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Panel: State of Public Pensions and Its Impact on Collective Bargaining

Elliot Susseles
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State of Public Pension and its Impact on Collective Bargaining

NATIONAL CENTER for the Study of Collective Bargaining in Higher Education and the Professions

April 2016

Elliot R. Susseles, CCP
Senior Vice President, National Practice Leader, Segal Waters Consulting, Washington, DC
Public Pension Environment

- Recovering Economy
- Rising pension contributions
- Plan changes to reduce costs and risks
- Multiple accounting and reporting rules—GASB, Moody’s and potential Federal requirements
- Changing workforce demographics
- Expanded media, state and federal scrutiny
- Taxpayer expectations vs. Member expectations
- Oh! Detroit
Public Pension Environment

- Print
- TV/Cable News
- Internet—Blogs
- Opinion Research
  - Pew Center
  - Manhattan Institute
  - National Institute for Retirement Security
- Center on Budget and Policy Priorities Policy Priorities
- Center for State & Local Government
- Governmental Accounting Office Reports


Published by The Keep, 2016
## Modifications to Design

### Plan Redesign

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combined Plan</td>
<td>A dual plan is an arrangement which consists of both a defined contribution and defined benefit plan. The defined benefit is the primary plan while the defined contribution plan establishes a minimum benefit and provides portability.</td>
</tr>
<tr>
<td>Cash Balance Plan</td>
<td>A cash balance plan is a defined benefit plan which looks like a defined contribution plan. Hypothetical account balances are credited annually with a percent of salary and a pre-defined interest crediting rate. The interest crediting rate is based on an index (e.g., one-year Treasury rate plus 1.5%) as defined in the plan. A simple example of a cash balance plan is one that allocates 5% of annual salary to each participant’s cash balance account and guarantees a fixed rate of interest on those contributions.</td>
</tr>
<tr>
<td>Defined Contribution Plan</td>
<td>A defined contribution plan is a retirement savings arrangement to which employees contribute on a tax-deferred basis through a payroll deduction. Employers may provide a matching contribution. The retirement benefits are based on the accumulated contribution plus or minus investment returns and administrative fees. The employee bears all investment risk and typically can take the benefit as a lump sum.</td>
</tr>
</tbody>
</table>
### Modifications to Design

#### Continuum of Public Retirement Plan Redesign

<table>
<thead>
<tr>
<th>Defined Benefit</th>
<th>Combined Plans</th>
<th>Cash Balance</th>
<th>Defined Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retention of defined benefit plan with changes for new hires:</td>
<td>Washington:</td>
<td>Nebraska (January 1, 2003):</td>
<td>Alaska (July 1, 2006):</td>
</tr>
<tr>
<td>- Raise retirement eligibility</td>
<td>- Employee choice of:</td>
<td>- Employees contribution: 4.8%</td>
<td>- All new employees</td>
</tr>
<tr>
<td>- Raise contributions</td>
<td>- Plan 2: DB–2% of pay plan</td>
<td>- Employer contribution: 7.5%</td>
<td>- Employer contribution: 3.5% plus 3.75% to retiree health fund</td>
</tr>
<tr>
<td>- Lower multiplier</td>
<td>- Plan 3:</td>
<td>Investment return guarantee:</td>
<td>- Employee contribution: 8%</td>
</tr>
<tr>
<td>- Reduced or suspended COLA</td>
<td>» DB–1% of pay plan</td>
<td>- At least 5% annual return</td>
<td></td>
</tr>
<tr>
<td>- Eliminate rehired retirees and spiking</td>
<td>» DC Employer contribution: 8%</td>
<td>- Potential for additional Board approved amount</td>
<td></td>
</tr>
<tr>
<td>Some states/localities have reduced COLA for existing retirees</td>
<td>Employee contribution: 5% – 15%</td>
<td>- Total not to exceed 8%</td>
<td></td>
</tr>
<tr>
<td>Some states/localities are considering changes for future accruals for current active employees</td>
<td>Oregon:</td>
<td>Louisiana:</td>
<td>Michigan (March 1997):</td>
</tr>
<tr>
<td></td>
<td>- Combined DB/DC plan</td>
<td>- Cash balance plan for new hires – implementation delayed</td>
<td>State Employees:</td>
</tr>
<tr>
<td></td>
<td>- Tier II:</td>
<td></td>
<td>- Employer contribution: 4% up to 7%</td>
</tr>
<tr>
<td></td>
<td>» DB 1.5% of pay plan employer funded</td>
<td></td>
<td>- Employee contribution: up to 3%</td>
</tr>
<tr>
<td></td>
<td>» DC 6% employee funded</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utah (July 2011):</td>
<td>Utah (July 2011):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee Choice of:</td>
<td>Employee Choice of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Tier II:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>» DB 1.5% of pay plan</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>» 10% cap on employer contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>DC funded by “excess” employer contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>OR</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>DC 10% employer contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rhode Island:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All workers in hybrid (7/2012)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Moves all new hires to hybrids (7/2014)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

