GO/PS Committees #2
June 21, 2011
Discussion

MEMORANDUM

June 17, 2011

TO: Government Operations and Fiscal Policy Committee
Public Safety Committee

FROM: Leslie Rubin, Legislative Analyst, Office of Legislative Oversight
Aron Trombka, Senior Legislative Analyst, Office of Legislative Oversight AT
Robert H. Drummer, Senior Legislative Attorney

SUBJECT: Retirement Benefits for New Public Safety Employees

At today's meeting, Councilmembers will discuss employee retirement benefits for new public safety employees. This discussion stems from the Council's review of the FY12 operating budget including the Council's decision to re-examine the structure and level of employee benefits. This worksession on public safety defined benefit retirement (pension) plans affords the Council the opportunity to assess the current system's costs and level of benefits and to consider alternative retirement plan structures.

Public safety employees include Police Officers, Firefighters, Correctional Officers, and Sheriff's Deputies. This memorandum focuses on the pension benefit for new public safety employees because only new public safety employees are eligible to join the County Government's defined benefit pension system. In 1994, the Council amended the County Code to close the pension system to new non-represented and non-public safety employees.[1] The current pension benefit is significantly more expensive to the County Government than other retirement benefits.

This packet is organized in three sections.

- Section A poses policy questions regarding employee retirement benefits.
- Section B summarizes past changes to the County Government's pension system.
- Section C summarizes four alternative ways to structure employee retirement benefits.

At today's worksession, Councilmembers will discuss policy questions related to the structure of the retirement benefit for public safety employees. At the conclusion of the policy discussion, staff will ask Councilmembers to provide guidance about the preferred characteristics of retirement plan(s) for new public safety hires. Based on this guidance, staff will prepare specific retirement plan options for the Committees to consider at the next worksession.

[1] New non-public safety and non-represented employees have the option to participate in the defined contribution Retirement Saving Plan or the hybrid cash balance Guaranteed Retirement Income Plan (see below).

A. Policy Framework

This section poses three policy questions to frame the Committees' discussion of public safety retirement benefits:

- What retirement benefits do current public safety employees receive?
- What do these retirement benefits cost?
- What is an "appropriate" retirement benefit?

1. What retirement benefits do current public safety employees receive?

All non-represented public safety management employees hired before October 1, 1994 and all *represented* public safety employees hired on or after that date are eligible for a pension under the Employees' Retirement System (ERS). The specific plan provisions governing an employee's retirement benefit are determined by when the employee was hired and which public safety group the member belongs to. This section describes the retirement benefits for employees hired after June 30, 1978. The table below identifies key current pension plan provisions for the different public safety groups.

Public Safety Pension Plan Provisions and Examples of Modifications
(employees hired after June 30, 1978)

Provision	Current Plan Provision	
Minimum Years of Service[2]	Police/Deputy Sheriff/Corrections:	25 years
	Fire:	20 years
Average Final Earnings (AFE)	All: Average of highest three years' salary	
Pension Multiplier (per year of credited service)	Police/Deputy Sheriff/Corrections:	2.4% of AFE[3]
	Fire:	2.5% of AFE[4]
Maximum Pension (as percent of Average Final Earnings)	Police:	86% of AFE
	Fire:	74% of AFE
	Deputy Sheriff/Corrections:	76% of AFE
Vesting Period	All: 5 years of service	

After 20 years of service, firefighters can retire with a pension of 50% of their average final salary. If they stay for 30 years, they receive a pension of 70% of their average final salary. Police Officers, Deputy Sheriffs, and Corrections Officers are eligible to retire after 25 years with a pension of 60% of their average final salary. After 30 years of service, Police Officers receive a pension of 72% of their average final salary and Deputy Sheriffs and Corrections Officers receive 70% of their average final salary.

The table on the next page shows the annual and lifetime pension payments that public safety employees currently receive if they retire at age 54 after 30 years of service with average final earnings (AFE) of $85,000.

Annual and Lifetime Pension Payments:

[2] This is the minimum years of service needed to be eligible to receive a pension (without an early retirement penalty) regardless of age. For all public safety bargaining units, an employee currently is eligible to receive a pension (without an early retirement penalty) at age 55 with 15 years of service.
[3] The Sheriff and Correction multiplier is 2.0% for each year after 25 years of service.
[4] The Fire multiplier is 2.0% for each year after 20 years of service.

Retiree with 30 Years of Service and $85,000 Final Earnings

Position	Annual Pension[5]	Lifetime Pension Payment[6]	
		Total	Inflation Adjusted[7]
Fire/Sheriff/Corrections	$59,500 (70% of AFE)	$1.85 million	$1.18 million
Police Officer	$61,200 (72% of AFE)	$1.91 million	$1.21 million

In 1978, the County Government "integrated" its pension system with Social Security for employees hired after 1978. This means that once a retiree reaches Social Security retirement age and receives both a monthly pension payment and a monthly Social Security payment, the amount of the pension payment is lowered to account for the retiree's additional income from Social Security. The ERS integrates with Social Security by using a separate, lower multiplier to calculate annual pension amounts when employees reach Social Security retirement age. Integrating defined benefit plans with Social Security lowers the long-term cost of pensions for employers.

For a more extensive discussion of current County Government retirement benefits, see OLO's memo discussing *Additional Information about Current Retirement Benefits* at ©1.

2. What is the cost of current public safety retirement plans?

In the past decade, the County Government has seen the overall annual cost of funding public safety defined benefit pensions rise 227%, from $25 million in FY02 to $82 million in FY11.[8] County Government pension costs for all employees are projected to rise another 32% by FY16. By comparison, the County Government's FY11 cost for retirements benefits for employees in the County Government's defined contribution (RSP) and cash balance (GRIP) retirement plans is approximately $14.7 million. At the same time, the RSP and GRIP had approximately 900 more members than the public safety groups in the ERS.

Another way to look at retirement costs is to measure the percentage of an employee's salary the employer must contribute to fund a pension benefit – often referred to as the "load." The table below compares public safety employees' retirement load in two specific years – 2002 and 2011. The table shows that approximately half of the annual cost of County Government employee pensions pays for unfunded liability.

County Government Contribution for Public Safety Pension Benefits, 2002 and 2011*
(Percent of Salary)

	Police		Fire		Deputy Sheriff/Corrections	
	2002	2011	2002	2011	2002	2011
Normal Cost	14.06%	19.03%	13.22%	17.95%	11.75%	18.16%
Unfunded Liability	3.49%	16.82%	5.68%	20.05%	0.50%	13.74%
Total	**17.55%**	**35.85%**	**18.90%**	**38.00%**	**12.25%**	**31.90%**

*For employees hired after June 30, 1978
Source: 2000 and 2009 Mercer ERS Actuarial Valuations, OLO calculations

The term "normal cost" refers to the amount an employer pays for pension benefits earned by employees for accrued years of service. As shown in the table above, normal costs have grown significantly over the past decade.

---

[5] When a retiree becomes eligible for Social Security, his/her annual pension decreases by an amount approximately equal to his/her annual Social Security payment.
[6] Lifetime pension payment assumes the employee lives until age 84, the current average life expectancy for male ERS members.
[7] The calculation of the lifetime pension benefit in 2011 dollars assumes an annual inflation rate of 3.0%.
[8] Source: 2000 and 2009 Mercer ERS Actuarial Valuations.

At the same time that the County Government is paying for pension normal costs, it also is paying down the pension system's "unfunded liability," the difference between what the system is projected to owe retirees and the amount of money available. As of December 2010, the County Government's pension system had a liability of $3.6 billion and $2.8 billion in assets, which means that the pension system has an unfunded liability of $854 million. The ERS currently faces this unfunded liability because:

- Employees received multiple retroactive pension benefit enhancements that were not fully funded (see page 5);
- The pension system, on average, did not earn the projected annual rate of return on investments over the last decade due to market downfalls, earning on average 4.11% annually from 2001 to 2010; and
- The County Government revised actuarial assumptions in 2005 and 2010 used to calculate the system's liability, which subsequently increased the total liability.

Even if the Council changes employees' pension benefits to lower costs, the County Government will still have to fund the outstanding liability.

3. What is an "appropriate" retirement benefit?

The adequacy of a retirement benefit is a subjective matter. Creating an "appropriate" retirement benefit requires establishing a balance between what a retiree needs to meet his/her financial needs and what the employer can reasonably fund.

When assessing a retirement benefit, Councilmembers should note the concept of the "three-legged stool." This decades-old doctrine states that a worker's income in retirement should come from three separate sources:

- Social Security benefits;
- An employer-provided pension plan; and
- Personal savings.

No "leg" of the stool is intended or expected to provide 100% of an employee's retirement income, but all are expected to contribute a portion.

As employers have switched from defined benefit plans to defined contribution plans, retirement planners have questioned the doctrine of the three-legged stool because defined contribution plans often do not provide an amount of retirement income comparable to defined benefit plans. The doctrine is still applicable for County Government public safety employees with employer-provided pension plans, however, the pensions of employees hired after June 30, 1978 are integrated with Social Security.

With respect to additional retirement and/or personal savings, Councilmembers should consider whether it is reasonable to expect that public safety retirees can earn additional employment income (and retirement and Social Security benefits) for several years after leaving County service. Public safety employees retire much earlier than non-public safety employees because they are required to work fewer years to receive full retirement benefits.

In addition, as average life expectancies increase, the number of years that retirees receive pension benefits increases. Since the ERS was established in 1965, the average life expectancy in the United States has increased by nine years for men, to 76 years old, and by seven years for women, to 81 years old.[9]

[9] 2010 projections, U.S. Census Bureau (2011).

According to the latest calculations from the County Government's actuary, the average life expectancy of ERS members is 84 years for men and 86 years for women. By comparison, the average life expectancy in Montgomery County is 81 years for men and 85 years for women.[10]

Identifying an "appropriate" retirement benefit joins together questions about the level and cost of the benefit. It does not serve the residents of the County or the County Government to create a retirement benefit that the County cannot fund in a sustainable fashion. At the same time, it does not serve employees well to develop a retirement benefit, simply because it is "less costly," that cannot effectively contribute to an employee's retirement. Developing an "appropriate" retirement benefit requires balancing the cost to the County and the benefit received by the retiree both for the current year and into the future.

B. Past Changes To County Government's Pension System

To provide additional context for the Committees' discussion, this section summarizes some past changes to the County Government's pension system to provide some historical perspective. The County Government established its current defined benefit pension system in 1965. Over the years, the County Government has changed pension benefits many times – in recent decades primarily through the collective bargaining process. These changes affected the retirement benefit received by both public safety and non-public safety employees.

Retroactive changes and associated costs. Changes to the ERS often have been "retroactive" enhancements to employees' pension benefits – meaning that an enhancement applies back to when an employee began County Government service. Retroactive enhancements increase the pension system's unfunded liability because the cost of the enhanced benefit for all past service was not paid when the service was performed.

In contrast, two out of the three times the County Government scaled back pension benefits since 1965 to lower pension costs, the decreased benefit was applied only to new hires – limiting the amount of savings from the changes. The two changes that applied only to new hires were:

- In 1978, when the County Government integrated its pension system with Social Security; and
- In 1994, when the County Government closed the pension system to new non-represented employees and to new non-public safety employees.

Last month, the Council enacted Bill 11-11, modifying the cap on pension cost of living adjustments for future service for all current and future employees and increasing contributions for all ERS members. These changes take effect on July 1, 2011.

Retroactive pension enhancements increase ERS liabilities and result in higher costs for the County Government. In the past, the County Government amortized the cost of pension enhancements over 40 years – the equivalent of taking out a 40 year mortgage for each enhancement. The table on the next page shows that the ultimate cost of retroactive enhancements amortized over 40 years is over three times as much as the initial cost of an enhancement.

[10] Institute for Health Metrics and Evaluation, University of Washington.

Examples of Amortized Costs of Retroactive ERS Pension Benefit Enhancements

Change	Initial Cost	Ultimate Cost (amortized over 40 years)
2001 pension multiplier increases	$121.9 million	$378.6 million
2005 20-year retirement for firefighters	$27.5 million	$85.4 million
Total	**$149.4 million**	**$446.0 million**

Note: Beginning in 2012, the County Government will recalculate the amount of time to pay its remaining unfunded liability – lowering it to 18 years.
Source: 2009 and 2010 Mercer ERS Actuarial Valuations

Changes to Pension Multipliers. When the County established its pension system in 1965, all employee pensions were calculated using the same multiplier. While different employee groups were required to work for different periods of time to qualify for a pension (e.g., 25 years for public safety vs. 30 years for non-public safety employees), all employees earned the same percent of salary for each year of service. Since 1965, however, multipliers for public safety employees were increased on two occasions.

As a direct result of increased pension multipliers, employees' pensions increased. Since the inception of the ERS, a public safety employee's pension after 25 years of service increased from 43.75% of salary to 60% of salary.

Changes in County Government Pension Multipliers

Employee Group	1965	1978	2011
Multiplier			
Non-Public Safety	1.75%	2%	2%
Police/Deputy Sheriff/Corrections			2.4%
Fire			2.5%
Pension at Full Retirement (% of average final salary)			
Public Safety at 25 years*	43.75%	50%	60%

* In 2007, firefighters' pension benefits were changed to allow them to retire with full benefits and 50% of salary after 20 years of service.
Source: Montgomery County Code

C. Alternative Retirement Plan Structures for New Public Safety Hires

This section discusses ways to reduce retirement benefit costs for public safety employees through four alternative retirement plan structures:

1. Defined Benefit Retirement Plan
2. Defined Contribution Retirement Plan
3. GRIP-Type Plan
4. Hybrid Retirement Plan

NOTE: Any change to a benefit that affects new hires alone will achieve relatively small savings in the initial years after implementation. The full fiscal impact of changes (referred to in this memo as "ultimate savings") will be realized only after new employees have replaced all current members of the workforce.

