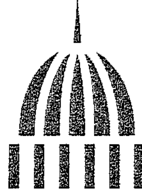

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

STATE PENSION REFORM IN 2010 AND 2011

Testimony for the
Senate Select Committee on the Kansas Public Employee Retirement System
Kansas Legislature
Topeka, Kansas

Ronald K. Snell
National Conference of State Legislatures
February 2, 2012

Introduction

State legislatures enacted more legislation on public retirement plans in 2010 and 2011 than in any previous year. In 2010, 21 states changed their plans in ways ranging from restrictions on the ability of retired people to return to a job covered by a public pension to completely restructuring plans. Thirty-two states enacted comparable range of legislation in 2011. This meant a total of 41 states over the two years, since some states acted in both 2010 and 2011.

The catalyst for so much activity was the fiscal condition of state retirement trust funds. By the end of the first decade of this century, state retirement plans had suffered a reversal of their financial standing in 1999. That year, the average funding ratio for 126 statewide plans (including the District of Columbia) reached a record high of 103 percent of accrued liabilities. Since then, two recessions have battered their assets and the slow recovery from the Great Recession has kept states from rebuilding pension system assets. Some systems have also suffered from inadequate state contributions and unfunded increases in benefits. The Boston College Center for Retirement

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Research recently estimated the average funding ratio for the same 126 plans to be 77 percent in 2010.[1] Other analysts report similar numbers.[2]

Those ratios, however, depend on accepting state retirement plans' assumptions about the value of their assets and the future investment return on them. Skeptics view the plans' assumptions as unduly optimistic and have contended that some retirement funds are so poorly funded, when valued as the skeptics recommend, that they may run out of assets within a decade.[3] The Boston College report does not make that claim, but it estimates that at market value, assets in 2010 covered only 67 percent of liabilities, and that under new accounting rules recommended by the Governmental Accounting Standards Board, assets would be about 53 percent of liabilities for the same selection of plans.[4]

Added to financial concerns are the aging of the state workforce and its increased propensity to retire, questions about the different retirement policies of the private and public sector, and a climate of opinion that questions public employee compensation compared to employment, retirement benefits and health insurance in the country overall.

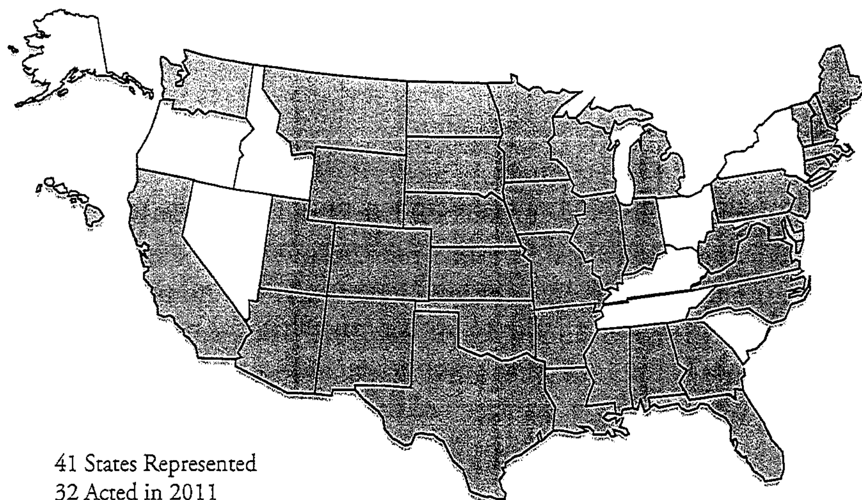
Legislation in 2010 and 2011

These issues have resulted in a record amount of legislation in 2010 and 2011 to restructure the contribution and benefits provisions of state retirement plans and in some states to reconfigure plan policies altogether.

Figure 1 shows the 41 states that enacted significant pension reform legislation for at least one statewide retirement plan for state employees or teachers in 2010 and 2011.

