NATIONAL CONFERENCE of STATE LEGISLATURES

The Forum for America's Ideas

Alternatives to Defined Benefit Pension Plans; Defined Benefit Pension Plan Reforms Across States

Presentation to the Investments and Pensions Oversight Committee

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Overview

- **State-administered plans represent only 6% of systems, but represent 88% of active members and 83% of assets.**
- **25-30% of the state & local workforce – roughly 6 million workers – are not covered by Social Security.**
  - **Majority of public safety employees are not covered by Social Security.**
- **Majority are traditional defined benefit plan designs.**

Overview (Cont'd)

- This session, pension related legislation is being or has been considered in at least 44 different states, territories or D.C.

- NCSL's Pension Legislation Database has 706 bills so far for 2018.

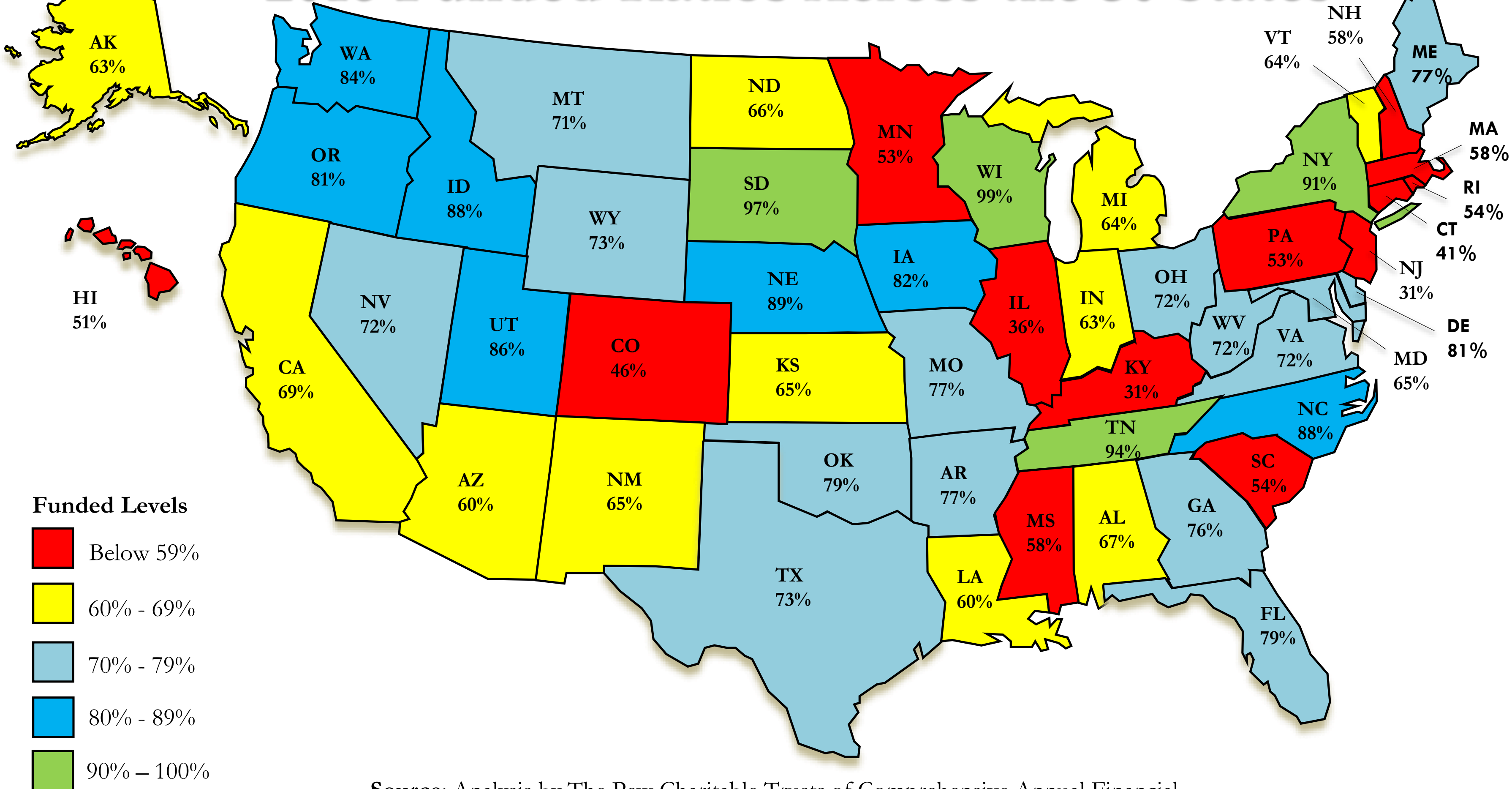
- At least 148 bills were enacted in 2017 in 39 different states.