Structure #1: Defined Benefit Retirement Plan

One option to reduce retirement costs is to retain a defined retirement benefit for new hires, but with less generous benefits. The Maryland General Assembly adopted this approach earlier this year when it reduced benefits for new employees hired into State-run employee pension plans, including plans for public safety officers.

Each specific provision of a defined benefit plan impacts a plan's cost. For example, decreasing a pension multiplier decreases the benefit and therefore reduces the employer's costs. Increasing the minimum retirement age reduces costs because employees must work more years before collecting a pension and will collect a pension for fewer years. The table below lists several current public safety plan provisions and examples of modifications that would reduce the long-term costs to the County for these benefits. The Council could consider modifications different from the examples listed in the table.

Public Safety Pension Plan Provisions and Examples of Cost Sharing Modifications
(employees hired after June 30, 1978)

Provision	Current Plan Provision		Example of Modification
Minimum Years of Service[11]	Police/Sheriff/Corrections:	25 years	Require minimum of 25 years of service
	Fire:	20 years	
Minimum Retirement Age	None		Establish minimum retirement ages
Average Final Earnings (AFE)	All: Average of highest 3 years		Change to average of highest 5 years
Pension Multiplier (per year of credited service)	Police/Sheriff/Corrections:	2.4% of AFE[12]	Reduce to 2.0% of AFE
	Fire:	2.5% of AFE[13]	
Maximum Pension (percent of AFE)	Police:	86% of AFE	Reduce to 70% of AFE
	Fire:	74% of AFE	
	Sheriff/Corrections:	76% of AFE	
Vesting Period	All: 5 years of service		Increase to 10 years of service
Employee Contribution (percent of salary)	Police/Sheriff/Corrections:	6.75%[14]	Increase to a higher percent of salary
	Fire:	7.5%[14]	

Effect on Employees. As shown on page 3, an employee who retires after 30 years of service with average final earnings of $85,000 would receive a pension benefit of approximately $60,000 per year. Over the retiree's lifetime, the stream of annual pension payments would total about $1.9 million, or about $1.2 million when adjusted for inflation. Adopting less costly pension provisions would result in new hires receiving a lower pension benefit. The actual amount of the reduction in the pension benefit for new hires would depend on the changes made.

Impact on Employer. Calculating the savings from modifying current pension benefits requires actuarial analyses. For example, the County's actuary previously calculated that modifying new hire pensions to require a minimum of 25 years of service combined with a 2.2% multiplier would ultimately reduce County pension costs by $4.5 million annually. In considering changes to pension plan provisions for new employees, Councilmembers could ask staff to work with the County's actuary to develop a combination of modifications that achieve a targeted level of savings (for example, a 10% reduction in annual County payments to the ERS trust fund).

[11] Minimum years of service need to reach full retirement regardless of age. For all public safety bargaining units, an employee currently is eligible for retirement at age 55 with 15 years of service.
[12] The Sheriff and Correction multiplier is 2.0% for each year after 25 years of service.
[13] The Fire multiplier is 2.0% for each year after 20 years of service.
[14] Police/Sheriff/Corrections employee contributions will be 5.75% of salary in FY12 and will rise to 6.75% of salary in FY13; Fire employee contributions will be 6.5% of salary in FY12 and will rise to 7.5% of salary in FY13. The employee contribution is greater for salary earned above the Social Security Wage Base ($106,800 in 2011).

Structure #2: Defined Contribution Retirement Plan

Another option to reduce retirement costs is to establish a defined contribution plan for new public safety hires. This would mirror the Council's actions in 1994 when it closed the defined benefit system to new non-represented employees and new represented non-public safety employees and created the defined contribution Retirement Savings Plan (RSP).

Under this approach, public safety employees would become members of the RSP and both the County Government and an employee would contribute a fixed percent of the employee's salary to an individual self-directed retirement account.

Effect on Employees. The table below shows examples of the savings an employee would have accumulated at retirement based on different combinations of employee and employer contributions. The County could establish a defined contribution plan with any combination of employee and employer contribution rates.

The examples assume the employee retires after 30 years with a final salary of $85,000 and earns a 7.25% annual rate of return from retirement fund investments.[15] Actual account earnings depend on the performance of employee investment selections.

Examples of Defined Contribution Savings:
Employee with 30 Years of Service; $85,000 Final Salary; 7.25% Annual Return

Contribution (% of salary)		Account Balance at Retirement
Employer	Employee	
8%	4%	$536,000
8%	6%	$625,000
10%	6%	$714,000
12%	6%	$804,000
12%	8%	$893,000

An employee who leaves County Government service can transfer his/her retirement account balance to another qualified account (either an account sponsored by another employer or a private account) without penalty.

Impact on Employer. The County Government would save money by instituting a defined contribution benefit for new public safety hires as long as the County Government's contribution rate was lower than the current contribution rate for public safety pensions – currently about 18% to 20% of salary.[16]

The table on the following page shows estimates of the ultimate annual savings from replacing an 18% defined benefit employer contribution with lower employer contributions under a defined contribution plan. An actuarial analysis is required to more precisely calculate the multi-year fiscal impact of moving to a defined contribution retirement plan.

[15] The current guaranteed rate of return under the Guaranteed Retirement Income Plan (see below) is 7.25%
[16] This refers to public safety pension "normal costs" and excludes costs for the pension system's unfunded liability.

Estimates of Ultimate Savings from Creating a Defined Contribution Retirement Plan for New Public Safety Employees

Employer Contribution	Approximate Ultimate Annual Savings[17]
8% of Salary	$21 million
10% of Salary	$17 million
12% of Salary	$13 million

Unlike defined benefit plans, defined contribution plans do not place market risk on the employer. The employer's cost of a defined contribution benefit is a fixed and knowable percent of an employee's salary that can be budgeted with a high level of certainty. In contrast, employer's pension trust fund costs are a function of multiple risk factors beyond the employer's control (such as actuarial trends, retirement rates, life expectancy, and investment performance).

Structure #3: GRIP-Type Plan

A third option is to include new public safety hires in the Guaranteed Retirement Income Plan (GRIP). Similar to the RSP defined contribution plan, the County Government also offers non-represented and represented non-public safety employees the option of participating in the GRIP. The GRIP is an example of a cash balance plan in which both the County Government and the employee contribute to an employee's retirement account. Under the GRIP, the County guarantees the employee a 7.25% annual return on the contributions rather than the employee investing the funds.

Effect on Employees. As with a defined contribution benefit, in a cash balance plan, employee and employer contributions would be deposited into individual retirement accounts. The table on the previous page shows the amount of money that would accrue in a GRIP account of an employee who retires after 30 years with a final salary of $85,000.

As with a defined contribution plan, in general, an employee who leaves County Government service can transfer his/her retirement account balance to another qualified account (either an account sponsored by another employer or a private account) without penalty.

Impact on Employer. Similar to a defined contribution plan, the County would save money (compared to the cost of the current pension benefit) by implementing a cash balance retirement plan as long as the employer's contribution rate fell below current normal pension costs.

The risk in a cash balance retirement plan is shared between an employer and the employee, but with more risk borne by the employer. Like a defined contribution plan, an employer's annual contribution to a cash balance plan is fixed and knowable. The employer, however, is responsible for guaranteeing a fixed rate of return on each account. If the employer falls short of its investment goal, the employer is obligated to make up any difference. In practice, the risk to the employer associated with a cash balance plan is lower than the risk associated with a defined benefit plan. An actuarial analysis is required to calculate the multi-year fiscal impact of moving to a cash balance retirement plan for new public safety employees.[18]

[17] The estimate of the ultimate annual savings is based on salary data included in the December 2010 Actuarial Valuation Report for the Employees' Retirement System.
[18] For a discussion of these issues, see, *A Role for Defined Contribution Plans in the Public Sector* by the Center for State and Local Government Excellence at ©29.

Structure #4: Hybrid Retirement Plan

A fourth option is to create a mandatory hybrid retirement plan for new public safety hires. A hybrid retirement plan includes both defined benefit and defined contribution components. Hybrid plans can take different forms. The County Government's GRIP retirement plan with a fixed employer contribution rate coupled with a guaranteed annual return is one type of hybrid plan.

In a "stacked" hybrid plan, the employer provides a defined benefit for an employee up to a specified salary level (for example, $50,000). In addition, the employer makes defined contributions to a retirement account for any portion of an employee's salary that exceeds the maximum defined benefit salary level (for example, the portion of an employee's salary that exceeds $50,000).

In a "parallel" hybrid plan, the employer funds a defined benefit pension and also contributes to an employee retirement account based upon the employee's full salary. Because the employee receives two separate retirement benefits, the benefit level for each part of a hybrid plan generally is less generous than the benefit for a stand-alone defined benefit or defined contribution plan.

Effect on Employees. If the County adopted a hybrid retirement plan for new hires, new employees would receive a less generous pension than current employees but would also accumulate savings in a retirement account. The table on the next page shows <u>examples</u> of a parallel hybrid plan and a stacked hybrid plan. The table shows the annual pension payment as well as the amount of money that would be in the account of an employee who retires after 30 years of service with average final earnings of $85,000. Other options could also be considered.

Examples of Hybrid Retirement Plan Benefits:
Employee with 30 Years of Service and $85,000 Final Earnings

Plan Type	Defined Benefit Component	Defined Contribution Component
Parallel Hybrid	**Pension Formula:** 1.2% of average final earnings for each year of credited service	**Contribution Rates:** Employer: 6% of salary Employee: 4% of salary
	Annual Pension Amount: $30,600 (36% of salary)	**Retirement Account Balance:** $446,000
Stacked Hybrid	**Pension Formula:** 2.4% of annual earnings up to $50,000 for each ear of credited service	**Contribution Rates:** Employer: 20% of salary above $50,000 Employee: 8% of salary above $50,000
	Annual Pension Amount: $36,000 (42% of salary)	**Retirement Account Balance:** $105,000

Impact on Employer. An actuarial analysis is required to calculate the savings that would be achieved through shifting new public safety employees into a hybrid retirement plan. The savings achieved will be a function of the specific design of the hybrid plan.

Comparison of Different Plan Structures

The table on the following page compares the characteristics of the four different retirement plan structures described above.

Characteristics of Retirement Plan Structures

	Defined Benefit Plan	Defined Contribution Plan	Cash Balance GRIP-Type Plan	Hybrid Plan
Amount of Benefit	The benefit a retiree receives depends on specific plan provisions. No one plan structure is inherently more or less generous than another.			
Cost to County	The cost of a retirement benefit depends on specific plan provisions. No one plan structure is inherently more or less costly than another.			
Assumption of Financial Risk	Employer	Employee	Employer	Shared by employer and employee
Portability of Benefit	Not transferable between jobs (with exception of some other public sector jobs in Maryland)	Transferable between jobs	Transferable between jobs	Defined contribution portion transferable between jobs
Consistency with Retirement Benefits for Other Employees	Structure similar to current public safety benefit	Structure similar to current non-represented and non-public safety benefit	Structure similar to current non-represented and non-public safety benefit	New type of benefit
Budget Predictability for Employer	Not fixed or knowable. A function of multiple variables including investment performance.	Fixed and knowable.	Partially predictable. Fixed annual employer contribution. Risk of guaranteed rate of return borne by employer.	Partially predictable. Fixed annual employer defined contribution. Annual employer contribution to pension trust fund is a function of multiple variables.
Compatibility with Current Disability Retirement Benefit	Compatible	Would require amendment of disability retirement structure.	Would require amendment of disability retirement structure.	Would require amendment of disability retirement structure.

MEMORANDUM

March 17, 2011

TO: Councilmembers

FROM: Aron Trombka, Senior Legislative Analyst
Leslie Rubin, Legislative Analyst
Office of Legislative Oversight

SUBJECT: Follow-up to OLO Report on Achieving a Structurally Balanced Budget: Additional Information about Current Retirement Benefits

This memorandum responds to Councilmember Elrich's request for additional information about retirement plan benefits currently provided to employees of the County Government and Montgomery County Public Schools (MCPS). It is organized as follows:

- Part A provides an overview of defined benefit, defined contribution, and hybrid retirement plans;
- Part B summarizes the current retirement plans for County Government and MCPS employees;
- Part C presents calculations of the income from retirement benefits for four hypothetical examples of employees who elect to retire on July 1, 2011; and
- Part D contains a series of questions and answers that explain the different retirement benefit amounts illustrated by the examples presented in Part C.

In sum, the primary factors that drive the amount of an employee's retirement benefits are the structure of the retirement plan the employee belongs to and the amount of time an employee has been enrolled in the plan.

A. Overview of Defined Benefit, Defined Contribution, and Hybrid Retirement Plans

Defined Benefit Plans. A defined benefit plan provides a retired employee with a sum of money paid regularly as a retirement benefit (i.e., a pension) from the time of retirement until death. A retiree's annual pension is determined by a formula that takes into account the employee's final earnings, years of service,[1] and a pension "multiplier."[2] In addition, defined benefit plans often include a provision to annually increase the dollar amount of the pension (post-retirement) with a cost-of-living adjustment (COLA).

[1] Defined benefit plans often allow members to count earned sick leave toward their years of service for retirement purposes.

[2] A pension multiplier is the percent of wages used to calculate an annual pension.

