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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Employment, Labor and Retirement Program
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

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)

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

### Some States Adopt Hybrid Plans

#### Defined Benefit

- Multiplier Rate (%)  
  - Years of Service  
  - Final Average Salary

#### Defined Contribution

- Member contribution (% of salary)
- Employer contribution (% of salary)
- Investment Gains or Losses

**401(k)-style Defined Benefit**

- **Final Benefit**

#### Diagram

- **Earnings of typical taxpayer**
  - **DC**
  - **DB**
  - **“Stacked” hybrid plan**
  - **“Parallel” hybrid plan**
# Tennessee Hybrid Plan (2013)

<table>
<thead>
<tr>
<th>Applicability</th>
<th>Future State Employees, Teachers and Higher Ed Employees hired after July 1, 2014.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee Contribution</strong></td>
<td>7% (DB: 5%, DC: 2%) – Provision for employees to opt out of 2% DC contribution.</td>
</tr>
<tr>
<td><strong>Employer Contribution</strong></td>
<td>8% (DB: 4%, DC: 4%).</td>
</tr>
<tr>
<td><strong>Retirement Eligibility</strong></td>
<td>Age 65 with 5 YOS or Rule of 90 (old plan was 30 YOS or age 60).</td>
</tr>
<tr>
<td><strong>Multiplier</strong></td>
<td>1% (old plan was 1.575%).</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>5 Years for DB Benefits. Immediate vesting for DC contributions.</td>
</tr>
</tbody>
</table>
Pennsylvania Default Hybrid Plan  
(State Employees)  
(2017)

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

<table>
<thead>
<tr>
<th>Applicability</th>
<th>State Employees and County Employees hired after July 1, 2013.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee</strong></td>
<td>5% for non-hazardous duty employees.</td>
</tr>
<tr>
<td><strong>Contribution</strong></td>
<td>8% for hazardous duty employees.</td>
</tr>
<tr>
<td><strong>Employer</strong></td>
<td>4% for non-hazardous employees.</td>
</tr>
<tr>
<td><strong>Contribution</strong></td>
<td>7.5% for hazardous employees.</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>After 5 Years.</td>
</tr>
<tr>
<td><strong>Guaranteed</strong></td>
<td>4% annually with additional interest credits made each year equal to 75% of the 5 year average investment return in excess of 4%.</td>
</tr>
</tbody>
</table>
# Kansas Cash Balance Plan (2012)

<table>
<thead>
<tr>
<th>Applicability</th>
<th>State Employees, Teachers, County Employees, Some City Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Security Coverage</td>
<td>Yes</td>
</tr>
<tr>
<td>Employee Contribution</td>
<td>6% Mandatory</td>
</tr>
<tr>
<td>Employer Contribution</td>
<td>3%-6%, depending on YOS</td>
</tr>
<tr>
<td></td>
<td>4% at 5 Years</td>
</tr>
<tr>
<td></td>
<td>5% at 12 Years</td>
</tr>
<tr>
<td></td>
<td>6% at 24 Years</td>
</tr>
<tr>
<td>Vesting</td>
<td>After 5 Years</td>
</tr>
<tr>
<td>Guaranteed Interest Credit</td>
<td>5.25% 4% Annually, possibility of additional dividends if investment experience warrants</td>
</tr>
</tbody>
</table>
When Were Non-DB Plans Adopted?

**Figure 1. Introduction of State Defined Contribution Plans, by Year, 1947-2013**

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

Where Are Non-DB Plans in Place?

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.
Why Have Non-DB Plans Been Adopted?

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

• **After the Great Recession:**
  o Avoid high costs associated with large unfunded liabilities;
  o Unload some investment and mortality risk associated with DB;
  o 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*

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

*Not offered* means enrollment in a combined DB/DC plan is not offered.


**One new employee out of the 63 eligible joined the North Dakota DC plan in 2010.

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?
  o Intergenerational equity?

• Transition costs?
  o Starve legacy plan of necessary contributions?
  o Amortization methods?
  o Different investment strategy?
Increases in Employee Contributions
2009–2017

- **Yellow**: Future Members Only (8 states)
- **Green**: At Least Some Current Members (26 states)
# Changes in Employee Contributions in 2012

## Kansas – Tier 1
Employees hired *before* July 1, 2009

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>Raises from 4% to 5%</th>
<th>Remains at 4% OR</th>
<th>Remains at 1.85%</th>
<th>Reduces to 1.4% for future service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiplier</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Kansas–Tier 2
Employees hired *after* July 1, 2009

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>Remains at 6%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiplier</td>
<td>Gains an increase from 1.75% to 1.85%</td>
</tr>
<tr>
<td>COLA</td>
<td>Loses annual COLA provided in 2007 legislation.</td>
</tr>
</tbody>
</table>
### Changes in Employee Contributions in 2012

**New York – Tier VI**

**New Tier Scales Employee Contributions to Salary**

<table>
<thead>
<tr>
<th>Applicability</th>
<th>Most state &amp; local government employees &amp; teachers, including NYC plans.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$45k or less</td>
<td>3%</td>
</tr>
<tr>
<td>$45k – $55k</td>
<td>3.5%</td>
</tr>
<tr>
<td>$55k – $75k</td>
<td>4.5%</td>
</tr>
<tr>
<td>$75k – $100k</td>
<td>5.75%</td>
</tr>
<tr>
<td>$100k – $179k</td>
<td>6%</td>
</tr>
</tbody>
</table>

No contribution on earnings in excess of the governor’s salary, currently $179k.

Employee contributions were 3% for general employees; 3.5% for teachers.
Higher Age and Service Requirements for New Members 2009–2017

Total: 38 States
## Higher Age and Service Requirements, Alabama’s New Members in 2012

<table>
<thead>
<tr>
<th>Tier</th>
<th>Employees Hired</th>
<th>Normal Retirement</th>
<th>Benefits Base</th>
<th>Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Alabama–Tier 1</strong></td>
<td>Before January 1, 2013</td>
<td>After 25 years or at age 60.</td>
<td>Highest 3 years out of last 10.</td>
<td>2.0125%</td>
</tr>
<tr>
<td><strong>Alabama–Tier 2</strong></td>
<td>After January 1, 2013</td>
<td>At age 62 (no more 25 years &amp; out)</td>
<td>Highest 5 years out of last 10.</td>
<td>1.65%</td>
</tr>
</tbody>
</table>
Reductions in Post-Retirement Benefit Increases 2009–2017

Total: 30 States

- Green: Future hires only (10 states)
- Blue: At least some active employees (7 states)
- Yellow: People already retired and active employees (13 states)
Montana’s GABA Reduction in 2013 and Subsequent Litigation

Montana Public Employees Retirement System
GABA changes

<table>
<thead>
<tr>
<th>Hired before July 1, 2007</th>
<th>3%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hired b/t 2007 and July 1, 2013</td>
<td>1.5%</td>
</tr>
<tr>
<td>Members hired July 1, 2013 and later</td>
<td>1.5% (each year funding at or above 90%)</td>
</tr>
<tr>
<td></td>
<td>1.5% minus 0.1% (for each 2% PERS is funded below 90%)</td>
</tr>
<tr>
<td></td>
<td>0% whenever PERS amortization period is 40+ years</td>
</tr>
</tbody>
</table>

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

• Visit [www.ncsl.org/pensions](http://www.ncsl.org/pensions) for retirement reports, legislative summaries, webinars and presentation materials prepared by NCSL.

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