Overview (Cont'd)

This report is concerned with state legislation changing state retirement plans for general employees and teachers, which 48 states revised between 2009 and 2018 – some more than once:

- 2009 – 10 states
- 2010 – 21 states
- 2011 – 32 states
- 2012 – 10 states
- 2013 – 6 states and Puerto Rico
- 2014 – 8 states
- 2015 – 4 states
- 2016 – 2 states
- 2017 – 8 states
- 2018 – 5 states

2016 Funded Ratios Across the 50 States

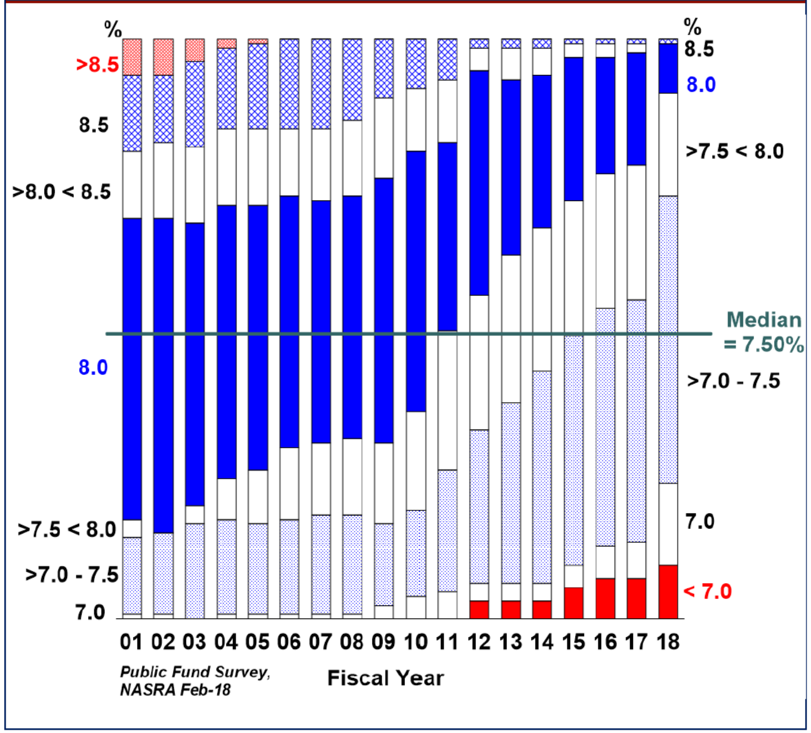


Source: Analysis by The Pew Charitable Trusts of Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations, other public documents, or as provided by plan officials: https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/04/the-state-pension-funding-gap-2016.

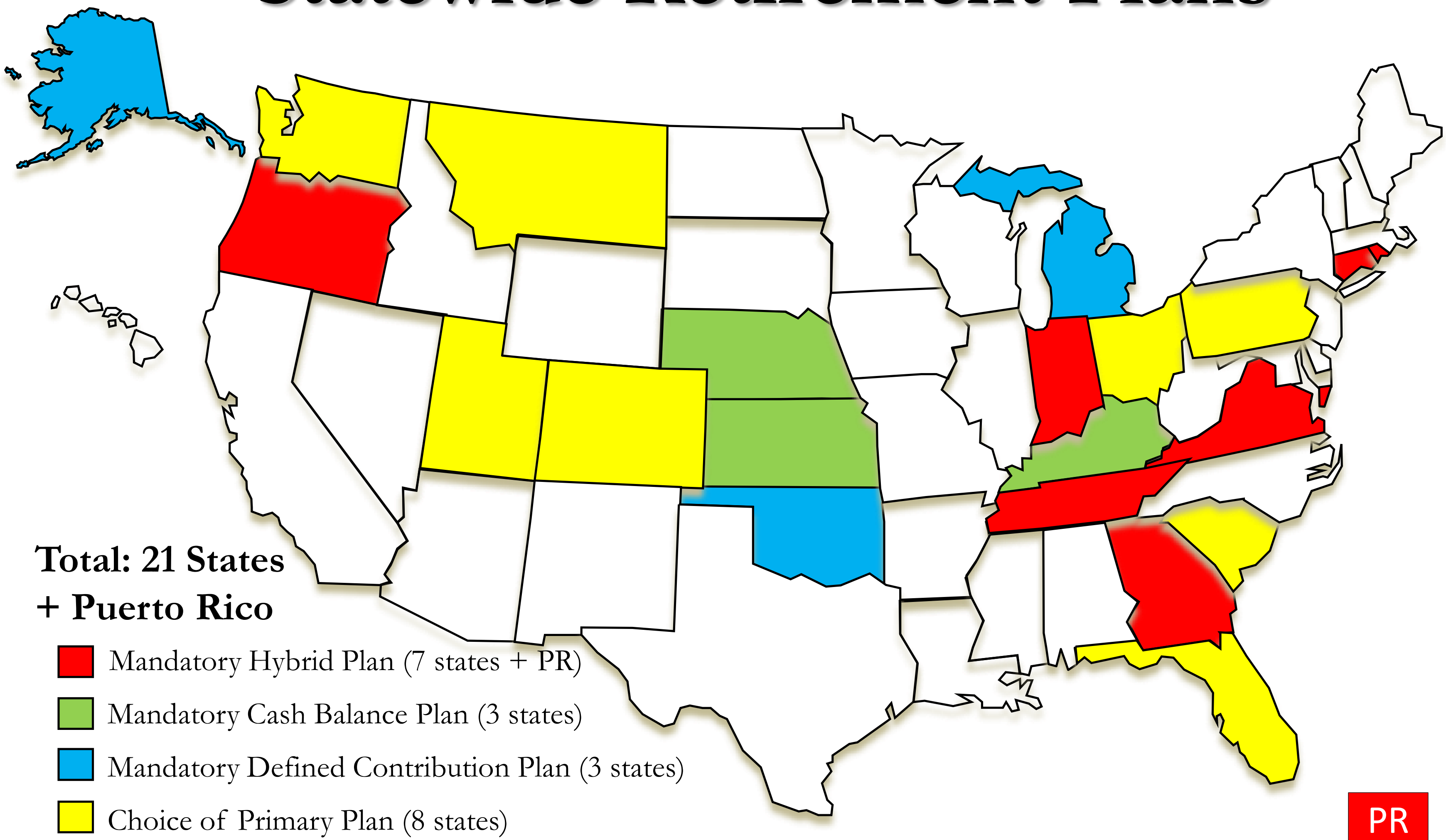
State Pension Fund Expected Rates of Return