1

To fund defined benefit plans, employers make annual contributions into a retirement trust fund[3] based on the projected funding needed to pay promised pensions to both current and future retirees. Plans often require employees to contribute a set percent of salary each year to help fund their future retirement benefits. The money in the retirement trust fund is managed by the employer (often at the direction of an independent board). A combination of employee contributions, employer contributions, and the trust fund's investment earnings pay for employees' pensions.

In defined benefit plans, employees are required to work a minimum number of years before they become eligible to receive a pension (called "vesting"). If an employee separates from the employer before vesting, the employer typically refunds the employee's contributions to the plan. If an employee vests but separates from the employer before qualifying for retirement, typically the employee can either receive a refund of his or her own contributions plus interest or receive a pension at a later date – when the employee would have been eligible for retirement from the employer.

Defined benefit plans place the financial risk for funding pensions on the employer. The employer remains responsible for paying participating employees an annual pension amount upon their retirement, regardless of the balance in the retirement trust fund.

Factors that Affect Pension Benefits. In most defined benefit plans, the following factors determine the amount of a retiree's annual pension:

- Final salary: An employee's final salary is one of the three main components in calculating a pension.
- Multiplier: The multiplier, which reflects a percent of wages used to calculate an annual pension, is the second of the three main pension formula components.
- Length of service: The length of an employee's service with an employer is the third of the three pension formula components.
- Social Security integration: Social security integration refers to whether a pension plan lowers the pension amount that a retiree collects when the retiree reaches Social Security retirement age (SSRA). In an integrated plan, the pension amount decreases when an employee reaches SSRA. In a non-integrated plan, the pension amount does not decrease.

The equation below shows one example of how an employee's final salary and years of service are combined with a multiplier to calculate the amount of an employee's pension.

Final Earnings	x	Multiplier	x	Years of Service	=	Annual Pension
$70,000	x	2%	x	30	=	$42,000

Defined Contribution Retirement Plans. In a defined contribution plan, an employee contributes a set percent of his or her salary to a retirement account. Often an employer also will make contributions to the employee's retirement account – either contributing a set percent of an employee's salary or matching a percent of an employee contribution. The employee guides investment of the funds in the retirement account and bears the entire risk of changes in investment returns. The employer's financial responsibility ends after making any required contribution to an employee's retirement account.

[3] The amount of the annual contribution required by the employer typically is determined by an actuary.

Unlike defined benefit plans, defined contribution plans are portable. This means that upon separation, employees can take retirement funds in a defined contribution plan with them and transfer the funds to a new retirement account. Upon retirement, the employee's benefit is the total of the employee and employer contributions and any investment income earned on the joint contributions.

Factors that Affect Defined Contribution Retirement Benefits. The following factors determine how much money an employee will accumulate in a defined contribution retirement account.

- Annual salary: Employer and employee contributions to defined contribution plans are often calculated as a percent of an employee's annual salary.
- Employer/employee contribution rate: Employer and employee contribution rates determine the amount of money (e.g., percent of salary) deposited annually into an employee's retirement account.
- Length of service: Length of service affects both the total amount contributed to an employee's retirement account and the length of time to earn investment income for the account.
- Investment choices and market performance: The size of a defined contribution account is a function of the market return of the investment choices selected by the employee.

Hybrid Plans. Hybrid plans have characteristics of both defined benefit and defined contribution plans. Some hybrid plans have a defined benefit component and a defined contribution component, while others have different structures entirely. With a hybrid retirement plan, the financial risk is shared between the employer and the employee, with the specific division of risk varying by the details of the funding and benefit structure of the hybrid plan.

B. Summary of County Government and MCPS Retirement Plans

1. County Government.

The County Government provides all three types of retirement plans, and County law outlines which employees are covered by which plans. The table below summarizes each plan and the employees covered. Participation is required for full-time employees, and optional for part-time employees.

Summary of County Government Retirement Plans

<table>
<tr><th>Retirement Plan</th><th>Plan Type</th><th>Active Members*</th><th>Covered Employees</th></tr>
<tr><td>Employees' Retirement System (ERS)</td><td>Defined Benefit</td><td>4,635</td><td>• Employees hired before October 1, 1994
• Represented public safety employees regardless of date of hire</td></tr>
<tr><td>Employees' Retirement Savings Plan (RSP)</td><td>Defined Contribution</td><td>3,272</td><td rowspan="2">• Non-public safety employees hired on or after October 1, 1994
• Non-represented public safety employees hired on or after October 1, 1994</td></tr>
<tr><td>Guaranteed Retirement Income Plan (GRIP)</td><td>Hybrid</td><td>942</td></tr>
</table>

* This is the number of active MCG employees enrolled in the retirement plan as of October 2010.

Employees' Retirement System (ERS) – Defined Benefit. As shown in the table above, employees hired before October 1, 1994 and all represented public safety employees belong to the County Government's defined benefit pension plan. These employees are divided into seven different pension groups determined by their bargaining unit and date of hire. Each group has a separate set of variables used to calculate pensions (e.g., multiplier, average final salary, etc.) and different requirements for retirement eligibility (combination of age and/or years of service).

The ERS is integrated with Social Security, meaning that retirees receive a smaller pension (determined by a formula that varies by group) once they reach Social Security retirement age. The County Government's Board of Investment Trustees manages and invests ERS funds.

Retirement Savings Plan (RSP) – Defined Contribution. The County Government opened its defined contribution plan in 1994 when it closed its defined benefit plan to non-public safety and non-represented employees hired after October 1, 1994. For most employees in the RSP, the County currently contributes 8% of salary and the employee contributes 4% of salary annually.[4] Employees in this plan direct the investment of the funds in their retirement account and can take their funds with them when they leave County Government service.

Guaranteed Retirement Income Plan (GRIP) – Hybrid. The County Government created its hybrid plan, the GRIP, in 2009. The GRIP is open to all employees who are eligible for the RSP. New hires must choose between the two plans and existing RSP members were given a one-time option to transfer to the GRIP.

Like the RSP defined contribution plan, the County currently contributes 8% of salary and the employee contributes 4% of salary to an employee's GRIP account for most employees. Like a defined benefit plan, the County guarantees a fixed rate of return (currently 7.25% annually) on funds in employees GRIP accounts. If GRIP investments earn less than the guaranteed return annually, the County is responsible for making up the difference. Investments that earn more than the guaranteed return offset part of the cost of the County's annual contribution to the GRIP accounts.

Summary of Retirement Plan Factors. The table on the next page summarizes the key provisions that determine the amount of pension/retirement benefits for the different County Government's retirement plans.

[4] A small number of non-represented public safety employees participate in the RSP and GRIP. For these employees, the County contributes 10% of the employee's salary and the employee contributes 3%.

Summary of County Government Retirement Plans:
Key Provisions that Determine the Amount of an Employee's Pension/Retirement Benefit

Defined Benefit Plans	FY11 Contribution (percent of salary)		Minimum Age / Years of Service		Multiplier	Final Salary Calculation	Social Security Integration
	Employee	Employer	Any Age	Or			
Non-public safety hired pre 10-1-94	4%	24.9%	30 years	60 years old/ 5 years of service	2.0%	Average of highest 3 consecutive years	Integrated for employees hired after July 1, 1978
Police	4.75%	31.9%	25 years	55 years old/ 15 years of service	2.4%		
Deputy Sheriff/Corrections	4.75%	35.85%	25 years	55 years old/ 15 years of service	2.4%		
Fire	5.5%	38%	20 years	55 years old/ 15 years of service	2.5%		

Defined Contribution Plan / Hybrid Plan

Employees hired on or after October 1, 1994	FY11 Contribution (percent of salary)	
	Employee	Employer
Non-Public Safety	4%	8%
Non-Represented Public Safety	3%	10%

Source: Montgomery County Code Chapter 33; Montgomery County Employees' Retirement System 2009 Actuarial Valuation Report

2. Montgomery County Public Schools

All MCPS employees participate in a defined benefit retirement plan. Approximately three quarters of MCPS employees participate in a defined benefit plan funded and administered by the State of Maryland. All other MCPS employees participate in a locally-funded defined benefit plan that is identical to the State plan. MCPS refers to these plans (whether State-funded or MCPS-funded) as the employees' Core Pension.

In addition to the Core Pension, State law requires MCPS to provide a Pension Supplement to employees in the State pension plan.[5] MCPS provides the Pension Supplement to all MCPS employees, regardless of whether they are in the State- or locally-funded plan. The Pension Supplement that MCPS provides is 150% higher than required by State law. The Core Pension multiplier of 1.8% combined with the 0.2% Pension Supplement provides MCPS employees with an overall 2.0% pension multiplier.

The table below summarizes the key factors that determine the amount of an MCPS employee's pension benefits.

Summary of MCPS Pension Plans:
Key Provisions that Determine the Amount of an Employee's Pension*

Core pension paid by...	Active Employees+	FY11 Contribution (percent of salary)		Minimum Age / Years of Service		Multiplier	Final Salary Calculation	Social Security Integration
		Employee	MCPS	Any Age	Or			
State	16,923	5.5%	1.92%	30 years	60 years old/ 5 years service	2%	Average of highest 3 consecutive years	Non-Integrated for service after 7-1-98
MCPS	4,956	5.5%	20.49%					

* For employees hired on or after July 1, 1998
\+ This is the number of active MCPS employees enrolled in the pension plan as of September 2010
Source: MCPS' *Understanding Your Retirement* (October 2009)

C. Income from Retirement Benefits – Four Examples

OLO calculated the pension/retirement income that four hypothetical employees who elect to retire on July 1, 2011 would receive under current retirement plan designs. OLO calculated retirement benefit income for one MCPS employee and three County Government employees (listed below) who were chosen to illustrate (1) differences between MPCS and County Government pension plans, (2) the impact on retirement income from retiring after 20 years compared to 30 years, and (3) the difference in retirement income from a defined benefit plan compared to a defined contribution plan.

Example (1): MCPS Teacher with Master's Degree and 30 years of service
Example (2): Master Firefighter with 30 years of service
Example (3): Firefighter III with 20 years of service
Example (4): Child Welfare Case Worker with 30 years of service

To calculate the income from retirement benefits, OLO needed to make certain assumptions about the hypothetical employees. For the four calculations, OLO assumed the employees:

- Had similar starting salaries;
- Began employment with the agency (County Government or MCPS) at age 24; and
- Retired at the maximum salary for their grade.[6]

[5] State law requires MCPS to provide a Pension Supplement of a 0.08% multiplier. MCPS adds an additional 0.12%, for a total multiplier of 0.2%. Montgomery County is the only Maryland county required to supplement State teacher pensions.

[6] Based on past pay adjustments, employees who work in the same job class until they are eligible for normal retirement will have reached the maximum salary for that grade.

In addition, the calculations:

- Assume Social Security benefit amounts based on the scenario that a retiree does not take another paid job after leaving County service and will be eligible for benefits beginning at age 62; and
- Present all dollar amounts in pre-tax, current year dollars.

With the exception of the Firefighter III example, OLO calculated benefits for an employee who retired after 30 years of service. Because firefighters are eligible for normal retirement after 20 years of service,[7] OLO calculated the retirement benefits for a Firefighter III who served 20 years.

A complete list of assumptions used to calculate retirement benefit income appears on page 11. Of course, changing the assumptions would alter the calculations.

Example (1): Teacher with Master's Degree. Teachers participate in the State retirement system and receive a supplemental pension benefit from MCPS. As shown in the table below, a teacher who retires after 30 years of service on July 1, 2011, would receive an annual pension equal to 48.5%[8] of average final salary.[9] At the current maximum salary of $96,966, the teacher would retire with an annual pension of $47,009.

At age 62, the retiree would begin receiving an annual Social Security benefit of $17,724. Because MCPS' pensions do not integrate with Social Security, the Teacher receives a Social Security benefit of $17,724 in addition to his/her annual pension of $47,009, for a total retirement benefit of $64,733. Under current law, the Teacher's pension and Social Security benefits are both adjusted annually to account for inflation.

Annual Pension Payments for an MCPS Teacher with Master's Degree Retiring at Maximum Salary in July 2011 (Current Year $)

Years of Service	30
Age at Retirement	54
Final Salary	$96,966
Annual Retirement Benefit (until age 62)	**$47,009**
Pension	$47,009
Social Security	$0
Annual Retirement Benefit (age 62+)	**$64,733**
Pension	$47,009
Social Security	$17,724

The table above shows that the amounts of the annual pension ($47,009) and of the Social Security benefit ($17,724) remain constant over time. The amounts remain constant because they are shown in current year dollars and OLO assumed that future cost of living adjustments will approximate the future rate of inflation, canceling each other out. For example, future cost of living adjustments will raise the Teacher's annual pension income above $47,009. However, the increases will be offset by inflation, keeping the value of future payments equal to $47,009 when measured in current year dollars.

[7] Firefighters at age 55 or older are eligible for normal retirement with 15 years of service.

[8] Teachers receive an annual pension equal to 1.28% of average final salary for each year of service before FY99 and 2.00% of average final salary for each year of service from FY99 onward.

[9] Average final salary equals the mean of the employee's highest three consecutive years of salaries.

Example (2): Master Firefighter. Firefighters participate in the County Government's Employees' Retirement System. After 30 years of service, a firefighter receives an annual pension equal to 70% of his/her average final salary. At the current maximum Master Firefighter salary of $87,422, the employee would retire with an annual pension of $58,382.

Because the County Government's pension integrates with Social Security, when the retired Master Firefighter reaches age 62, s/he will receive a Social Security benefit of $17,028 and will receive a reduced pension of $40,138 per year. Under current law, the Master Firefighter's pension and Social Security benefits are both adjusted annually to account for inflation.

