Senate Research Office

AT ISSUE

RETIREMENT SYSTEMS

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The recent August 9th recall elections in Wisconsin reminded us the extent to which state citizens will go when their benefits are at stake. Especially in the wake of recent market changes, it should also remind us how fragile state pensions are. What exactly happened in Wisconsin? In short, Governor Scott Walker attempted to overhaul the state's pension and public benefit system, but much of the focus was on his measure to limit collective bargaining rights of public employee unions. The changes made to Wisconsin's pension system are similar to those made in a number of other states, such as Ohio and New Jersey. According to the National Conference of State Legislatures (NCSL), over 20 states made changes to pension benefit levels, contribution rate structures, or both to improve the long-term sustainability of their retirement plans in 2010. Combined with the 2011 changes, 39 of 50 states enacted major retirement system revisions, with some states making revisions in both years.[1]

Why all the big changes? The increased focus on fiscal responsibility at the national level may have brought attention to some of the states' flailing pension programs. For many years, states have been underfunding their pension programs while retaining the same, or higher, levels of benefits to retirees. Faced with almost no other alternatives, states have taken initiative and reformed their public pension systems in an attempt to balance their books. NCSL also points to concerns about the viability of retirement plan benefits and funding that date to the 2001 recession, severe investment losses in the 2007-2009 recession, and demographic change and state fiscal conditions.[2]

Will any of these factors impact Georgia's retirement systems the way they have other states' systems? To assess this most effectively, basic information about the different types of plans state retirement systems run and how Georgia administers its plans will be helpful. Then, we will look at some of the recent trends exhibited by the states and see how they surfaced in New Jersey, Ohio, and Wisconsin. Finally, a brief assessment of Georgia's wellbeing is included.

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[1] Report found at http://www.ncsl.org/?tabid=22763
[2] http://www.ncsl.org/LinkClick.aspx?fileticket=WCg6SYg6vZ4%3d&tabid=301

PLAN TYPES

There are two basic types of public retirement plans that may be administered exclusively by a state or in conjunction with the other.

A **defined benefit plan**, also known as a pension, determines the employee's benefit on retirement by a set formula that accounts for service and final average salary. The employee's benefit is guaranteed by the employer, even if market returns do not cover the cost of benefit payments.

Although plan assets are held in trust and managed by professional investors, the employer retains the responsibilities of managing the plan and assumes the risk under defined benefit plans.

A **defined contribution plan**, such as a 401(k) or 457(b), requires contributions be paid into an individual account for each employee. These contributions are then invested, with the returns on the investment credited to the individual's account. The benefit of a defined contribution plan will depend upon the account balance at the time an employee is looking to use the assets.

Defined contribution plans place both the investment risk and reward with the employee, with the benefit dependent upon the investment returns of the contribution. Responsibilities are shifted to the employee, who decides whether to join the plan, how much to contribute, how to allocate those contributions among different options, how to change those allocations over time, and how to withdraw the accumulated funds at retirement.

A **hybrid plan** combines elements of both defined benefit plans and defined contribution plans, spreading the risks associated with the provision of retirement income between the employer and the employee.

GEORGIA SYSTEMS

Georgia's two largest administrators of retirement benefits are the Employees' Retirement System of Georgia and the Teachers Retirement System.

The **Employees' Retirement System of Georgia (ERSGA)** administers a number of plans, the largest of which is the **Employees' Retirement System plan (ERS).** ERS recently switched to a different retirement plan which determines plan membership by the employee's date of hire:

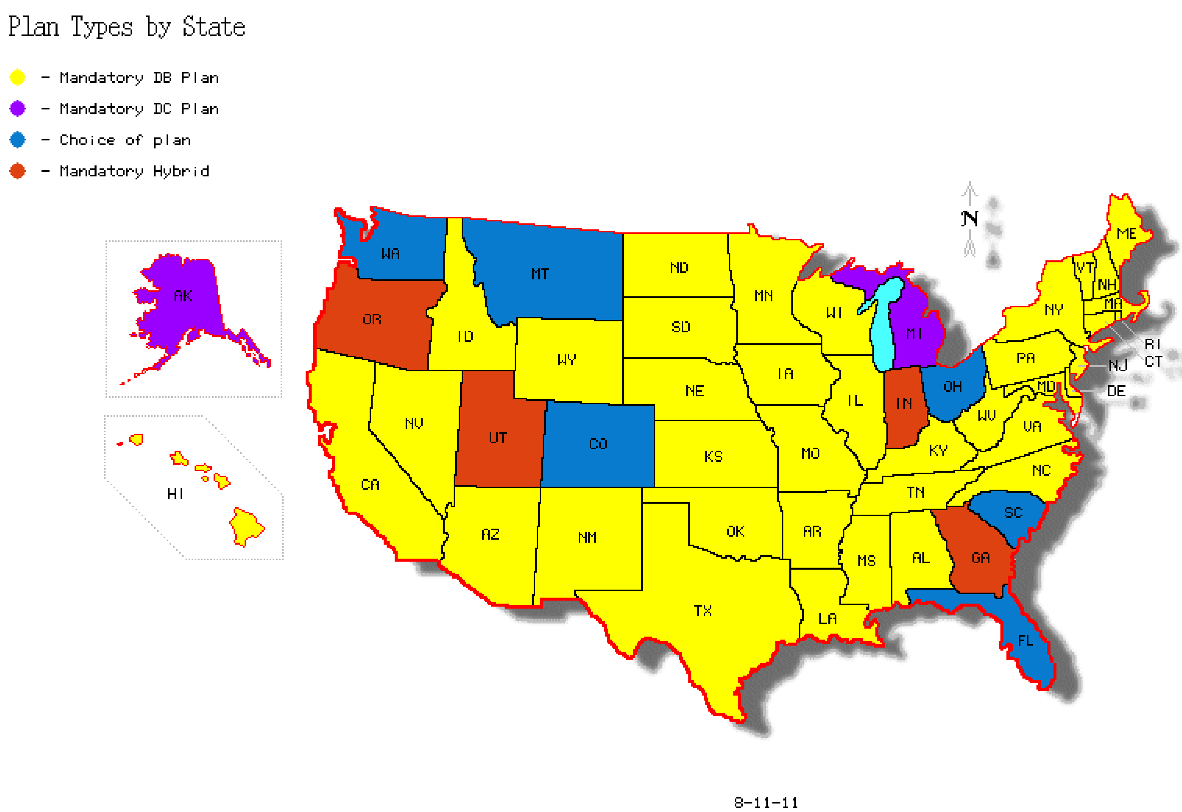
ERS Plan	Hire Date	Plan Type
The Old Plan	Before July 1, 1982	Defined Benefit
The New Plan	July 1, 1982 to December 31, 2008	Defined Benefit
GSEPS	January 1, 2009 to present	Defined Benefit + Defined Contribution (Hybrid)

The Georgia State Employees' Pension and Savings Plan (GSEPS) combines the traditional pension plan of the defined benefit with a defined contribution 401(k) plan.

The reason ERS moved to such a hybrid plan in 2009 was to manage the growing cost of employer pension contributions and the reflection of a trend to more mobile retirement plans. The State was experiencing turnover of 21 percent among workers in their first five years of employment with the state, and the retirement system made this change in an attempt to account for this shift.

The **Teachers' Retirement System (TRS)** is the largest of the state's retirement systems, and it remains a defined benefit system that allows a retiree to draw a monthly benefit upon retirement in an amount determined by the retiree's salary and years of service.