Most public pensions target a long-term rate of return between 7 and 8 percent

Figure 4: Change in Distribution of Public Pension Investment Return Assumptions, FY 01 to FY 18



Statewide Retirement Plans

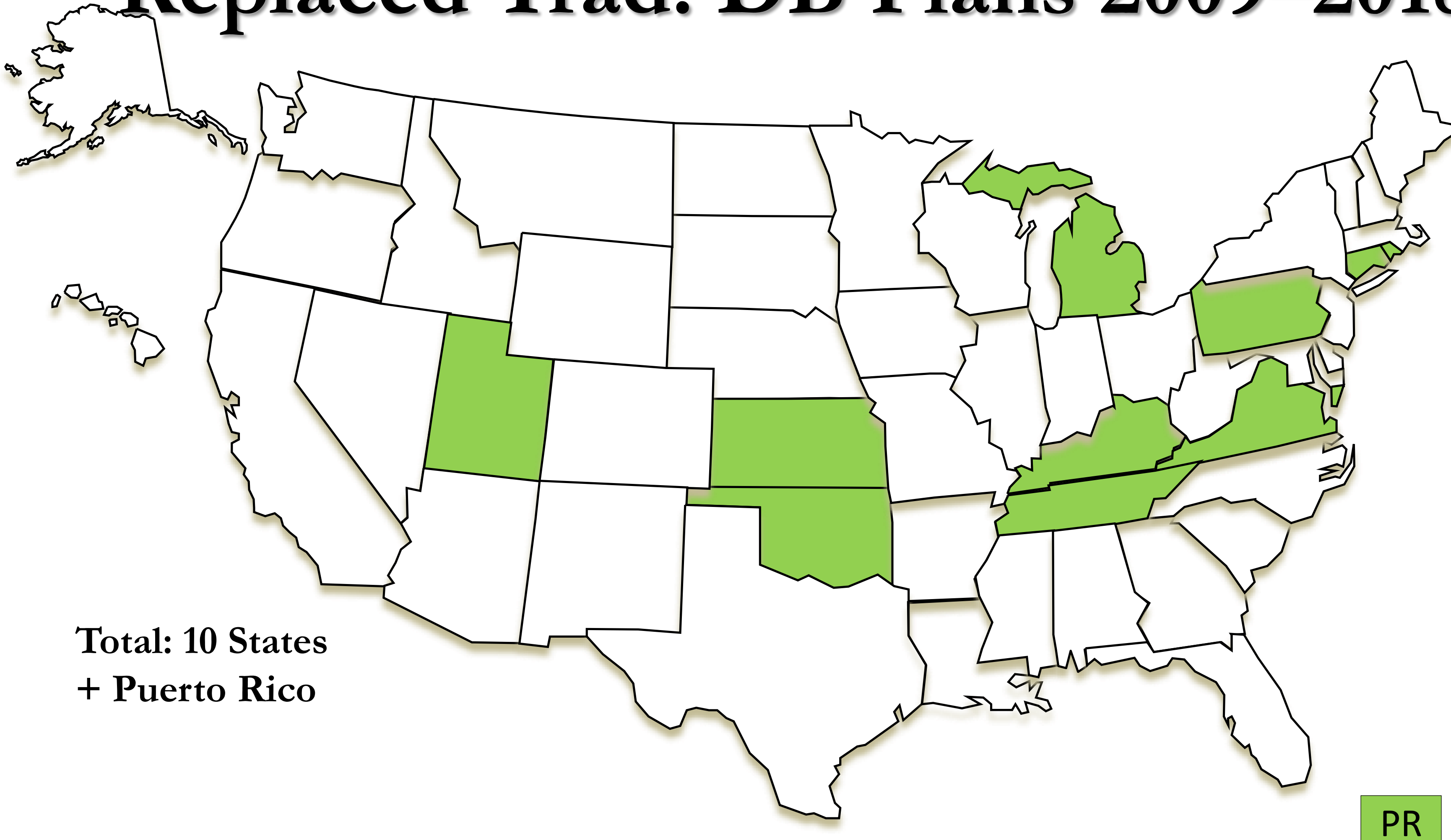


Total: 21 States
+ Puerto Rico

- Mandatory Hybrid Plan (7 states + PR)
- Mandatory Cash Balance Plan (3 states)
- Mandatory Defined Contribution Plan (3 states)
- Choice of Primary Plan (8 states)

Note: In April 2018, Kentucky enacted legislation to create a mandatory cash balance plan for new hires in its Teachers Retirement System and an optional DC plan for general employees. However, on June 2018, a judge ruled this legislation unconstitutional. Kentucky's governor has appealed the ruling.

