers Retirement Association. General proposals are similar for the two plans, but differ in detail.

- Increase contributions from both employees and employers, in varying amounts for general public employees, members of the Police and Fire Plan, and members of the teachers' plan. The amounts of increase would be equally divided between employees and employers.
- Annual increases to retirees (COLAs) would be lowered or suspended for two years, depending on plan. When the plans are 90 percent funded again, the annual increases will return to the current rate of 2.5 percent a year.
- Decrease the interest paid on the amounts in deferred retirement accounts.
- For the Public Employee plan, increase the vesting requirements for newly enrolled members from 3 years to 5 years of credited service for general plan members. Also provide 50 percent vesting after 5 years for Police and Fire and Local Government Correctional Plan members—increasing 10 percent each additional year of service until fully vested after 10 years

NEW JERSEY SB 2, PASSED UNANIMOUSLY BY THE SENATE ON FEBRUARY 22.

- Changes the basis of membership in the Teachers Pension and Annuity Fund (TPAF) and the Public Employee Retirement System (PERS) from amount of compensation to hours worked weekly. New employees must work 32 hours a week to be eligible for TPAF and 35 hours a week for PERS eligibility. Others may be eligible for membership in the Defined Contribution Retirement Plan. The threshold for membership in the DC plan is increased from \$1,500 to \$5,000 in annual compensation.
- Reduces multiplier in calculation of retirement benefit, to reverse an increase granted in 2001, for new members, from 1/55 to 1/60.
- Caps the amount of salary used in calculations of final average salary at the Social Security contribution cap for new members of the police and firefighters system. (This was done in 2009 for teachers and general employees).
- Extends period over which final average salary is calculated for general members and teachers from three years to five, and for public safety members from the last year to three years, for new members.
- Provides that new members of state retirement plans after the date of enactment will not possess non-forfeitable right to receive benefits: effectively, vesting is returned to 10 years from five years.
- Allows all new members and those with less than 10 years of service to choose a defined contribution plan in place of the defined benefit plan, or to withdraw entirely from any state retirement plan.
- Requires the state to make the full annual employer's contribution to state plans beginning July 1, 2011. The requirement will be phased in with increments of 1/7 of the actuarial requirement beginning in FY 2012, and is to be at 100% in the eighth fiscal year thereafter.

This bill closes the existing defined benefit plans of the Utah State Retirement System and replaces them with an employee choice of a defined contribution plan and a hybrid plan. Employees hired on or after July 1, 2011, may choose between the two. Those who fail to make a choice will be enrolled in the hybrid plan. The plan is a noncontributory plan covering all state and local government employees and teachers in the state.

*Defined contribution plan description*

- The defined contribution plan will provide individual employee accounts to which employers will contribute 10% of employee compensation for public employees, 12% for public safety members. Employees are not required to contribute but may do so. Employee contributions are immediately vested. Employer contributions will be vested after four years' covered employment.

*Hybrid plan description*

- The hybrid plan will include a defined benefit and a defined contribution component.
- For the DB component, employers will pay up to 10 percentage points of an employee's compensation toward the amount that is required to keep the plan actuarially sound. (The 2010 employer contribution rate for the existing non-contributory plan is 14.22%.) The employee will contribute any additional amount required to make up the actuarial requirement needed to keep the plan solvent..
- For the DC component, employers will contribute 10% of employee compensation less the amount the employer contributes to the DB component. The employer contribution will be deposited in a 401(k) plan to which the member may choose, but is not required, to make additional contributions. Employer contributions will vest after four years' membership in the plan; employee contributions vest immediately. The member may direct the investment of his or her contributions immediately, and those of the employer after they are vested.
- Eligibility for the DB benefit is qualified with somewhat higher age and service requirements than the existing DB

plan, a lower multiplier, and more restrictions on early retirement. The base of final average salary will be five years instead of the three years in the current plan.

- An annual cost-of-living increase applies to the DB component: CPI to an annual maximum of 2.5%. Amounts of CPI greater than 2.5% will be accumulated and applied to the COLA in years when the CPI is less than 2.5%. Previous law allowed for COLA's of CPI capped at 4%.

#### *Public safety officers and firefighters*

- The law creates comparable new plans for firefighters and public safety officers, with a higher employer contribution and earlier retirement ages for the defined benefit portion of the hybrid plan. Employers are required to provide disability coverage for professional and voluntary firefighters and public safety officers.

#### VERMONT RETIREMENT COMMISSION RECOMMENDATIONS

In December 2009, the commission issued recommendations to increase age and service requirements for pensions and lengthening the period for calculating final average salary for state employees and teachers who are more than five years away from retirement. Its most innovative recommendation was to recalculate the division of contributions between employers and employees annually on the basis of actuarial conditions.

- Employer and employee contributions would be recalculated annually on the basis of actuarial recommendations.
- The state share would float between 55% and 60% of the total (state shares are presently 66% for the state employees' system and 76% for the teachers' system).
- The employee share would float between 40% and 45%.
- The new rates would apply to all state employees and teachers.

VERMONT HB 764 AS APPROVED BY THE HOUSE OF REPRESENTATIVES FEBRUARY 22

The bill increases normal retirement age from 62 to 65 or the Rule of 90 and increases the contribution rate for existing and future member of the Teachers Retirement System, and reduces state contributions for the retiree health program. Applies to all members with less than 25 years of service.

- Replaced existing non-contributory plan for all state and local government employees (including public safety and judiciary) with a requirement that new state and local employees contribute five percent of creditable compensation. Local governments may pay the employee share; state employers may not.
- Increases the number of months used to calculate average final compensation from 36 to 60.
- Reduces inflation-based component of COLAs for new employees.
- Reduces the state contribution to the Optional Retirement Plan for employees of higher education from 10.4% to 8.9%, and requires a 5% contribution from them.
- For general employees, changes normal retirement eligibility from age 50 with 30 years of service to age 65 with 5 years of service, or the Rule of 90 (whenever age plus years of service add to 90. Also defines retirement age as the age of eligibility for normal Social Security retirement.