Annual Pension Payments for Master Firefighter
Retiring at Maximum Salary in July 2011
(Current Year $)

Years of Service	30
Age at Retirement	54
Final Salary	$87,422
Annual Retirement Benefit (until age 62)	**$58,382**
Pension	$58,382
Social Security	$0
Annual Retirement Benefit (age 62+)	**$57,166**
Pension	$40,138
Social Security	$17,028

The amounts of the annual pre-Social Security ($58,382) and post-Social Security pensions ($40,138) as well as the Social Security benefit ($17,028) remain constant over time. The amounts remain constant because they are shown in current year dollars and OLO assumed that future cost of living adjustments will approximate the future rate of inflation, canceling each other out. For example, future cost of living adjustments will raise the Master Firefighter's annual pre-Social Security pension income above $58,382. However, the increases will be offset by inflation, keeping the value of future payments equal to $58,382 when measured in current year dollars.

Example (3): Firefighter III. Firefighters who retire after 20 years of service receive an annual pension equal to 50% of average final salary. At the current maximum Firefighter III salary of $74,272, the employee would retire with an annual pension of $37,318.

Because the County Government's pension integrates with Social Security, when the retired Master Firefighter reaches age 62, s/he will receive a Social Security benefit of $12,336 and will receive a reduced pension of $25,656 per year. Under current law, the Firefighter's pension and Social Security benefits are both adjusted annually to account for inflation.

Annual Pension Payments for Firefighter III
Retiring at Maximum Salary in July 2011
(Current Year $)

Years of Service	20
Age at Retirement	44
Final Salary	$74,272
Annual Retirement Benefit (until age 62)	**$37,318**
Pension	$37,318
Social Security	$0
Annual Retirement Benefit (age 62+)	**$37,992**
Pension	$25,656
Social Security	$12,336

The amounts of the annual pre-Social Security ($37,318) and post-Social Security pensions ($25,656) as well as the Social Security benefit ($12,336) remain constant over time. The amounts remain constant because they are shown in current year dollars and OLO assumed that future cost of living adjustments will approximate the future rate of inflation, canceling each other out. For example, future cost of living adjustments will raise the Firefighter's annual pre-Social Security pension income above $37,318. However, the increases will be offset by inflation, keeping the value of future payments equal to $37,318 when measured in current year dollars.

9

Example (4): Child Welfare Case Worker (Grade 23). Non-public safety County Government employees hired since 1994 participate either in the Retirement Savings Plan (RSP) of the Guaranteed Retirement Income Plan (GRIP). RSP and GRIP participants do not receive an annual pension. Instead, the County Government and the employee both make annual contributions to a retirement account. Currently, the County Government annually contributes 8% of salary and the employee contributes 4% of salary to the employee's RSP or GRIP retirement account.

The current maximum salary for a Grade 23 County Government employee is $88,027. In this example, the Child Welfare Case Worker participated in the GRIP and received an annual guaranteed return of 7.25% for the entirety of his/her County employment.[10] Under current terms of the GRIP, the Child Welfare Case Worker would have accumulated a retirement account balance of more than $536,000 by the end of his/her 30 years of service.

In addition, the retiree would be eligible for a Social Security benefit of $17,076 per year beginning at age 62. The receipt of Social Security benefits does not alter the retirement benefit for employees in the RSP or GRIP.

Retirement Account Balance for Child Welfare Case Worker
Retiring at Maximum Salary in July 2011
(Current Year $)

Years of Service	30
Age at Retirement	54
Final Salary	$88,027
Social Security Benefit (age 62+)	$17,076
Retirement Account Balance	$536,132

A table summarizing the income from retirement benefits for the four positions appears on the following page. The assumptions used in the calculations are listed below the table. The table on the following page also includes a present value calculation of the retirement income for each of the four employee examples (see question #4 on page 13).

[10] Neither the RSP nor the GRIP existed 30 years ago. A Child Welfare Case Worker (or other non-public safety County Government employee) who retires in July 2011 after 30 years of service would receive a pension as a member of the Employees' Retirement System (ERS). The County closed the ERS to non-public safety and non-represented employees hired since 1994 and the majority of current non-public safety County Government employees participate in the RSP or GRIP.

The Child Welfare Case Worker example in this memo is a hypothetical case intended to illustrate the retirement benefit for an employee who retires after 30 years in the GRIP. A similar example for an RSP participant could be calculated based on assumptions of the market performance of the employee's investment selections.

Summary of Income from Retirement Benefits
Four Examples of Employees Retiring at Top of Salary Grade in July 2011

	Teacher (MA Degree)	Master Firefighter	Firefighter III	Child Welfare Case Worker
Years of Service	30	30	20	30
Age at Retirement	54	54	44	54
Final Salary	$96,966	$87,422	$74,272	$88,027
Annual Retirement Benefit (until age 62)	$47,009	$58,382	$37,318	$0
Pension	$47,009	$58,382	$37,318	--
Social Security	$0	$0	$0	$0
Annual Retirement Benefit (age 62+)	$64,733	$57,166	$37,992	$17,076
Pension	$47,009	$40,138	$25,656	--
Social Security	$17,724	$17,028	$12,336	$17,076
Retirement Account Balance	--	--	--	$536,132
Present Value of Retirement Benefit				
excluding Social Security	$1,363,264	$1,291,709	$1,198,851	$536,132
including Social Security	$1,753,192	$1,666,325	$1,470,243	$911,804

Assumptions

- All dollar amounts represent current year dollars.
- Pension payments and retirement account withdrawals are subject to Federal and State income tax. All dollar amounts shown are pre-tax dollars.
- All employees worked full time, were hired into their positions at age 24, and retire on July 1, 2011 with no unused sick leave.
- All employees retired with a top of grade salary for the position (including longevity awards).
- The Social Security Administration's online "Social Security Quick Calculator" is the source for annual Social Security benefits.
- Social Security pension amounts assume that retirees do not take another paid job after leaving County service and will be eligible for benefits beginning at age 62.
- The Child Welfare Case Worker's retirement account balance assumes a starting salary of $25,000; an annual employer contribution of 8% of salary; an annual employee contribution of 4% of salary; and participation in the GRIP with an annual guaranteed return of 7.25%.
- Present value calculations assume that pension and Social Security cost of living adjustments equal the future rate of inflation.
- Present value calculations assume an average life expectancy of 84 years (the current average life expectancy assumption for ERS plan members).

D. Retirement Plan Questions and Answers

This final section adopts a question and answer format to explain the major variations between/among the retirement benefits received by the four employee examples presented above.

1. Why does the Teacher's annual pension payment remain unchanged after age 62, while the two Firefighters' pensions from the County Government decrease at that age?

<u>**Social Security Integration:**</u> Since FY79, the County Government's pension plan has "integrated" with Social Security. Social Security integration means that an employer reduces a retiree's annual pension payment when the retiree becomes eligible for Social Security.[11] When a Firefighter becomes eligible for Social Security, the County Government's integrated plan reduces the annual pension payment to 68.75% of the initial annual pension amount.

Neither the State's pension plan nor the MCPS pension supplement integrates with Social Security for service after July 1, 1998. Therefore, for all service after that date, a Teacher's pension is not reduced when a retiree becomes eligible for Social Security.

2. If the Teacher's final salary is greater than the Master Firefighter's final salary, why does the Teacher receive a lower annual pension (up to age 62) than the Master Firefighter?

<u>**Pension Multipliers:**</u> As described earlier in this memo, a retiree's annual pension payment is based on both average final salary and a multiplier. The Master Firefighter who worked for 30 years earned a pension equal to 2.5% (the multiplier) of average final salary for the first 20 years of service plus 2.0% of average final salary for the next 10 years of service. The multipliers result in the Master Firefighter receiving a pension equal to 70% of final average salary after 30 years of service.

Teachers receive an annual pension equal to 1.28% of average final salary for each year of service before FY99 and 2.0% of average final salary for each year of service from FY99 on. A Teacher retiring this summer after 30 years of service would have a pension equal to 48.5% of average final salary. In future years, a Teacher retiring after 30 years of service will have worked additional post-FY99 years (with those years subject to the higher 2.0% multiplier), and so, will have a higher pension.

3. The Firefighter III retires with a final salary that is about 85% of the Master Firefighter's final salary. Why is the annual pension for the Firefighter III only equal to about 64% of the Master Firefighter's annual pension?

<u>**Years of Service:**</u> One of the primary factors that determines a retiree's final pension is years of service. In the examples shown in this memo, the Master Firefighter worked for 30 years while the Firefighter III worked for 20 years. Based on current Employee Retirement System plan provisions, a firefighter's annual pension equals 50% of average final salary after 20 years of service and rises to 70% of average final salary after 30 years of service. Working ten additional years results in the retiree receiving a higher annual pension.

[11] For the examples in this memo, OLO assumed that the retirees would not take another paid job after leaving County service. As such, these retirees would become eligible for Social Security benefits beginning at age 62.

4. **The Teacher and the Firefighters receive annual pension payments while the Child Welfare Case Worker leaves employment with a retirement account. Is there a way to compare these different types of retirement benefits?**

Present Value Analysis: Pensions offer a stream of fixed payments from the time of retirement until the end of life; retirement accounts provide a cash balance that is available for withdrawal or re-investment during retirement.[12] The two plan types offer different benefits that make them difficult to compare.

Nonetheless, a present value analysis offers one means of comparison. Present value is a calculation of the current value of future cash payments. These calculations allow for a comparison of a current year cash amount (such as a retirement account balance) with a stream of future cash payments (such as pension benefits). Present value analysis also can be used to compare the relative value of different pension plans.

OLO calculated the present value of the Teacher, Master Firefighter, Firefighter III pension benefits shown as examples in this memo.[13] For this analysis, OLO assumed that retirees would receive benefits through age 84, the current average life expectancy for members of the County Government's Employees' Retirement System. For the Child Welfare Case Worker, the cash balance of his/her retirement account at retirement equals the present value of this benefit.

As shown in the table below, the present value of the retirement benefits (excluding Social Security benefits) for the four examples shown in this memo are:

Position	Type of Retirement Benefit	Years of Service	Present Value of Retirement Benefit
Teacher (MA)	Pension	30	$1,363,264
Master Firefighter	Pension	30	$1,291,709
Firefighter III	Pension	20	$1,198,851
Child Welfare Case Worker	Retirement Account	30	$536,132

5. **Are retirement plan benefits and Social Security the sole source of income for retired County employees?**

Post-Retirement Employment and Savings: The amount of income (other than retirement benefits and Social Security) available to retirees varies depending on the life and financial circumstances of the retiree. Depending on age, skill sets, and health, a person could take a new job after leaving County employment.

In addition, employees who are able and choose to set aside additional retirement savings during their working years have additional resources available to them during retirement. The County Government and MCPS provide employees the option of making additional pre-tax contributions (capped under federal law) annually to deferred compensation accounts.

c. Steve Farber

---

[12] ERS and GRIP account withdrawals are subject to IRS penalties if made before the retiree reaches the age of 59½.

[13] Present value analyses commonly discounts future payments to account for inflation. The present value calculations in this memo do not discount future pension or Social Security payments because both of these benefits include annual cost of living adjustments. The present value calculations in this memo assume that pension and Social Security cost of living adjustments approximate the future rate of inflation.

MEMORANDUM

March 14, 2011

TO: Councilmembers

FROM: Karen Orlansky, Director
Office of Legislative Oversight

SUBJECT: **Follow-up to OLO Report on Achieving a Structurally Balanced Budget: County Government and MCPS Data on Employee Recruitment, Hiring, and Turnover**

This memorandum responds to questions from Councilmember Riemer related to County Government and MCPS employee recruitment, hiring, and turnover. The agency information summarized below reflects data that were either already published or that the human resources offices of County Government and MCPS were able to compile at OLO's request with relative ease. While more refined information may be possible to gather, it would require substantial additional agency staff time to extract it from various data sets.

If you have any questions about the information in this memo, please contact Leslie Rubin at x77998.

1. Employee Recruitment and Hiring

The County Government and MCPS provided OLO with summary data related to employee recruitment and hiring, including data on the number of applications received annually, the number of minimally qualified applicants, and the number of individuals hired for certain positions. These data are presented below.

County Government. Between FY05 and FY10, the County Government received, on average, 74 applicants for every posted job announcement, including postings for public safety and non-public safety positions. The table below summarizes the average number of resumes (or applicants) received per job posting for each of the past six fiscal years.

Average Number of Applicants per Job Posting, FY05 – FY10

	FY05	FY06	FY07	FY08	FY09	FY10	Annual Average FY05-FY10
Average number of applicants per job posting	69	68	69	72	87	81	74

Source: MCG Office of Human Resources, Fall 2010

Note that these data reflect averages for all job postings. Because these are averages across many different types of jobs, the data do not reflect the number of applications received for jobs that historically either receive an unusually large number of applicants or jobs that are considered "hard to fill."

The County Government's Office of Human Resources (OHR) also provided data specific to the recruitment and hiring of police officer candidates and fire rescue recruits between calendar years 2008 and 2010. During these three years, a total of approximately 4,700 individuals applied to be a police officer candidate and approximately 9,000 individuals applied to be fire rescue recruits.

Each year, 80-86% of the police officer candidate applicants and 98% of fire rescue recruit applicants met (or exceeded) the minimum qualifications for these entry-level public safety positions. Over these three years, the County Government hired a total of 2.8% of the police officer candidate applicants who met minimum qualifications and 1.4% of the fire rescue recruit applicants who met minimum qualifications. The table below summarizes the data on the number of applicants who met minimum qualifications and the number eventually hired.