Replaced Trad. DB Plans 2009–2018



Total: 10 States
+ Puerto Rico

Defined Contribution (DC) Plans

- Function like savings accounts.
- Funds are more portable.
- Stabilizes states' costs for new hires.
- Risks and responsibilities shifted to employee:
  - Risk of losing funds with investment fluctuations.
  - No guaranteed rate of return.
  - Employee must (usually) choose:
    - Employee contribution amount (risk of saving too little);
    - Among investment options.
- Administrative & investment costs are generally higher than with DB plans.

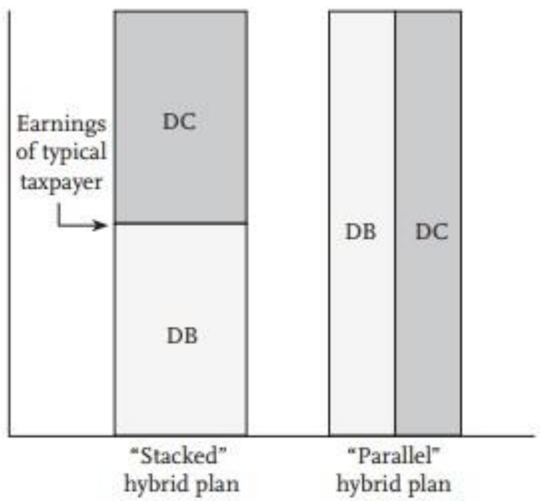
Sources: Center for Retirement Research at Boston College, *A Role for Defined Contribution Plans in the Public Sector*
National Institute on Retirement Security, *A Better Bang for the Buck*

Oklahoma Defined Contribution Plan (2014)

Applicability	State Employees and Elected Officials hired after November 1, 2015.
Employee Contribution	3% Mandatory, up to 7% permissible. (pre-tax basis)
Employer Contribution	3% Base + dollar-for-dollar match of employee contribution up to an additional 4%
Vesting	After 1 Year: 20% After 2 Years: 40% After 3 Years: 60% After 4 Years: 80% After 5 Years: 100%

Source: http://www.opers.ok.gov/2014-legislative-summary

Some States Adopt Hybrid Plans



Defined Benefit		**401(k)-style Defined Contribution**		
Multiplier Rate (%) x Years of Service x Final Average Salary	+	Member contribution (% of salary) + Employer contribution (% of salary) + Investment Gains or Losses	=	**Final Benefit**

Tennessee Hybrid Plan
(2013)

Applicability	Future State Employees, Teachers and Higher Ed Employees hired after July 1, 2014.
Employee Contribution	7% (DB: 5%, DC: 2%) – Provision for employees to opt out of 2% DC contribution.
Employer Contribution	8% (DB: 4%, DC: 4%).
Retirement Eligibility	Age 65 with 5 YOS or Rule of 90 (old plan was 30 YOS or age 60).
Multiplier	1% (old plan was 1.575%).
Vesting	5 Years for DB Benefits. Immediate vesting for DC contributions.

Pennsylvania Default Hybrid Plan (State Employees) (2017)

Applicability	Future State Employees hired on or after Jan. 1, 2019.
Employee Contribution	(DB: 5%, DC: 3.25%)
Employer Contribution	(DC: 2.25%).
Retirement Eligibility	Age 67 with 3 YOS or Rule of 97 (old plan was 65/3 or Rule of 92).
Multiplier	1.25%
Vesting	3 Years

Cash Balance Plans

- Kentucky adopted in 2013.
- Kansas and Louisiana adopted in 2012, but the Louisiana plan was ruled unconstitutional.
- Very rare in the public sector.
- A cash balance plan:
  - Provides each member with an individual account.
  - Employees and employers contribute to the account.
  - The member cannot choose how the money is invested.
  - Members' accounts are managed in one trust fund, and members are guaranteed a return on investment.
  - If investment return makes it possible, member accounts can receive additional returns.
  - In public plans, upon retirement, the member receives an annuity based on the account balance.

Kentucky Cash Balance Plan (2013)

Applicability	State Employees and County Employees hired *after* July 1, 2013.
Employee Contribution	5% for non-hazardous duty employees. 8% for hazardous duty employees.
Employer Contribution	4% for non-hazardous employees. 7.5% for hazardous employees.
Vesting	After 5 Years.
Guaranteed Interest Credit	4% annually with additional interest credits made each year equal to 75% of the 5 year average investment return in excess of 4%.

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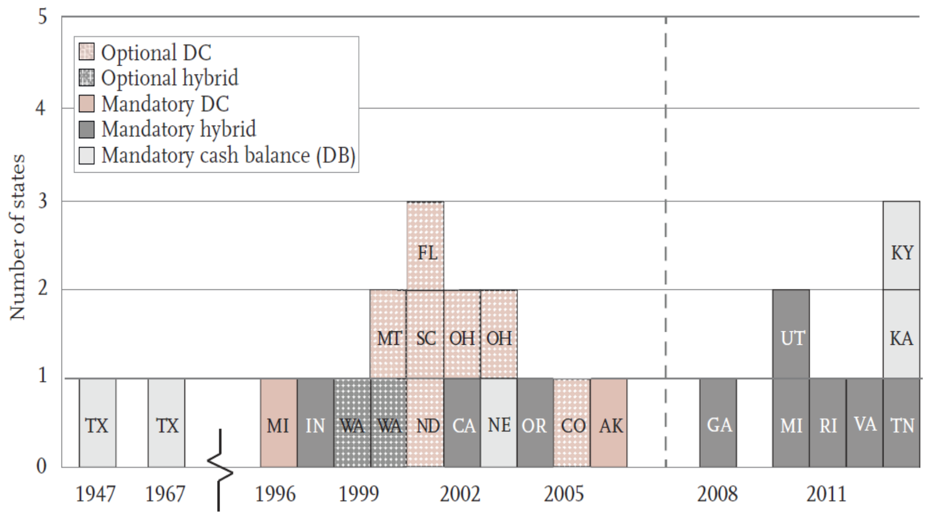
Kansas Cash Balance Plan (2012)