With the understanding of the different types of retirement plans and the types of systems Georgia operates, the map below illustrates which states operate on mandatory defined benefit (DB) plans, mandatory defined contribution (DC) plans, mandatory hybrid plans, and which states offer employees a choice of plan.[3]



[3] http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7BDE1B05E7-1053-4B2E-BEB3-F9C6C5371779%7D.PDF

TRENDS

With 39 states making changes to their retirement structures in the past two years, some common trends have developed. NCSL highlighted a number of these trends in a recent report.[4]

1. With two exceptions, states have revised, not replaced, traditional benefit pension plans.

   - Utah is the first exception. The state closed its defined benefit plan for all state and local employees and is now offering new employees a choice of a defined contribution plan and a hybrid plan that includes a defined benefit plan and a mandatory defined compensation 401(k) plan.
   - Indiana is the second exception. Senate Bill 524 established a defined contribution plan as an option for new state employees, and those employees who do not make an explicit choice to become a member of this plan automatically join the Public Employees' Retirement Fund (PERF).

2. Costs have been shifted to members through higher contributions, longer service requirements, higher ages for normal retirement, and lower post-retirement benefit adjustments.

3. There are more restrictions on retirement before normal age and on retired people returning to covered service, often called double dipping.

4. A number of states increased contribution requirements, sometimes pairing increased employee contribution requirements with reduced employer contributions. This signals a shift toward equalization of employee and employer retirement contributions, and is a testimony to continuing pressure on state budgets.

5. A number of states revised their provisions for automatic cost-of-living-adjustments (COLAs),[5] reducing future commitments owed by the states. The following three states offer examples of different methods of revision:

   - Florida eliminated the COLA for service earned on or after July 1, 2011, thus eliminating future COLAs.
     - Subject to the availability of funding, this will expire June 30, 2016 and the previous 3 percent COLA will be reinstated
   - Hawaii reduced its COLA from 2.5 percent to 1.5 percent for new members after July 1, 2012.
   - Maine froze its COLA for three years and will cap it at 3 percent in future years based on the CPI.

[4] http://www.ncsl.org/?tabid=22763

[5] An automatic COLA is made annually and is usually pinned to a measure of inflation, such as the Consumer Price Index. The purpose of a COLA is to reduce inflationary erosion of the purchasing power of retirement benefits. (NCSL).

NEW JERSEY, OHIO, AND WISCONSIN

The trends listed above are seen in the publicized pension reforms in New Jersey, Ohio, and Wisconsin. New Jersey's changes were more wholesale, touching on a number of different policy trends. Ohio's proposed changes are also reflective of the trends seen in many states. Finally, Wisconsin revamped the Wisconsin Retirement System (WRS) method of determining contribution levels, but it also made some significant changes to its vesting procedures, which is discussed.

New Jersey

New Jersey Senate Bill 2937[6] overhauled the state's pension system and the level of contribution employees are required to pay for health care benefits. The bill made various changes to the manner in which a majority of the public employee retirement systems operate and to the benefit provisions of those systems. The increases in employee contribution rates will become effective upon the implementation of necessary administrative actions for collection and will not be applied retroactively to the bill's effective date.

COLAs are suspended for all current and future retirees of all public retirement systems. However, once the committees are established, as discussed below, they are authorized to reactivate the COLA on pensions and to modify the basis for the calculation of the COLA and to set the duration and extent of the activation.

The New Jersey bill established new pension committees to be appointed when their system reaches a targeted funded ratio of 75 percent in FY12, which is to increase annually by increments in each of the subsequent seven fiscal years, until the ratio reaches 80 percent at which it is to remain for all subsequent fiscal years. Once this target funded ratio is achieved, each committee will then have the authority to modify certain terms of the retirement system, including:

- Member contribution rate;
- Formula for calculation of final compensation or final salary;
- Fraction used to calculate a retirement allowance;
- Age at retirement; and
- Benefits provided for disability retirement.