There are many choices for redesign.
## Modifications to Design
### Summary of Recent State Plan Changes

<table>
<thead>
<tr>
<th>Contribution Rate Changes</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| Employer New Hires        | CA, HI, IA, KS, LA, MN, ND, NJ, NM, TN | • Raise all contribution rates  
• Reinstate higher contributions based on funding levels or investment returns  
Lower employer contribution rates  
• Mandate employee contributions  
• Prohibit “pick-up” of employee contributions |
| Employee New Hires        | AL, FL, DE, HI, IA, LA, MN, MO, MS, MT, NY, VT, WY | |
| ALL EE                    | AL, CO, DE, FL, KS, MD, NE, NH, NJ, ND, NM, OH, SC, TX, VA, VT | |
| ALL ER (+)                | HI, NE, SC | |
| ALL ER (-)                | AL, AR, CO, FL, NM, ND, OH, TX, VT | |

<table>
<thead>
<tr>
<th>COLA</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | CT, HI, FL, IL, MD, MI, MS, KS, OK, UT, VA, TN | • Suspension tied to funding or CPI  
• Suspension tied to funding percentage or investment returns  
• Elimination tied to benefit amount  
Annual dollar cap  
• Freeze based on service accrual date  
• Delay start  
• Grant after a date certain  
• Apply changes to non-vested |
| Actives                   | AZ, CT, FL, KS, MD, MS, VA | |

<table>
<thead>
<tr>
<th>Sponsor Contribution Rules</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| IA, KS, LA, MD, NJ, VA, VT | • Additional contributions to ARC  
• Require ARC  
• Funding from Casino/Real Estate sales  
Earmark pension savings to pay down unfunded liability  
• Require payment of the ARC |
| New Hires                 | AL, AZ, DE, FL, CO, CT, IA, IL, LA, NY, MT, WY | |
| Actives                   | HI, NH, NJ, NC, MD, VA, WY | |

<table>
<thead>
<tr>
<th>Anti-Spiking</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | AL, AZ, DE, FL, CO, CT, IA, IL, LA, NY, MT, WY | • Limits pensionable compensation  
• Longer FAS period  
• Assess final year costs to last employer |
| Actives                   | HI, NH, NJ, NC, MD, VA, WY | |

<table>
<thead>
<tr>
<th>Multiplier</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | GA, HI, MD, MS, MT, NH, NJ, NY, KS, WY, TN | • Lower multiplier  
• Raise multiplier  
• Rolling rate based on service  
Reduce longevity multiplier or period  
• Apply change to non-vested |
| Actives                   | KS, VA, VT | |

<table>
<thead>
<tr>
<th>Retirement Eligibility</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | AL, AZ, CT, DE, FL, HI, IL, MA, MN, MO, MS, MT, NH, NJ, NC, ND, OK, WY, WI, WY | • Raise service requirements  
• Longer vesting period  
Eliminate combined age/service rule  
• Increase combined age/service rule |
| Actives                   | AZ, CO, CT, TX | |

<table>
<thead>
<tr>
<th>Retirement Age</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | DE, HI, MA, ME, MO, NH, ND, NY, OK, VA, SC, WA, WY, TN | • Raise normal retirement age  
• Apply to non-vested  
• Coordinate with social security normal retirement age  
Suspend pension and health benefits based on earnings after rehire  
• Require full contribution |
| Actives                   | AZ, CO, ME, VA, VT | |

<table>
<thead>
<tr>
<th>Re-employment</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| AZ, AK, CO, GA, IL, MD, ME, MI, MS, NM, SD, UT | • Eliminate service accrual after rehire  
• Limit compensation  
Choice of Defined Benefit, Hybrid or Defined Contribution  
New hires in Hybrid |
| New Hires                 | GA, IN, KS, LA, MI, UT, VA | |
| Actives                   | LA, RI | |

<table>
<thead>
<tr>
<th>Hybrid</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
</table>
| New Hires                 | NJ, NY, UT, TN | • Part-time workers  
• Higher Paid  
Optional |
| Actives                   | LA, RI | |

<table>
<thead>
<tr>
<th>Defined Contribution</th>
<th>State</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Hires</td>
<td>NJ, NY, UT, TN</td>
<td></td>
</tr>
<tr>
<td>Actives</td>
<td>LA, RI</td>
<td></td>
</tr>
</tbody>
</table>

Sources: National Media Reports, National Conference of State Legislatures, May 2011, September 2011 and April 2013
Boulders, Rocks, Pebbles, Sand

There are numerous benefit changes that would reduce cost, but by how much?