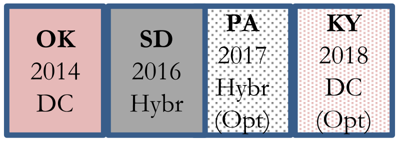
Applicability	State Employees, Teachers, County Employees, Some City Employees
Social Security Coverage	Yes
Employee Contribution	6% Mandatory
Employer Contribution	3%-6%, depending on YOS 4% at 5 Years 5% at 12 Years 6% at 24 Years
Vesting	After 5 Years
Guaranteed Interest Credit	~~5.25%~~ 4% Annually, possibility of additional dividends if investment experience warrants.

When Were Non-DB Plans Adopted?

Figure 1. Introduction of State Defined Contribution Plans, by Year, 1947-2013[4]

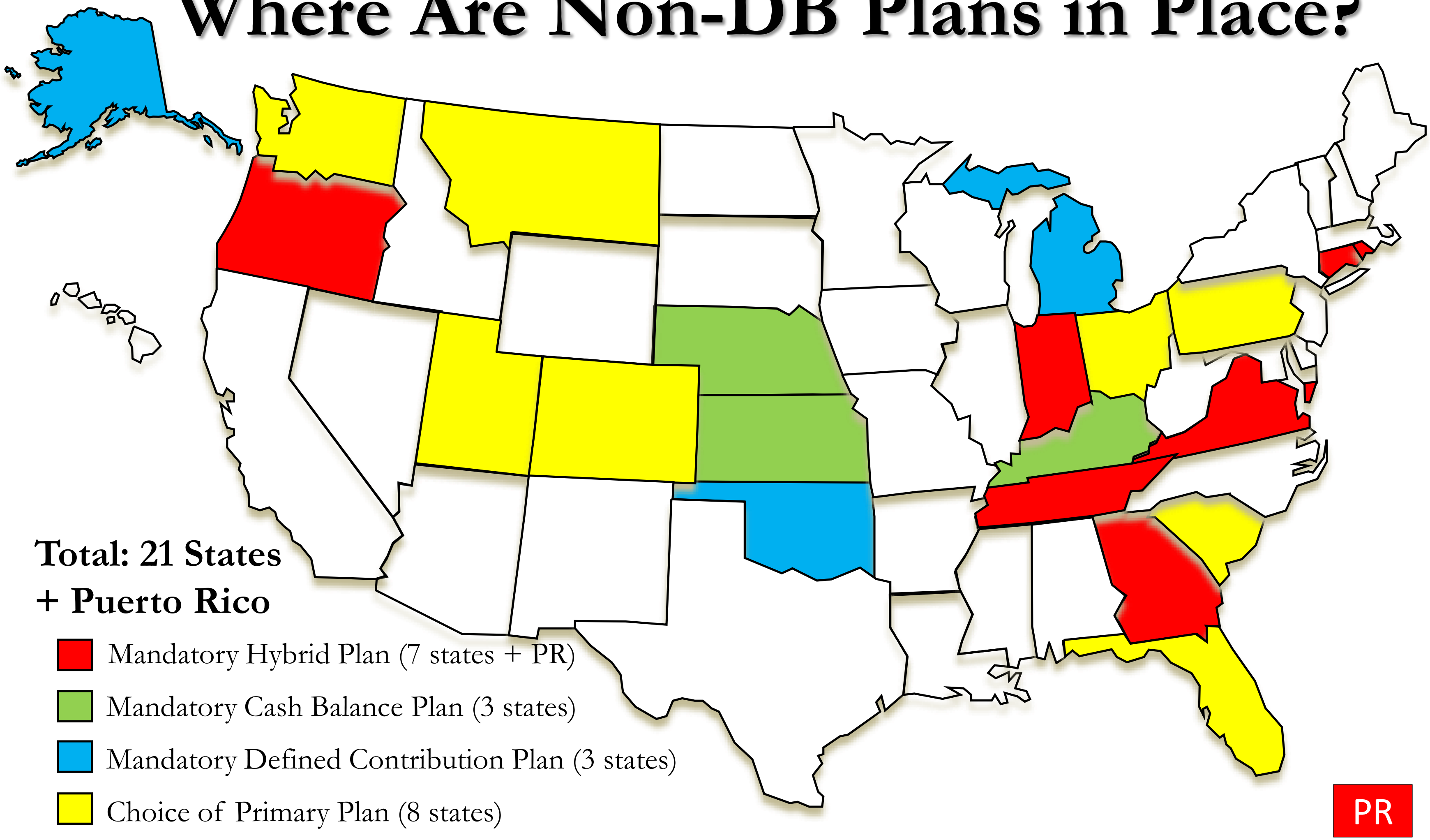


Sources: Actuarial reports; state websites; National Association of State Retirement Administrators (2013); and Munnell (2012).



Source: Center for Retirement Research at Boston College, *A Role for Defined Contribution Plans in the Public Sector: An Update*, 2014.

Where Are Non-DB Plans in Place?