Summary of Police and Fire Recruitment and Hiring for Applicants Meeting Minimum Qualifications, Calendar Years 2008-2010

Calendar Year	Number of Applicants Meeting Minimum Qualifications	Number of Qualified Applicants Hired	Percent of Qualified Applicants who were Hired
Police Officer Candidates*			
CY08	993	55	5.5%
CY09	1,813	16	0.9%
CY10	1,069	36	3.4%
Police Total	**3,875**	**107**	**2.8%**
Fire Rescue Recruits**			
CY08	6,347	106	1.6%
CY09		18	0.3%
CY10	2,536	0	0%
Fire Total	**8,883**	**124**	**1.4%**

* Total number of police office candidate applicants: CY08 = 1,217. CY09 = 2,264. CY10 = 1,240

** Total number of fire rescue recruit applicants: CY08 and CY09 combined = 6,479. CY10 = 2,591

Source: MCG Office of Human Resources

Montgomery County Public Schools. MCPS' Office of Human Resources and Development provided data on MCPS' recruitment and hiring of teachers between school years 2007 and 2011 (SY07-SY11). During this five-year period, the number of teacher applicants each year ranged from a low of 6,387 (SY08) to a high of 9,984 (SY10). During this same time period, the number of applicants interviewed by MCPS each year ranged from 1,126 (SY11) to 3,556 (SY08). As MCPS hired fewer teachers, the percent of total applicants hired declined. Specifically, in SY07, MCPS hired 17.6% of all applicants; and in SY10, MCPS hired only 6.4% of all applicants.

Before the current school year, MCPS staff report that they had received more teacher applications annually than they had the capacity to review. To select applicants to interview, MCPS staff first identified specific qualifications being sought and used a database to pull out a subset of the entire pool of teacher applications that met those qualifications; a cohort of individuals for interview was then selected from this subset. Beginning in SY11, a new data management system allows MCPS to review all applications to identify individuals to interview.

Summary of MCPS Teacher Recruitment and Hiring, School Years 2007-2011

School Year	Applicants			
	#	# Interviewed	# Hired	% Hired
MCPS Teachers				
SY07	7,250	3,220	1,279	17.6%
SY08	6,387	3,556	976	15.3%
SY09	6,545	2,493	779	11.9%
SY10	9,984	1,984	641	6.4%
SY11	6,738	1,126	493	7.3%
Total	**36,904**	**12,379**	**4,168**	**11.3%**

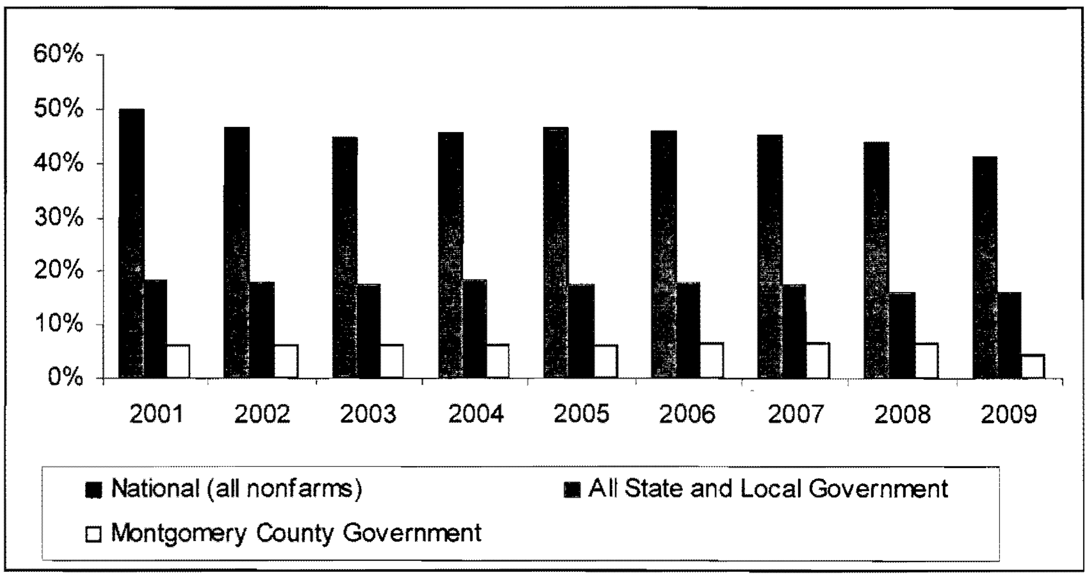
Source: MCPS Office of Human Resources and Development

2. Employee Retention/Turnover Data

OLO obtained employee retention/turnover data for the County Government and MCPS and corresponding national data for comparison.

County Government. Between 2001 and 2009, the County Government's turnover rate – the percent of employees who separate from County Government employment – was 6.6% of the workforce (or less) each year, as shown in the chart and table below. During this time period, County Government turnover rates remained substantially below national turnover rates (which ranged from 40% to 50% annually) as well as below the average turnover rates for all state and local government (which ranged from 16% to 19% annually).

Comparison of Employee Turnover Rates
County Government vs. National and State/Local, 2001-2009



	2001	2002	2003	2004	2005	2006	2007	2008	2009
Montgomery County Gov't	6.0%	6.1%	6.2%	6.2%	6.1%	6.6%	6.5%	6.4%	4.4%
National (non-agricultural jobs)	49.8%	46.3%	44.5%	45.4%	46.5%	46.0%	45.1%	43.6%	41.0%
All State and Local Gov't	18.5%	17.9%	17.3%	18.3%	17.6%	18.1%	17.6%	16.2%	16.1%

Source: Bureau of Labor Statistics Job Openings and Labor Turnover Survey; MCG Personnel Management Review

According to information compiled by the Office of Human Resources, between 74.6% and 84.1% of County Government turnover over the past decade was classified as "voluntary," as opposed to other types of turnover such as involuntary, management/fiscal, and medical. During this same time period, the percent of turnover classified as "retirement" ranged between 24.5% and 41.6%. (See table below.)

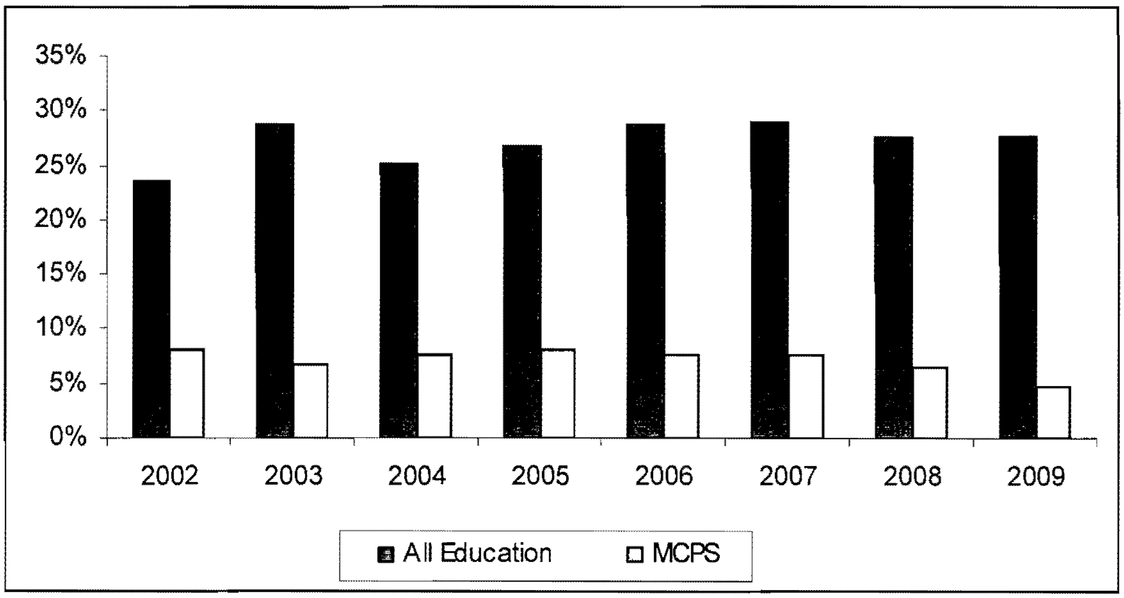
County Government Employee Turnover Rates, Voluntary and Retirement-Based, 2001-2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Voluntary	74.6%	80.8%	76.7%	79.4%	82.3%	79.0%	79.5%	84.1%	69.3%
Any Type of Retirement	24.5%	36.5%	41.6%	32.4%	28.9%	28.2%	26.9%	38.6%	33.2%

Source: Bureau of Labor Statistics Job Openings and Labor Turnover Survey; MCG Personnel Management Review

Montgomery County Public Schools. MCPS' historical turnover rate is also low compared to national turnover rates at all levels of education. Between 2002 and 2009, MCPS' turnover rate ranged between 4.7% and 8%, while the national turnover rate for all education levels during the same time period ranged from 23.5% to 29%. The chart and the table below illustrate this data.

Comparison of Employee Turnover Rates
MCPS vs. National, 2002-2009



	2002	2003	2004	2005	2006	2007	2008	2009
MCPS*	8.0%	6.9%	7.6%	7.9%	7.7%	7.6%	6.4%	4.7%
All Education**	23.5%	28.7%	25.1%	26.6%	28.8%	29.0%	27.6%	27.7%

*Fiscal year data

**Includes entire education sector (e.g., elementary, secondary, college, post-graduate, technical)

Source: Bureau of Labor Statistics Job Openings and Labor Turnover Survey; MCPS Staff Statistical Profile, 2006 and 2009

(17)

The table below contains additional data on MCPS' overall turnover rate compared to its teacher turnover rate, and data on the percent of all turnover attributable to teacher separations and to retirement. The data show that between FY02 and FY09, the turnover rate for teachers was very close to MCPS' overall turnover rate. Teacher turnover ranged from 4.6% to 8.1%, while all turnover for MCPS employees ranged from 4.7% to 8.0%. Turnover from teacher separations ranged from 51.8% to 60.7% during this time period and turnover due to retirement ranged from 28.7% to 37.9%.

MCPS Turnover Trends, FY02 – FY09

	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09
Teacher Turnover Rate*	8.1%	6.7%	7.9%	7.7%	7.4%	7.7%	7.4%	4.6%
Overall turnover rate	8.0%	6.9%	7.6%	7.9%	7.7%	7.6%	6.4%	4.7%
% of Turnover								
Due to Teacher Separations	54.7%	53.1%	55.4%	51.8%	51.3%	53.5%	60.7%	52.0%
Due to Retirement	29.2%	31.1%	33.2%	33.0%	28.7%	32.4%	31.9%	37.9%

*Does not include transfers or promotions
Source: MCPS Staff Statistical Profile, 2006 and 2009

FY10 data on turnover in the County Government and MCPS will be available in April as part of the Council's review of agency budgets and with the publication of the County Government's latest Personnel Management Review.

c: Steve Farber

Summary of FY12 State Pension Changes in House Bill 72 – the Budget Reconciliation and Financing Act:

- **Employees' Pension System**
- **Teachers' Pension System**
- **State Police Retirement System**
- **Correctional Officers Retirement System**
- **Law Enforcement Officers Pension System**

Area	Current Provision	New Provision	Employees Affected: Current	Employees Affected: Hired After July 1, 2011
All Systems				
Cost-of-Living Adjustments (for all service credit earned after July 1, 2011)	Linked to CPI; capped at 3% per year or unlimited*	Linked to Consumer Price Index (CPI) with the following caps: 2.5% if the State Retirement and Pension System achieves 7.75% rate of return in prior year; 1% if 7.75% rate of return not met	✓	✓
Average Final Compensation	Highest three consecutive years	Highest five consecutive years+		✓
Vesting Period	5 years	10 years		✓
Employees' Pension System and Teachers' Pension System				
Employee Contributions	5% of salary	7% of salary	✓	✓
Multiplier	1.8%	1.5%		✓
Early Retirement	Age 55/15 years svc.	60 years old and 15 years of service		✓
Full Service Retirement	30 years service; or from 62 y.o./5 years svc. to 65 y.o./2 years svc.	65 years old (y.o.) and 10 years of service; or Rule of 90 – age plus years of service must equal 90		✓
State Police Retirement System				
Full Service Retirement	At least 50 y.o.; or 22 years svc.	At least 50 years old; or 25 years of service at any age		✓
Deferred Retirement Option Program (DROP) (for all accounts opened after July 1, 2011)	6% interest compounded monthly Eligib. up to 28 years svc	4% interest compounded annually Eligibility up to 29 years of service		✓
Law Enforcement Officers Pension System				
Employee Contributions	4% of salary	6% of salary in FY12 7% of salary in FY13 and after	✓	✓
Deferred Retirement Option Program (DROP) (for all accounts opened after July 1, 2011)	6% interest compounded monthly Eligib. up to 28 years svc	4% interest compounded annually Eligibility up to 29 years of service		✓

* COLAs for retirees in the State Police Retirement System and the Correctional Officers Retirement System are based on the CPI and are not capped.

+ Pension calculations for the State Police Retirement System and the Correctional Officers Retirement System based on the highest five years (not consecutive).

Source: *Retirement Reform*, MD Department of Management and Budget

9

Survey of Public Pension Benefits in Maryland

Ann M. Sturner, FSA

BOLTON
PARTNERS, INC.

20

Bolton Partners was asked by the MACo to provide a survey of pension benefits for local governments in Maryland. Many of these plans are our clients and the timing was such that we thought that a quick survey would be of interest. Why now? Almost all governmental employees in Maryland are covered by mature defined benefit plans. Mature plans with common investment approaches have suffered material investment losses over the last few years. Those losses are being reflected in gradual (but significant) contribution increases often covering the period FY10-FY15. At the same time tax revenues have been hard hit. Some employers have responded already by raising both employer and employee contributions (e.g. Anne Arundel County, Baltimore County and City of Baltimore).