None of these committees will have the authority to change the number of years required for vesting. Therefore, this provision incentivizes the attainment of the target funded ratio and the maintenance of that ratio. Once it is reached, the committees may then change the terms of the retirement systems to perhaps more accurately reflect the ability of the systems to pay benefits. It also allows the modification of these terms in a setting where the pension systems are more stable and may be able to withstand more changes without the immediate risk of the inability to pay benefits as they come due.

[6] http://www.njleg.state.nj.us/2010/Bills/S3000/2937_I1.HTM

Ohio

Ohio considered Senate Bill 3[7] and House Bill 69[8], both concerning the state's public pension programs.

Senate Bill 3 would make a number of changes to the Public Employees Retirement System (PERS) of Ohio. One such change would alter the benefit formulas for members by requiring an additional two years of service credit or of age to be eligible to retire, and it requires members retiring based on 32 or more years of service credit to be at least age 55. Those members who are eligible to retire not later than ten years after the bill's effective date or who on that date have 20 or more years of total service credit are exempt from this new criteria.

The State Teachers Retirement System would increase member contributions from 10 percent to 12.5 percent of compensation and would reduce the COLA from an annual 3 percent to 2 percent for those retiring no later than July 31, 2011 and to 1.5 percent for those retiring on or after August 1, 2011.

Wisconsin

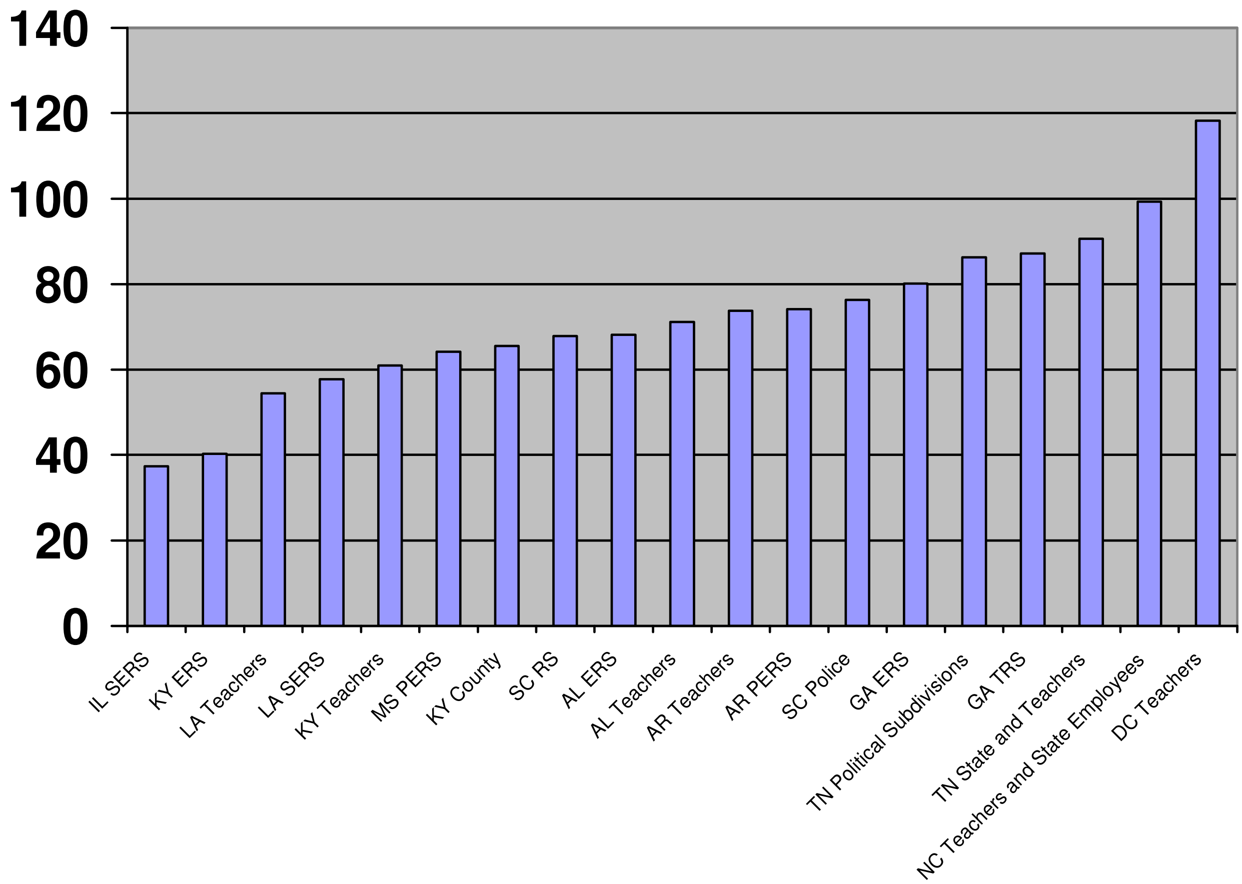
Wisconsin Act 32[9] established a vesting period for public employees hired after the date of the Act to receive retirement benefits. Instead of immediate vesting, as the previous law provided for, new employees will now be required to earn five years of creditable service to be entitled to a benefit, such as a Wisconsin Retirement System (WRS) retirement annuity or lump sum retirement benefit. If an employee were to leave before the five-year period ended, he would take with him his employee contributions, which vested immediately, along with investment returns, and the employer contributions and years of creditable service would be forfeited.