Total: 21 States + Puerto Rico

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Why Have Non-DB Plans Been Adopted?

- **Before the Great Recession:**
  - Offer employees the opportunity to manage their own money and participate directly in a rapidly rising stock market.

- **After the Great Recession:**
  - Avoid high costs associated with large unfunded liabilities;
  - Unload some investment and mortality risk associated with DB;
  - Have a less back-loaded benefit structure to aid short term employees when they leave.

Who Participates in Non-DB Plans?

- Small number of participants, but this will change over time
- Currently, a small amount of assets under management
- Classes of employees

Retirement Plan Choices for Public Employees

Table 2. **New Hire Elections in Most Recent Complete Year***

System	DB Plan Enrollments	DC Plan Enrollments	Combined Plan Enrollments
Colorado Public Employees' Retirement Association	88%	12%	Not offered
Florida Retirement System	75%	25%	Not offered
Montana Public Employee Retirement Administration	97%	3%	Not offered
North Dakota Public Employees Retirement System**	98%	2%	Not offered
Ohio Public Employees Retirement System	95%	4%	1%
State Teachers Retirement System of Ohio	89%	9%	2%
South Carolina Retirement Systems	82%	18%	Not offered

"Not offered" means enrollment in a combined DB/DC plan is not offered.
**Data for Colorado, North Dakota, and Ohio PERS are for January 2010 through December 2010. Data for Florida, Montana, STRS Ohio, and South Carolina are for July 2010 through June 2011.*
*** One new employee out of the 63 eligible joined the North Dakota DC plan in 2010.*

Source: Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers, Milliman, National Institute on Retirement Security, August 2017.

So How are Post-Recession Reform Efforts Playing Out?

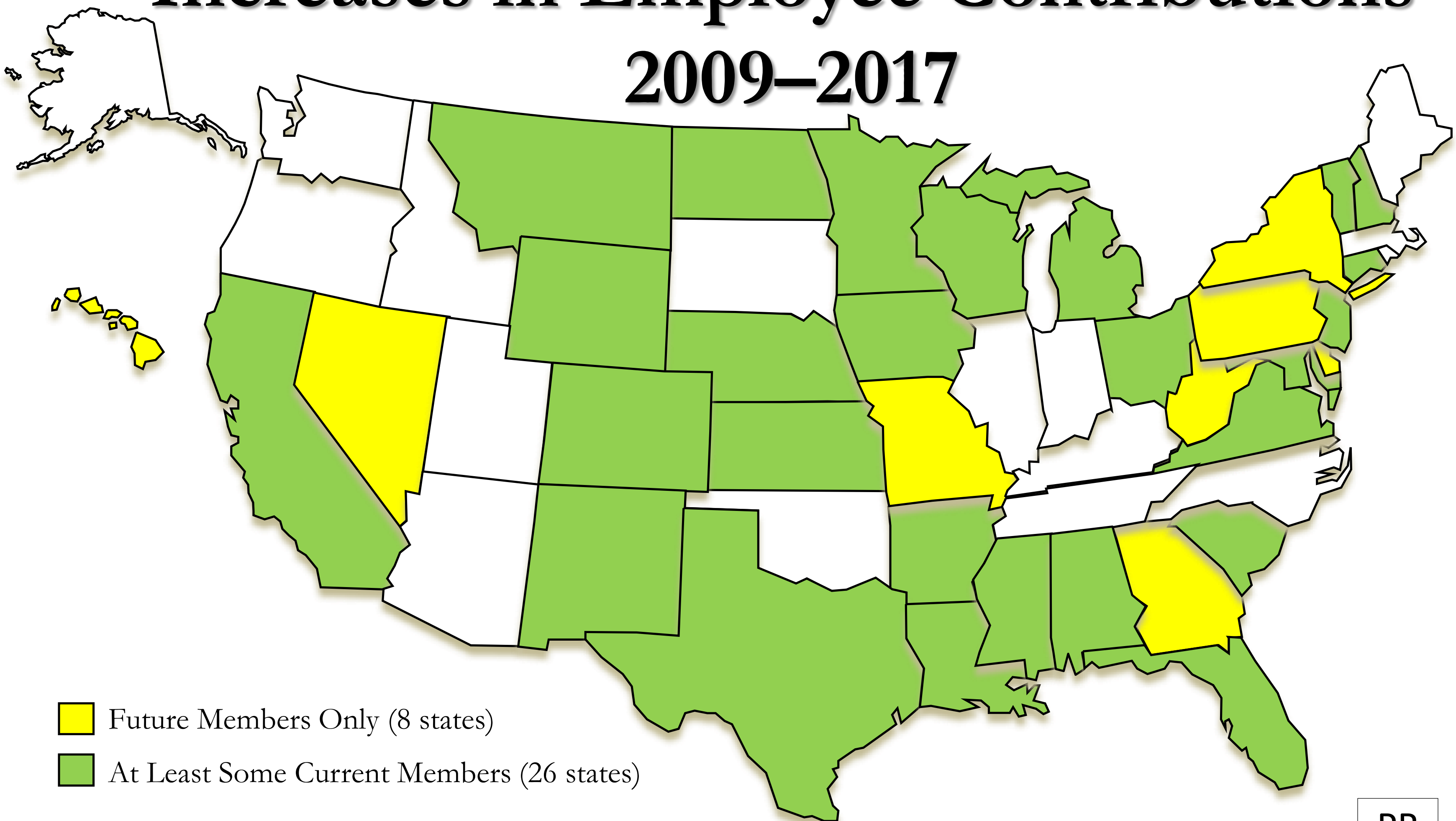
- Competitive compensation and adequate retirement benefits for public employees?
- Employers' ability to attract and retain qualified workers?
- Benefit portability?