If an employer wants to change benefits it needs to consider whether they will be competitive after the change. In a time like now it might not take as much to be competitive but a pension (even a defined contribution pension) is a long term plan that needs to be competitive over the long term. The balance between being competitive and prioritizing fiscal needs is one that elected officials must decide.

Attached are three charts. The first is a basic comparison chart of plans for police officers. The second is a similar chart for general employees. The third is a graphic representation of the value of employer and employee provided benefits for police officers. Each of these is described below:

Benefit Comparison for Police Officers

We compared the benefits offered by the following nine jurisdictions. All provide defined benefit plans for their police officers:

1. Anne Arundel County
2. Baltimore County
3. Calvert County
4. City of Baltimore
5. Howard County
6. LEOPS (State administered plans for local governments covering police officers)
7. Montgomery County
8. Prince George's County
9. State Police

One thing to understand about a survey like this is that we almost always focus on the benefit offered to new hires. Many of these groups have higher benefits for "closed" groups of employees. However, if the question is whether or not what you offer is going to attract new employees, only the new "tier" of benefit is relevant. So for example, City of Baltimore just changed its benefits 7/1/2010 and these changes are reflected in this chart.

21

BOLTON
PARTNERS, INC.

Features Surveyed:

1. First we looked at how many jurisdictions also have Social Security coverage for their police officers. The answer is mixed but most are not covered by Social Security.

2. Next we looked at the basic benefit formula. All groups have benefits tied to an average of pay over their last few years of credited service (CS). The period of time over which the average final compensation (AFC) is determined varies but 36 months is the most common.

3. All of the plans only consider base pay. None include overtime (which avoids the types of large "spiking" issues found in other plans). However, the exact definition of base pay does vary some. For example, some include shift differential and some do not.

4. The "Normal Retirement Age" varies from plan to plan. In every case a police officer age 50 with 25 years has reached his/her Normal Retirement Age. However, some officers can reach this age in their 40's under the plans' "20 and out" or "25 and out" benefit (the State Police have a "22 and out").

5. All of these plans require employee contributions. Generally these contributions are made on a pre-tax basis. As noted above, many plans have been increasing these amounts recently. Those in Social Security would also be contributing an additional 6.2% of their salaries up to the Social Security Wage Base (SSWB).

6. All of the plans have some type of COLA provision. The variation in the COLA designs is material.

7. The final item is the "Form" of payment. This is the normal form of payment. Often the benefit produced by the pension formula is paid just for the life of the retiree. However, in some cases (particularly when the officers are not covered by Social Security) the normal form comes with a survivor benefit. When this is not provided, there is almost always an option to take a reduced benefit in order to provide a survivor benefit.

These are some of the key features employers and unions would want to compare. However, they are not the only important features of plans. Other factors which might be important include disability benefits, DROP provisions, credit for pre-employment military service and early retirement/vesting provisions.

Actuarial@boltonpartners.com Baltimore, Maryland Washington, DC Boca Raton, Florida
www.BoltonPartners.com
800 394 0263

Benefit Comparison for General Employees

We did a similar chart comparing benefits for general employees. Two of the counties (Calvert and Montgomery) provided defined contribution plans and not defined benefit plans for their general employees. This probably parallels the national situation where (1) defined contribution plans are more common for general employees than public safety employees but (2) even for general employees coverage under a defined benefit plan is still more common. In the private sector, defined contribution plans are more common.

Value of Benefits for Police Officers

Is there an easy way to combine all of these key features into a simple comparison of benefits? Ideally you probably need to look at combinations of age and service when people would retire since not everyone is hired at the same time nor do they all retire at the same time. However, we can look at one reasonable retirement age. Attached is a chart comparing police officer benefits based on retirement at age 50 with 25 years of service. The blue portion of the bar is the employer provided portion of the benefit and the red portion of the bar is the employee provided portion of the benefit. The bars include Social Security for those covered by Social Security. The table is ranked from the highest employer provided benefit (State Police) to the lowest (City of Baltimore). The largest total benefit is probably Howard County but employees pay for a large share of the benefit.

As we noted at the beginning, many employers are looking at the benefits they are offering. The Governmental Accounting Standards Board (GASB) accounting rules are also changing. It is unclear whether these changes will lead to benefit changes. But GASB is a subject for another article.

The following abbreviations are used in the benefit comparison charts found on the next four pages:

AFC = Average final compensation
CPI = Consumer price index
CS = Credited service
J&X% = Joint and survivor benefit with percentage (X%) continued to spouse upon retiree's death
SS Integration Level = IRS-prescribed average of the last 35 years of social security wage bases
SSNRA = Social security normal retirement age (67 for people born after 1959)
SSWB = Social security wage base ($106,800 for 2010)

** The information contained in this survey was obtained from publicly available sources and/or documentation provided directly to Bolton Partners by a jurisdiction. If any information is incorrect or out of date, please forward corrections to the author.*

Actuarial@boltonpartners.com
www.BoltonPartners.com
800 394 0263
Baltimore, Maryland
Washington, DC
Boca Raton, Florida

Benefit Comparison for Police Officers

	Anne Arundel County	Baltimore County	Calvert County	City of Baltimore	Howard County
Social Security	No	No	Yes	No	Yes
Plan Formula	2½% x AFC x CS up to 20 plus 2% x AFC x CS above 20 Maximum: 70% x AFC	2½% x AFC x CS up to 20 plus 2% x AFC x CS from 20 to 25 plus 3% x AFC x CS above 25 for each year above 25 earned after 2007 2% is used if less than 20 yrs	2.4% x AFC x CS up to 20 plus 2% x AFC x CS above 20 Maximum: 27 yrs CS	2½% x AFC x CS up to 20 plus 2% x AFC x CS above 20	2.5% x AFC x CS up to 20, graded thereafter based on chart (75% after 25 years, 80% after 30 years)
Earnings Include	Base Pay	Base Pay	Base Pay	Base Pay	Base Pay
Average Period (for AFC)	High 3 of last 5 years	Highest 12 months	Highest 36 consecutive months	Highest 36 consecutive months	Highest 36 consecutive months
When Full Benefits Paid (Normal Retirement Age)	20 years of service or age 50 with 5 years	25 years of service or age 60 with 10 years	20 years of service or age 55	25 years service or age 55 with 15 years	20 years service or age 62 with 5 years
Employee Contributions	5% of pay (7.75% for some)	8.0% of pay (effective 07/10) 8.5% of pay (effective 07/11)	8% of pay	Effective — % of pay 07/10 — 7% 07/11 — 8% 07/12 — 9% 07/13 — 10%	11.6% of pay, up to 30 years of service
Cost-of-Living Increases	60% CPI to a maximum of 2½%	Depends on investment performance, 3% maximum (0% if service < 20)	100% of CPI up to 3%	0% pre 55, 1%/year from 55 to 65, 2% after 65	100% of CPI up to 2%
Form Valued	Unreduced J&100% benefit with 5 year guarantee	Benefit is J&50% for married employees with 25 years of service	Life Annuity (guaranteed return of employee contributions)	Benefit is J&50% for married employees	Life Annuity

24

Benefit Comparison for Police Officers (cont.)

	LEOPS	Montgomery County	Prince George's County	State Police
Social Security	Depends on Employer	Yes	No	No
Plan Formula	2.3% x AFC x CS up to 30 plus 1% x AFC x CS above 30	Pre 67 (SSNRA): 2.4% x AFC x CS up to 36 Post 67 (SSNRA): 1.65% x (AFC up to SS Integration Level) x CS up to 36 plus 2.4% x (AFC above SS Integration Level) x CS up to 36 (slightly different after 36 yrs)	3% x AFC x CS up to 20 plus 2.5% x AFC x CS above 20	2.55% x AFC x CS Maximum: 28 yrs CS
Earnings Include	Base Pay Earning increase of over 20% (non promotion) may not be counted without Trustee approval	Base Pay	Base Pay	Base Pay Earning increase of over 20% (non promotion) may not be counted without Trustee approval
Average Period (for AFC)	Highest 36 consecutive months	Highest 36 consecutive months	Highest 2 years	Highest 36 consecutive months
When Full Benefits Paid (Normal Retirement Age)	25 years of service or age 50	Age 55 with 15 years, or 25 years of service	Age 55 or 20 years of service	Age 50 or 22 years of service
Employee Contributions	4% of pay	4.75% of regular base to SSWB, plus 8.5% in excess	8% first five years, 7% next 5 years, 5.5% thereafter	8% of normal salary
Cost-of-Living Increases	100% of CPI up to 3%	100% first 3% of CPI, plus 60% in excess, not to exceed 7.5%	$35 per month unless asset return is greater than 8%	100% CPI
Form Valued	Benefit is J&50% for married employees	Life Annuity (guaranteed return of employee contributions)	Life Annuity	Benefit is J&80%

Actuarial@boltonpartners.com Baltimore, Maryland Washington, DC Boca Raton, Florida
www.BoltonPartners.com
800.394.0263

Benefit Comparison for General Employees

	Anne Arundel County	Baltimore County	Calvert County	City of Baltimore
Social Security	Yes	Yes	Yes	Yes
Plan Formula	2% x AFC x CS Maximum: 60% x AFC	1/70 x AFC x CS (1.43% per year)	Defined Contribution plan. Employer contributes 5% of pay	1.6% x (AFC up SS Integration Level) x CS up to 30 plus 1.85% x (AFC above SS Integration Level) x CS up to 30 plus 1.85% x AFC x CS above 30 yrs
Earnings Include	Base Pay	Annual Earnable - same as Base Pay for all but AFSCME employees	Base Pay	Base Pay
Average Period (for AFC)	High 3 of last 5 years	Highest 36 months	NA	Highest 3 years (January 1 rates)
When Full Benefits Paid (Normal Retirement Age)	30 years of service or age 60 with 5 years	35 years of service or age 67 with 10 years	NA	30 years of service or age 65 with 5 years
Employee Contributions	4% of pay	6.5% of pay (effevtive 7/10) 7.0% of pay (effective 7/11)	3% of pay	None
Cost-of-Living Increases	60% CPI to a maximum of 2.5%	Depends on investment performance, 3% max (0% if service < 20 yrs)	NA	Minimum of 1.5%. Additional increases depend on investment performance
Form Valued	Life Annuity (guaranteed return of employee contributions)	Life Annuity (guaranteed return of employee contributions)	Lump Sum or Rollover	Benefit is J+40% for married employees

26

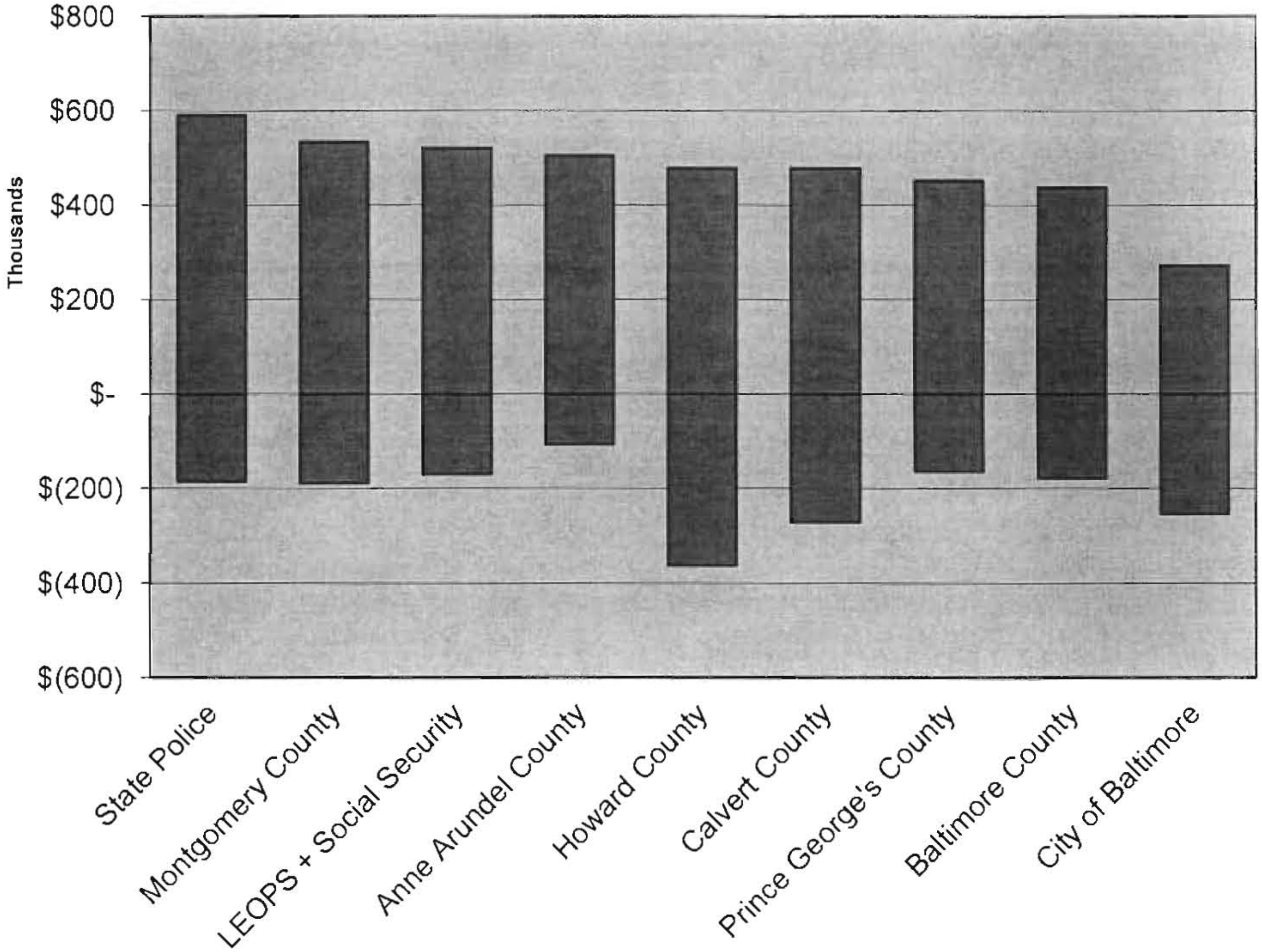
Benefit Comparison for General Employees (cont.)