[1] Alicia Munnell, Jean-Pierre Aubry, Josh Hurwitz and Laura Quinby, *How Would GASB Proposals Affect State and Local Pension Funding?* Center for Retirement Research at Boston College, (Brief No. 23, November 2011), p. 3.
[2] See, Wilshire Consulting, *2010 Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation* (Wilshire, Santa Monica, Cal., March, 2010, and the comparable 2011 report.
[3] Alicia Munnell, Jean-Pierre Aub, Josh Hurwitz and Laura Quinby, *Can State and Local Pensions Muddle Thorough?* (Center for Retirement Research at Boston College, March 2011, 2-3, and references.
[4] Munnell and others, *How Would GASB Proposals Affect,*11-14.

Major Pensions Legislation in 2010-2011:
All Topics



Changes Within Traditional Defined Benefit Plans

Almost all public employees in the United States are members of traditional defined benefi(DB) plans, similar in structure to the Kansas Public Employee Retirement System. A number of states allow employees to choose between defined benefit and defined contribution (DC) plans, which are similar to private-sector 401(k) plans. Only two states currently use DC plans as primary, mandatory coverage for general public employees or teachers. Two more state have closed such plans to new employees. Many states, however, offer a DC plan to employees in higher education, and most if not all offer employees a voluntary DC plan as a deferred compensation savings account. The four states that have and have had DC plans as basic coverage for state employees and teachers are:

- Alaska statewide plans for public employees and teachers, since 2007;
- The Michigan state employees' retirement plan, since 1996;
- The Nebraska public employees' retirement plan from 1967 to 2002; and
- The West Virginia teachers' plan, from 1991 to 2005.

A few additional states provide other alternatives to defined benefit plans for state employees or as statewide plans for teachers. Nebraska has sponsored a cash-balance plan for state employees since 2003, which itself replaced a defined contribution plan. Hybrid plans, which provide each member with both a defined benefit component and an individual-account component, existed in Georgia, Indiana, Oregon and Washington for state employees, teachers, or both, before 2010.

In 2010 and since, a number of states, like Kansas, have considered basic plan redesign. The great bulk of legislation, however, in 2010 and 2011, has been within the framework of defined benefit plans. The changes in defined benefit plans in 2010 and 2011 include:

Employee Contribution Requirements

- In 2010, 12 states increased the amounts members must contribute to their retirement plan. In seven states, the increase affected current employees and in five only new hires. Three of the latter group (Missouri, Utah and Virginia) previously had not required contributions for employees or had provided that employers would pay what was nominally an employee contribution. In Utah, the contribution requirement will come into effect only under certain actuarial situations. Wyoming required that current and future employees make contributions that previously had been paid by employers.
- In 2011, 19 states enacted increases in employee contributions, including those required from at least some current employees in 16 of the 19 states. In Florida, Michigan, Virginia and Wisconsin, new legislation required plan members to make contribution that formerly had been picked up by employers. Since some states made this change for different plans in the two years, 26 states in all have increased some employees' contributions in 2010 and 2011.

Eligibility for Retirement

- In 2010, 11 states enacted higher age and service requirements for pension benefits, generally only for new hires. However, in Vermont, the higher requirements will affect teachers who are more than five years away from retirement eligibility, and in Colorado members of the Public Employee Retirement Association who have less than five years' membership.
- In 2011, 17 states enacted higher age and service requirements for benefits, again generally for new hires, but including nonvested members in some instances.

Post-Retirement Benefit Increases (COLAs)

- In 2010, eight states reduced the amount of post-retirement benefit increases they will pay retired people in the future. In four states the reduction will affect only new hires when they eventually retire. In Rhode Island, the policy affected current members with less than 10 years of membership, and in Colorado, Minnesota and South Dakota, the reduction affected people already retired as well as those who retire in the future. The legislation faced legal challenges in each of those last three states as an unwarranted breach of contract. District courts in Colorado and Minnesota have upheld the legislation against the challenges.
- In 2011, 10 states reduced their commitments for future post-retirement benefit increases. The changes affect current employees in six of those states—Arizona, Florida, Maine,

Maryland, New Jersey and Rhode Island, whose changes are in addition to those made in 2010. In Maine, New Jersey and Rhode Island, the change will affect people who have already retired as well. Changes in Washington eliminated or limited future benefit increases for members of two closed plans.