So How are Post-Recession Reform Efforts Playing Out?

- Stable and predictable costs for taxpayers?
  - Intergenerational equity?

- Transition costs?
  - Starve legacy plan of necessary contributions?
  - Amortization methods?
  - Different investment strategy?

Increases in Employee Contributions 2009–2017



Future Members Only (8 states)

At Least Some Current Members (26 states)

PR

Changes in Employee Contributions in 2012

Kansas – Tier 1

Employees hired *before* July 1, 2009

Employee Contribution	Raises from 4% to 5%	**OR**	Remains at 4%
Multiplier	Remains at 1.85%		Reduces to 1.4% for future service

Kansas–Tier 2

Employees hired *after* July 1, 2009

Employee Contribution	Remains at 6%
Multiplier	Gains an increase from 1.75% to 1.85%
COLA	Loses annual COLA provided in 2007 legislation.

Changes in Employee Contributions in 2012

New York – Tier VI
New Tier Scales Employee Contributions to Salary

Applicability	Most state & local government employees & teachers, including NYC plans.
$45k or less	3%
$45k – $55k	3.5%
$55k – $75k	4.5%
$75k – $100k	5.75%
$100k – $179k	6%
No contribution on earnings in excess of the governor's salary, currently $179k.	

Employee contributions were 3% for general employees; 3.5% for teachers.

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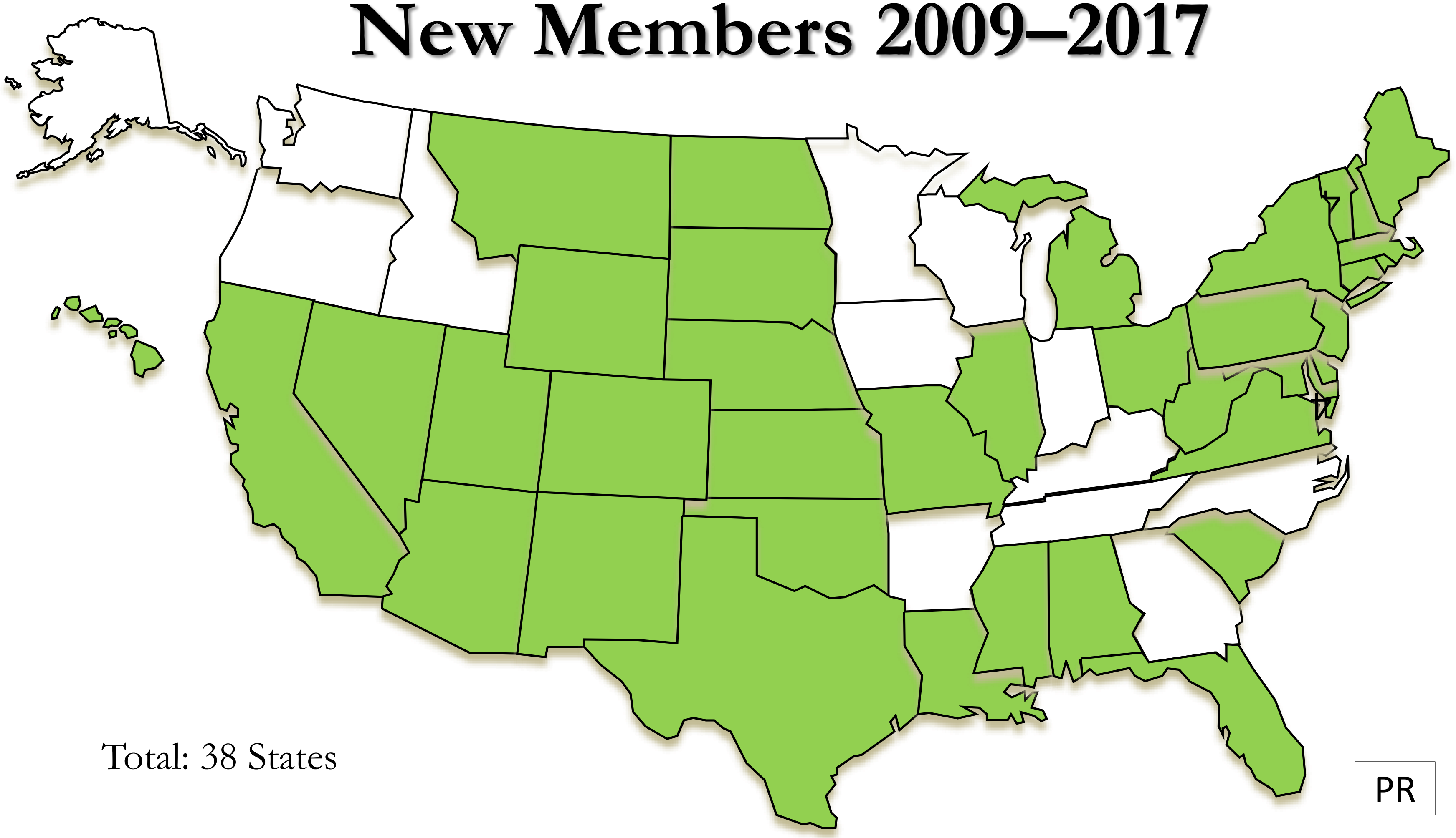
Higher Age and Service Requirements for New Members 2009–2017