	Howard County	Montgomery County	Prince George's County	State
Social Security	Yes	Yes	Yes	Yes
Plan Formula	1.55% x AFC x CS (some at 1.66% effective 7/1/2011)	Defined Contribution plan. Employer contributes 8% Limited option to put money in defined benefit plan and be credited with 7.25% (cash balance style benefit)	In State plan (non-contributory system) 0.8% x (AFC up to SS Integration Level) x CS plus 1.5% x (AFC above SS Integration Level) x CS Supplemental Plan: 1% x AFC x CS up to 30	1.8% x AFC x CS
Earnings Include	Base Pay	Base Pay	Base Pay Supplemental Plan: All Pay	Base Pay
Average Period (for AFC)	Highest 36 months	NA	Highest 36 consecutive months	Highest 36 consecutive months
When Full Benefits Paid (Normal Retirement Age)	30 years of service or age 62 with 2 years and sum of age and service equals at least 67	NA	30 years of service or age 62 with 5 years (grading up to 65/2) Supplemental Plan: Age 55 with 15 years or State plan NRA	30 years of service or age 62 with 5 years (grading up to 65/2)
Employee Contributions	2% of pay (some at 3% effective 7/1/2011)	4% of pay up to SS wage base and 8% of pay in excess of SS wage base	5% of pay in excess of SS wage base Supplemental Plan: 3.24% of pay	5% of pay
Cost-of-Living Increases	100% CPI up to a maximum of 3%	NA	100% CPI up to a maximum of 3% (based on initial benefit) Supplemental Plan: None	100% CPI to a maximum of 3%
Form Valued	Life Annuity	Lump Sum or Rollover	Life Annuity	Life Annuity

27

BOLTON
PARTNERS, INC.

Value of Benefits at Retirement for Police Officers (Blue = Employer Provided, Red = Employee Provided)



For more information contact Ann Sturner at 443.573.3922 or email ASturner@boltonpartners.com

(28)

Center for State &
Local Government
Excellence

Issue Brief

A Role for Defined Contribution Plans in the Public Sector

April 2011

29

What are the facts about defined contribution plans in the public sector? As you'll read in this issue brief, three new plans studied in Georgia, Michigan, and Utah combine elements of both defined benefit and defined contribution plans.

We know that state and local employees place a high value on retirement security and that a good benefit package is an asset to government recruiters, as salaries in the public sector tend to be lower than for comparable jobs in the private sector.

Unlike private sector employees, public employees typically contribute to their defined benefit plan. The authors remind readers that "in states where employees are covered by Social Security, the median contribution rate is 5 percent of earnings. In states without Social Security the median employee contribution rate is 9 percent." Many also participate in supplemental retirement savings plans when given the opportunity to do so.

The authors point out that "risk, cost, and human resource considerations are the real issues" to consider when making decisions about retirement plans. They suggest a novel alternative to the current hybrid plan designs: a "stacked" plan that would provide a defined benefit plan as the base, but would cap the benefit level at a fixed dollar amount. A defined contribution plan would be layered on top of the defined benefit plan for additional retirement savings, including for more highly compensated employees.

At the end of the day, policy leaders should focus on their human resources goals as they contemplate changes in the benefit plans that they offer.

The Center for State and Local Government Excellence gratefully acknowledges financial support from the ICMA Retirement Corporation to undertake this research project.

Elizabeth K Kellar

Elizabeth K. Kellar
President and CEO
Center for State and Local Government Excellence

A Role for Defined Contribution Plans in the Public Sector

By Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby*

Introduction

In the wake of the financial crisis, policymakers have been talking about shifting from defined benefit plans to defined contribution plans in the public sector. Three states–Georgia, Michigan, and Utah–have taken action, joining the 10 states that had introduced some form of defined contribution plans before 2008. Interestingly, these new plans are "hybrids" that combine elements of both defined benefit plans and defined contribution plans. Such an approach spreads the risks associated with the provision of retirement income between the employer and the employee. This *brief* provides an update on defined contribution initiatives in the public sector and then discusses whether the hybrids that have been introduced are the best way to combine the two plan types.

The *brief* proceeds as follows. The first section discusses the issues involved with moving from a defined benefit plan to a defined contribution arrangement. The second section recaps the role that defined contribution plans played in the public sector before the financial crisis. The third section describes the new hybrid plans recently adopted in Georgia, Michigan, and Utah. And the fourth section suggests that a better type of hybrid might be one where defined contribution plans are "stacked" on the state's defined benefit plan rather than placed alongside of it. The fifth section concludes that defined contribution plans have a role in the public sector, but that role is supplementing, not replacing, defined benefit plans.

* Alicia H. Munnell is director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby are research associates at the CRR. The authors would like to thank Beth Almeida, David Blitzstein, Ian Lanoff, David Powell, and Nathan Scovronick for helpful comments.

Defined Benefit vs. Defined Contribution

A defined benefit plan provides employees with lifetime retirement income based on a formula that accounts for service and final average salary. Most defined benefit plans in the public sector adjust benefits, at least partially, for inflation after retirement. Both employees and employers generally contribute to public sector plans. Defined benefit plan assets are held in trust and managed by professional investors.

In contrast, defined contribution plans are like savings accounts. The employee and employer both contribute money to the account, and the employee selects the investments from a list of options provided by the plan. The benefit at retirement depends on the value in the account and how employees elect to take receipt of the money–lump sum, periodic payments, or an annuity.

Evaluating whether to shift from a defined benefit to a defined contribution plan involves consideration of risks, costs, and human resource goals.

Risks

The defining characteristic of defined contribution plans is that they shift all the responsibilities and all the risk from the employer to the employee. In terms of responsibilities, the employee must decide whether to join the plan, how much to contribute, how to allocate those contributions among different investment options, how to change those allocations over time, and how to withdraw the accumulated funds at retirement. Under a defined benefit plan, the sponsor retains these responsibilities. The plan requires participation, sets contribution rates, invests the assets, and pays an annuity at retirement.

Leaving the responsibilities in the hands of employees means that they are exposed to the risks of saving too little, losing funds when financial markets fluctuate, seeing the value of their retirement income eroded by inflation, and outliving their resources since payment is generally not in the form of an annuity.

In a defined benefit plan, the sponsor bears the investment risk during the accumulation phase and then absorbs longevity risk and much of inflation risk after retirement. This arrangement means that if financial markets collapse, the sponsor–in the public sector, taxpayers–must come up with additional funds to cover promised benefits.[1] Public plan sponsors also face the "moral hazard" that benefit promises will not be funded. Participants, who believe that they will be paid regardless of funding, may not push for government contributions. And politicians are all too happy to address short-term priorities rather than put money aside for long-term funding needs. Similarly, legislatures sometimes make unfunded benefit improvements in good times that further aggravate the funding shortfall. As a result, future taxpayers and employees will be required to contribute not only to cover the accruing cost of benefits for current workers but also to cover benefits for retirees for whom insufficient funds have been put aside. A defined contribution plan avoids this type of "moral hazard," as the plans are fully funded by design.

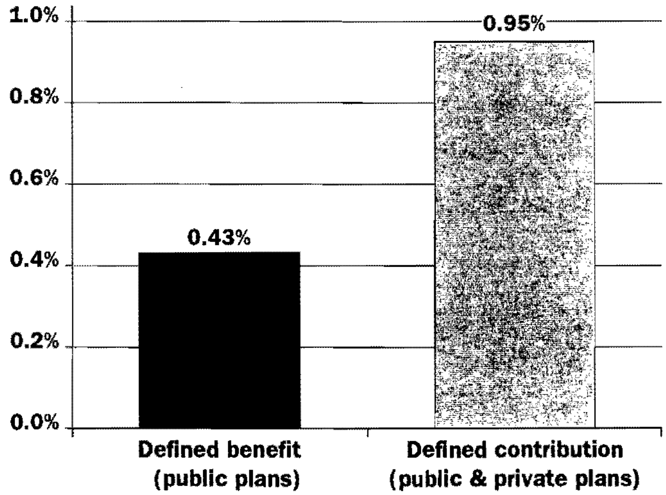
Costs

For any given level of benefits, defined contribution plans, which maintain individual accounts and typically update these accounts daily, have higher administrative expenses than defined benefit plans. In addition, most defined contribution plans use mutual funds or similar instruments as investment options–with an average expense ratio payable to the fund manager of about 0.60 percent for bond funds and about 0.67 percent for stock funds.[2] In contrast, defined benefit plans involve professionally-managed large investment pools with no individual account reporting. As a result, the annual cost of a defined contribution plan generally exceeds that of a defined benefit plan (see Figure 1).

Human Resource Issues

Defined benefit plans are designed to attract and retain qualified employees. As such, these plans become more valuable the closer the employee gets to the full retirement age, because accrual rates often increase with age, and the salary base is usually an average of the last three to five years of earnings. Vested employees who leave early forfeit significant retirement income because their accumulated credits are applied to their salary at termination rather than their salary at retirement.[3]

Figure 1. *Administrative and Investment Expenses as a Percent of Assets, by Plan Type, 2009*



Sources: U.S. Census Bureau (2008); and HR Investment Consultants (2009).

With a few exceptions, defined contribution plans were not initially created as retirement vehicles but rather as supplementary savings accounts.[4] Since the value of these plans increases more evenly over an employee's worklife, they provide no incentive to stay on the job. Similarly, they do not penalize employees who leave early. Mobile employees can take the funds in their account with them when they leave employment and roll them over into a new defined contribution plan or individual account.

Other Arguments and Counterarguments

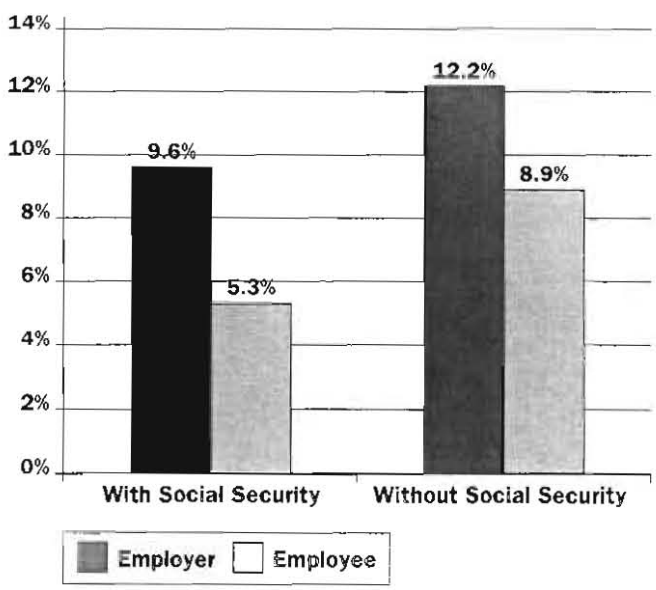
Risk, cost, and human resource considerations are the real issues relevant to deciding whether to shift from a defined benefit to a defined contribution plan. But other assertions also arise in the debate. Some supporters highlight the magnitude of the unfunded liabilities in public sector defined benefit plans as justification for switching to a defined contribution plan. The reality is that even with a new defined contribution plan, states and localities are still left to deal with past underfunding. A new plan only addresses pension costs going forward; it does not help close the current gap between pension assets and liabilities.[5]

Similarly, some contend that switching to a defined contribution plan would save money in the future.[6] But, as noted above, for any given level of benefits, defined contribution plans cost more.

Advocates may think that even if total costs increased, taxpayers could gain by shifting contributions from the government to the employee. Transferring the burden to the employee provided a major economic incentive in the private sector to move from defined benefit plans (where employees make no contributions) to 401(k) plans (where employees make the bulk of the contributions). But, in the public sector, many employees already make substantial contributions to their defined benefit pensions. In states where employees are covered by Social Security, the median contribution rate is 5 percent of earnings. In states without Social Security, the median employee contribution rate is 9 percent (see Figure 2). Therefore, state and local governments might meet significant resistance from public employees if they attempted to shift more of the cost to participants. Of course, moving to a defined contribution plan could be used as a mechanism to cut retirement benefits and thereby lower total employee compensation.