Calculation of Final Average Salary

- In 2010, eight states provided for longer periods for calculating final average salary (final average compensation), which is the basis for pension benefits.
- Eight states did so in 2011. A longer period usually means a lower base for the benefits.

Early Retirement

- In 2010, nine states reduced benefits available to those who take early retirement. Ten states did so in 2011.

Return to Covered Employment After Retirement

- In 2010, nine states imposed greater restrictions on retirees who return to employment that is covered by the retirement plan from which they are receiving a benefit. Six states did so in 2011.

Moving Away From Traditional Plan Design

Numerous legislatures have looked beyond traditional plan design to consider a defined contribution or a hybrid plan. In 2011, in addition to Kansas, the list includes Arizona, Florida, Maine, New Hampshire, Nevada, North Dakota, Oklahoma and Virginia, just to list those where governors, legislative leaders or study commissions recommended such a change. Governors in California, New York and Louisiana have current recommendations for a hybrid plan to replace a statewide defined benefit plan. In 2010 and 2011, three states replaced defined benefit plans with hybrid plans: Michigan and Utah in 2010, and Rhode Island in 2011.

Michigan

- The hybrid plan replaces a defined benefit (DB) plan for public school teachers and other employees hired after July 1, 2010.
- The hybrid includes a defined benefit plan with higher age and service requirements and a lower benefit than the former plan.
- Additionally, for all members, it includes an opt-out defined contribution (DC) plan, with an employer match (4-year vesting) for employee contributions. "Opt-out" means that

employees may choose not to participate in the DC component. Within limits, school districts may negotiate levels of employee contributions and employer match.

- There will be no post-retirement benefit increases for the DB portion of the plan.

Utah

The Utah plan offers new employees (as of July 1, 2011) a pair of choices.

- One is a straightforward DC plan, like those in the private sector, to which the employer will contribute 10 percent of compensation for general employees and teachers, and 12 percent for public safety employees. Employees are not required to contribute to the plan but may do so if they wish. There will be no employer match for any contributions employees make.
- The second possible choice, and the default plan for those who fail to make a choice, is a hybrid plan with a DB and an individual account, like a 401(k). Employers will contribute 10 percent of compensation (more for public safety employees) to the DB element. Employees are not required to contribute unless the employer contribution is inadequate to maintain the actuarial soundness of the plan's trust fund. In that situation, employees will be required to make up the shortfall. In the event that the employer contribution is more than is needed to maintain the actuarial soundness of the DB plan, the unneeded share of the employer contribution will be deposited in the employees' individual accounts. Employees may contribute to their accounts, but are not required to do so.

Rhode Island

The 2011 Rhode Island plan is also a hybrid plan somewhat similar to those in Michigan and Utah.

- It will continue a reduced defined benefit plan for all employees, and also enroll all employees in individual accounts. Contribution rates for the DB plan are reduced for state employees from 8.75 percent to 3.75 percent, and for teachers from 9.5 percent to 3.75 percent. Benefit accruals will be at somewhat less than half the rate of the former plan.

- The Rhode Island plan makes the individual accounts a more important part of eventual benefits than in Michigan and Utah. In Rhode Island, all employees will be required to contribute to them—5 percent of salary for employees covered by Social Security, and up to 9 percent of salary for employees who are not covered by Social Security. Employers will also contribute to the accounts, in amounts ranging from 1 percent of salary to 3 percent of salary, depending on the category of employee and whether the employee is in the Social Security system.

- The Rhode Island plan is unique for including all current employees in the restructuring. All current employees will retain benefits earned through July 1, 2012, when the transition goes into effect.

No state has followed Michigan in 1996 and Alaska in 2005 by adopting a pure defined contribution plan as sole and primary coverage for state employees or teachers. The Utah defined contribution plan is one alternative of two—the other alternative is a hybrid plan. Indiana also provided for a DC plan alternative to its long-standing hybrid plan for state employees in 2011. As this paper reports, hybrid plans are currently the preferred option for replacing a defined benefit plan. The three examples of Michigan, Rhode Island and Utah show that hybrid plans can be customized with considerable variety to meet state policy goals.