Total: 38 States

Higher Age and Service Requirements, Alabama's New Members in 2012

Alabama–Tier 1

Employees hired *before* January 1, 2013

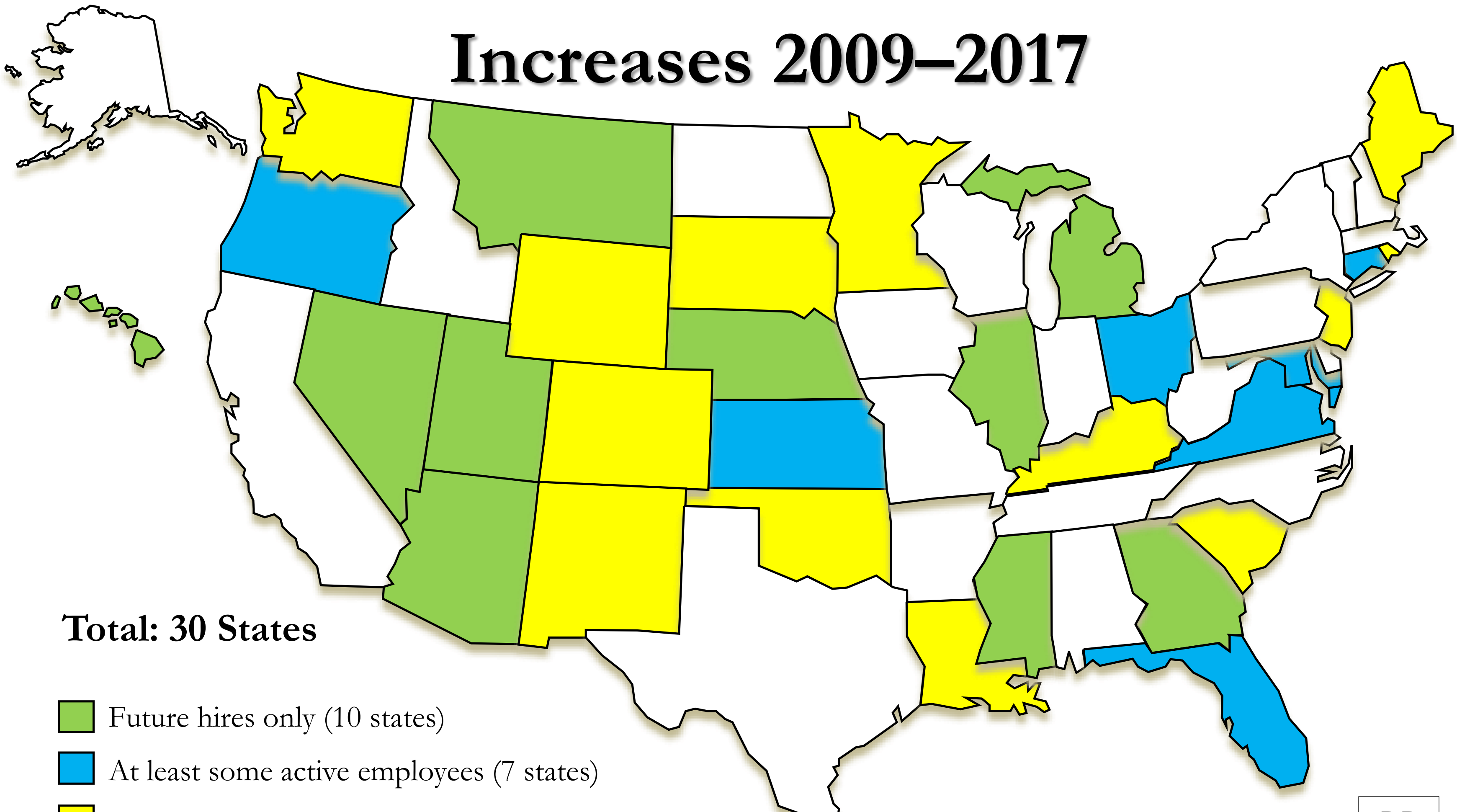
Normal Retirement	After 25 years or at age 60.
Benefits Base	Highest 3 years out of last 10.
Multiplier	2.0125%

Alabama–Tier 2

Employees hired *after* January 1, 2013

Normal Retirement	At age 62 (no more 25 years & out)
Benefits Base	Highest 5 years out of last 10.
Multiplier	1.65%

Reductions in Post-Retirement Benefit Increases 2009–2017



Total: 30 States

- Future hires only (10 states)
- At least some active employees (7 states)
- People already retired and active employees (13 states)

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Montana's GABA Reduction in 2013 and Subsequent Litigation

Montana Public Employees Retirement System GABA changes	
Hired before July 1, 2007	3%
Hired b/t 2007 and July 1, 2013	1.5%
Members hired July 1, 2013 and later	1.5% (each year funding at or above 90%) 1.5% minus 0.1% (for each 2% PERS is funded below 90%) 0% whenever PERS amortization period is 40+ years

Litigation => 2013 GABA reduction does not apply to retirees and current members

Sources and Contact

- Visit www.ncsl.org/pensions for retirement reports, legislative summaries, webinars and presentation materials prepared by NCSL.
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