PUTTING IT TOGETHER

As seen by the media coverage and tension regarding pension reform in other states, the funding of these retirement accounts affects numerous state employees in all states. With many states still operating retirement systems as defined benefit plans, the falls in the market directly impact the states. This explains the changes seen in the states as discussed above.

The nationally accepted funded ratio for a healthy retirement system is generally seen to be 80 percent, and a system is perceived to be better-funded the higher the funding ratio. With this benchmark, we can see how well Georgia is doing in the following graph, which displays southeastern states' actuarial funding ratios. The first state plan listed is Illinois State Employees' Retirement System (IL SERS), which has the lowest actuarial funding ratio, and the last state plan listed is DC Teachers, which has one of the highest.

[7] http://www.legislature.state.oh.us/bills.cfm?ID=129_SB_3
[8] http://www.legislature.state.oh.us/analyses.cfm?ID=129_HB_69&ACT=As%20Introduced
[9] http://legis.wisconsin.gov/2011/data/acts/11Act32.pdf



CONCLUSION

The reforms being made in other states are reflective of the unease states feel with regard to the stability and longevity of their retirement systems. It is important to note that every state is different, and every retirement system's benefits are different as well. The pension reform in New Jersey was needed after several issues, including the state neglecting to pay $15.11 billion in required payments to the pension funds.[10] However, other states have made their annual payments and may not be in the dire situation New Jersey was in when it passed its pension reform bill. Thus, it is important to remember that each state is different, and what works in one state may not work in another.

We can rest somewhat at ease in Georgia, as ERS and TRS are healthy systems, both funded at over 80 percent, which is the generally accepted level for a healthy retirement system. Additionally, Georgia was ahead of the curve when it implemented the changes to ERS and created a hybrid retirement plan.

[10] http://www.nj.com/politics/index.ssf/2011/06/assembly_passes_landmark_emplo.html

There are a number of websites that provide helpful information on this topic:

- National Conference of State Legislatures Article on State Reform Efforts
    - http://www.ncsl.org/?tabid=22763
- National Conference of State Legislatures Pension Page
    - http://www.ncsl.org/default.aspx?TabID=756&tabs=951,69,140#140
- National Association of State Retirement Administrators
    - http://www.nasra.org/
- Center for State and Local Government Excellence Pensions Page
    - http://www.slge.org/index.asp?Type=B_BASIC&SEC={ED445E61-FF4D-4990-ABC7-4018FAA0A16D}&DE={6A466EC1-4BDD-4B5B-A3A4-24CE69FFA289}