This is a way of prioritizing/ranking changes based on their impact to the ARC.

**Boulders**
Substantial Reduction in ARC—more than 20%

**Rocks**
Large Reduction in ARC—at least 10%

**Pebbles**
Small Reduction in ARC—about 5%

**Sand**
Minimal Reduction in ARC—less than 5%
Benefit Changes to Consider

- COLA
- Retirement Age
- Benefit Formula
- Purchase of Service
- Other
Relative Impact of Defined Benefit Plan Changes

Types of potential changes—will likely require legislative approval

**Boulders**
- Fund 100% of the Annual Required Contribution
- Eliminate the COLA
- Deliver future pension benefits under a new plan structure with shared risk
- Change to a career average pension plan
- Change to a cash balance pension plan

**Rocks**
- Modify the COLA
- Increase minimum retirement age for unreduced benefits
- Add minimum retirement age for early retirement benefits
- For current active employees in current plan, change benefit formula for future service
- Increase employee contribution rate
Relative Impact of Defined Benefit Plan Changes

Types of potential changes—will likely require legislative approval

**Pebbles and Sand**

- Increase final average salary period from 3 or 5 years to 5 or 7 years
- Modify purchase of service benefits
- Eliminate interest on member accounts
- Eliminate the loan provisions
- Reduce disability and death benefits
- Prohibit pay spiking
Changing State Budgets

General Fund Expenditures by Function, Estimated Fiscal 2010

- Elementary & Secondary Education: 35.7%
- Medicaid: 15.4%
- Public Assistance: 1.9%
- Corrections: 7.2%
- Transportation: 0.8%
- Higher Education: 12.1%
- Pension Contributions: 3.8%
- All Other: 23.1%

Source: National Association of State Budget Officers 2009 State Expenditure Report
Impact of Changes
General Fund Expenditures

General Fund Expenditures by Function, Estimated Fiscal 2012

- All Other: 33.7%
- Elementary & Secondary Education: 19.8%
- Medicaid: 23.9%
- Higher Education: 9.9%
- Transportation: 8.1%
- Corrections: 3.2%
- Public Assistance: 1.4%

Source: National Association of State Budget Officers 2012 State Expenditure Report
Changing State Budgets

Expenditures by Function (Estimated Fiscal 2015)

Total State Expenditures

- Medicaid, 27.4%
- K-12, 19.3%
- Higher Ed, 10.3%
- Transportation, 7.7%
- Corrections, 3.1%
- Public Assistance, 1.3%
- All Other, 30.9%

State Funds

- Medicaid, 15.6%
- K-12, 24.5%
- Higher Ed, 13.3%
- Transportation, 7.2%
- Corrections, 4.5%
- Public Assistance, 0.9%
- All Other, 34.0%

Source: National Association of State Budget Officers 2015 State Expenditure Report
Published by The Keep, 2016
Fiscal Stress Measures:

- Ratio of Required Contributions to the Total Budget of the Sponsoring Entity
- Required Contributions as a Percentage of Payroll
- Ratio of Market Value of Assets to Total General Fund Revenue of the Sponsoring Entity
- Ratio of Unfunded Actuarial Accrued Liability (UAAL) to Sponsoring Jurisdiction Population (UAAL per Capita)
- Ratio of Annual Required Contribution (ARC) to Sponsoring Jurisdiction Population (ARC per Capita)
State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform

This study examines the long-term effects of pension reforms on employer costs and on state budgets for a sample of 32 plans in 15 states.

The results show:

- For most plans, the reforms fully offset or more than offset the impact of the financial crisis on the sponsors’ costs.
- For the sample as a whole, pension costs as a share of state-local budgets are projected to eventually fall below pre-crisis levels.
- A few caveats: the projections assume that the reforms stick, that plan sponsors consistently make their required payments, and that they earn expected returns.

Source: “State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform,” Boston College, Center for Retirement Research - March 2013
Employer Normal Cost as Percent of Payroll, Pre-Crisis and Post-Reform, by Funded Status

Source: “State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform,” Boston College, Center for Retirement Research – February 2013

State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform, February 2013
Impact of Changes
State Budgets

Pension Costs as Percent of State-Local Budgets, Sample Average, Pre-Crisis through Post-Reform

Source: “State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform,” Boston College, Center for Retirement Research – February 2013
Ongoing Questions

- **Environment**: Will economic recovery be enough?
- **Design**: Which is more important – cost or risk?
- **Legal**: Will design reforms stick?
- **Detroit Wild Card**:
  - Municipal Bond Market
  - Funding Practices
  - Federal Policymakers
Questions