The main issue appears to be one of risk. From the perspective of sponsoring governments, shifting to a defined contribution plan would eliminate investment, inflation, and longevity risk from these entities and, thereby, taxpayers. These plans would be funded by definition and, when things go wrong in financial markets, the taxpayer would not be responsible for covering the shortfall. The other side of alleviating risks for taxpayers is that public employees must face the risk of saving too little, the risk of poor investment returns, the risk that inflation will erode the value of their income, and the risk that they might outlive their assets.[7]

Figure 2. *State and Local Employer and Employee Median Contribution Rates, 2009*



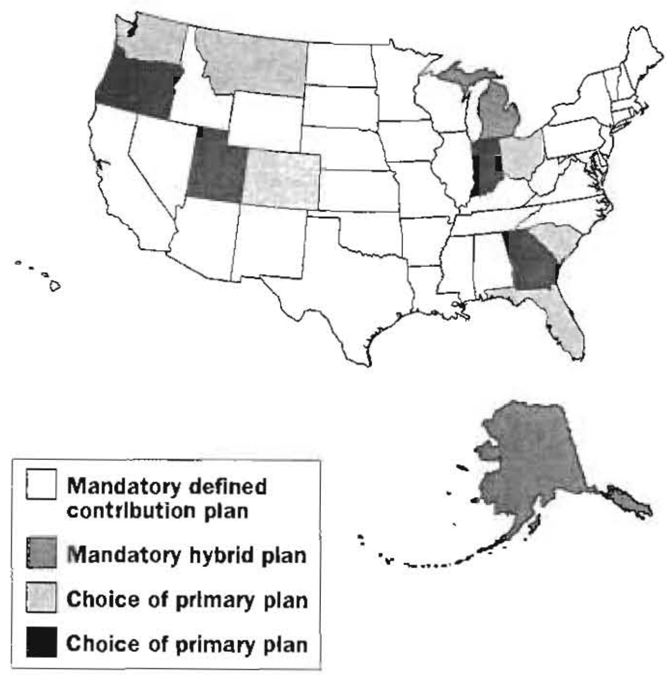
Source: Public Plans Database (2009).

Pre-2008 Defined Contribution Activity

The fact that defined contribution plans put employees at such risk may help explain why before the financial crisis only a smattering of states had introduced these plans on a mandatory basis.[8] Importantly, only two states–Michigan and Alaska–required all new hires to participate solely in a defined contribution plan (see Figure 3).[9] The mandate applied only to new hires, because most states are constrained by their constitution or case law from reducing benefits for current employees. Two states–Oregon and Indiana–adopted "hybrid" plans, where employees are required to participate in both a defined benefit and a defined contribution plan. Another six states retained their defined benefit plan and simply offered the defined contribution plan as an option to their employees.[10]

The time line of the introduction of these defined contribution plans is interesting (see Figure 4). Some of the changes may have been a response to economics or politics, but much of the activity occurred in the wake of the fantastic performance of the stock market during the 1990s.[12]

Figure 3. *Defined Contribution Plans, by State, 2011*

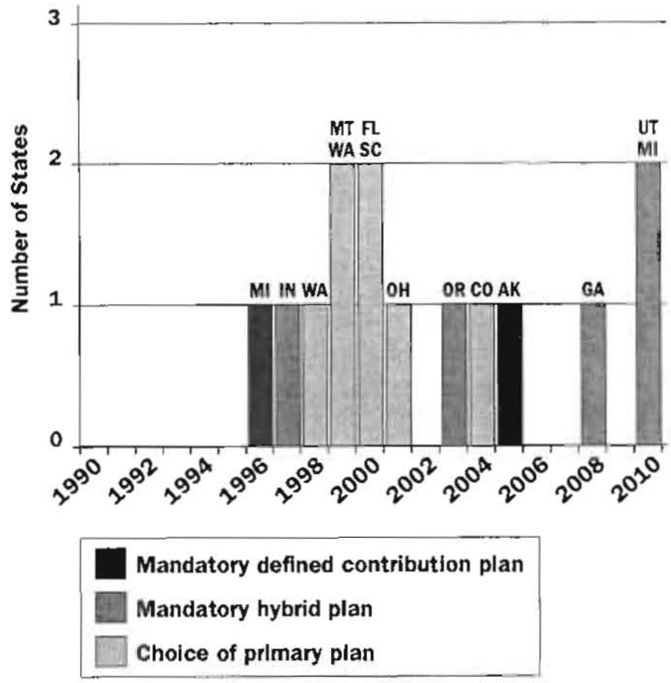


Note: For specific definitions of the classifications used in this figure, see footnote 11.

Sources: Various retirement systems' annual reports and websites of state legislatures.

33

Figure 4. *Introduction of State Defined Contribution Plans, by Year*



Note: For specific definitions of the classifications used in this figure, see footnote 11.

Sources: Various retirement systems' annual reports and websites of state legislatures.

Since the plans are relatively new, the compulsory plans apply ouly to new hires, and the others are optional, the number of participants and amount of assets in defined contribution plans are modest (see Appendix).[13] To date, participants account for less than 5 percent of all state and local workers, and assets amount to less than 1 percent of total state and local pension assets.[14] ("Fact Sheets" on each of the mandatory defined contribution plans discussed in this *brief* are available at http://slge.org.)

Post-Crisis Developments

In the wake of the financial crisis, three states (Michigan, Georgia, and Utah) have introduced mandatory "hybrid" plans for new employees. Interestingly, none of the three has followed the Alaska-Michigan (SERS) model of relying solely on a defined contribution plan. Rather, each has adopted a plan where new employees accumulate retirement income under both a defined benefit and a defined contribution plan. An additional nine states are discussing defined contribution options.[15]

Today's hybrid plan model could be redesigned to work better.

Georgia

General state employees covered under Georgia's Employee Retirement System (ERS) hired after January 1, 2009, are covered under the new hybrid plan; existing ERS members had the option to join the new plan. New hires are automatically enrolled in the 401(k) plan (unless they affirmatively elect not to participate) and contribute 1 percent of salary with additional contributions up to 5 percent eligible for an employer match.[16] The match is 100 percent of the automatic contribution and 50 percent of optional contributions, for a maximum match of 3 percent of salary. Employees can contribute up to the Internal Revenue Service (IRS) limit, but will receive no further employer match.

The defined benefit plan will pay 1 percent for each year of service on the annual average of the highest 24 months of earnings.[17] Members contribute 1.25 percent of salary to the defined benefit plan, and the state contributes an actuarially-determined rate, which was 6.54 percent of payroll in 2009.

System communiqués indicate that the change was driven primarily by the preference of young workers, who constitute 62 percent of the state's workforce, for wages over benefits. In response, the State raised wages and introduced the smaller hybrid plan, with a 401(k) component so that young mobile workers would have something to take with them when they left state employment.

Michigan

As discussed above, since 1997 all new Michigan general state employees have been enrolled in a 401(k) plan. But when the time came to revamp the system for public school employees, the State decided to adopt a hybrid. Employees hired after July 1, 2010, automatically contribute 2 percent of salary to the 401(k) (unless they affirmatively elect not to participate), with optional contributions up to the IRS limit. The sponsor matches 50 percent of the employee's first 2 percent of contributions.[18]

The defined benefit plan for new hires will pay 1.5 percent for each year of service on the annual average of the highest 60 months of earnings. Employees will contribute 6.4 percent of salary to the plan. Whereas the accrual rate is the same as it was under the two existing defined benefit plans for school employees, the age and service requirements for this plan have been increased and the cost-of-living adjustment eliminated.

Press reports suggest that future employer costs (including required contributions for retiree health insurance) were a major motivation for the new plan.[19] Essentially, the new plan reduces the benefits compared to the existing defined benefit plan, and the defined contribution plan involves an extremely modest contribution from the employer.

Utah

State and local government employees hired after July 1, 2011, will have the option to participate in either a defined contribution plan or in a hybrid. In the case of the defined contribution plan, the employer will automatically contribute 10 percent for most public employees and 12 percent for public safety and firefighter members.[20] Employees can contribute up to the IRS limit. Employee contributions vest immediately, and employer contributions vest after four years. Members can direct the investment of their contributions immediately, and those of the employer after four years.

Under the hybrid plan, the employer will pay up to 10 percent of an employee's compensation toward the defined benefit component; employees will contribute any additional amount to make the required contribution. The defined benefit plan for new employees is less generous than the former plan: the accrual rate is reduced from 2.0 percent per year to 1.5 percent; the period for calculating final average salary was increased from high three years to high five; and the employee contribution increased from zero to the cost above 10 percent. For the defined contribution component of the hybrid plan, employers will contribute 10 percentage points minus the amount contributed to the defined benefit plan. For example, if they contribute 10 percent to the defined benefit plan, they will contribute nothing to the defined contribution plan.

Table 1 summarizes the provisions of the new hybrid plans. The pattern is quite similar in several respects. First, the combined cost of the new plan is significantly less than the pre-existing defined benefit plan. Second, the commitment to the defined contribution plan is minimal. Experience with 401(k)s in the private sector suggests that participants tend to stay where they are put.[21] So if automatic contributions are set at 1 percent or 2 percent of earnings, participants are likely to keep their contributions at that level. Low saving in the defined contribution component means that employees will be forced to rely primarily on the now-reduced defined benefit plan in retirement.

Table 1. *Provisions of New Hybrid Plans*

Provision	Georgia	Michigan	Utah
	Defined benefit plan		
Accrual rate	1.0%	1.5%	1.5%
COLA	Ad-hoc	None	CPI up to 2.5%
Contributions: Employer	6.54% (2009)	TBD	10% cap
Contributions: Employee	1.25%	6.4%	DB cost > 10%
	Defined contribution plan		
Automatic contribution	1%	2%	10% – DB cost
Employer match	100% on first 1%, 50% on next 4%	50% on first 2%	None

Note: Michigan Public Schools' 2010 Actuarial Valuation Report has not yet been released.

Sources: Various retirement systems' annual reports, legislation, and websites of state legislatures.

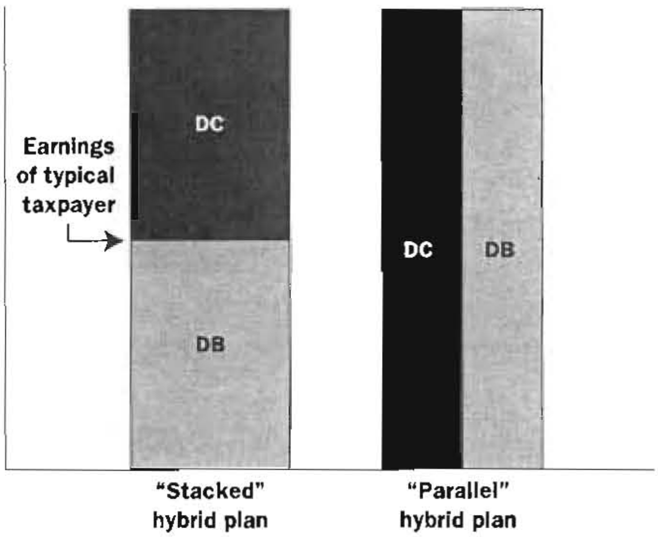
A Better Mousetrap?

The emergence of hybrid plans reflects an attempt to balance employee and taxpayer risk. But, to date, states are achieving this goal by reducing the government's contribution across the board rather than considering how best to use each plan type.

Defined benefit plans provide the most secure income for long-service employees. While some public sector employees leave in the first 10 years, many tend to remain for a full career.[22] Therefore, defined benefit plans are an effective mechanism for public sector employers to attract and retain employees. Defined benefit plans, however, put the taxpayer at risk if financial markets drop, inflation takes off, or retirees live longer than expected.

A fair question is how much risk should taxpayers bear? Utah answered that question by capping employer contributions at 10 percent of payroll. Such a cap, however, places lower paid and higher paid participants at equal risk of having to increase contributions. A better approach to limiting taxpayer risk is to cap the income covered by the defined benefit plan. Such a cap would prevent the situation where the typical taxpayer, earning $50,000, is forced to pay higher taxes when the stock market plummets to cover benefits for highly-paid public employees, such as university presidents. Therefore, the proposal would be to limit coverage

Figure 5. *"Stacked" Hybrid Plan versus "Parallel" Hybrid Plan*



Source: Authors' illustration.

under the defined benefit plan to earnings below, say, $50,000 (indexed for inflation).[23] Many public sector workers would still be covered in full under the defined benefit plan.

Earnings above $50,000 would be covered by a defined contribution plan. Thus, someone earning $100,000 would receive benefits based on the first $50,000 from the defined benefit plan and benefits on the second $50,000 from the defined contribution plan. That is, instead of "parallel" plans where employees contribute to both a 401(k) and a defined benefit plan from the first dollar of earnings, "stacked" plans would maintain the defined benefit plan as a base and provide defined contribution coverage for earnings above some cutoff (see Figure 5). The stacked approach is a suggestion for a "better plan design" and could be wed with any desired size of the plan.

The advantage of the "stacked" approach is that it allows employees with modest earnings to receive the full protection of a defined benefit plan. This group would be the most vulnerable if required to rely on a 401(k) for a portion of their core retirement benefit. Indeed, the private sector experience with 401(k)s illustrates the concern. The typical private sector taxpayer approaching retirement (ages 55-64) had accumulated only $78,000 in 401(k) assets before the financial crisis.[24] So maintaining a full defined benefit plan for public employees such as elementary school teachers would be preferable. More highly-paid public employees would still have the protection of a defined benefit plan as a base and would then rely on the 401(k) for earnings replacement that exceeded the earnings of a typical private sector worker.[25] This overall arrangement offers a reasonable balance by providing adequate and secure benefits targeted to public employees who need them most while limiting the risk to taxpayers of covering large pension shortfalls.

One question is whether such a stacked approach would violate IRS non-discrimination rules. The legal answer is that tax-qualified governmental plans are generally not subject to non-discrimination provisions.[26] On a substantive level, the government contribution for the defined contribution plan could be less than for the defined benefit plan, so that the two plans taken as a whole do not favor higher-paid workers.

Conclusion

Defined contribution plans may well have a role in the public sector, but in combination with, not as an alternative to, defined benefit plans. The hybrids introduced in Georgia, Michigan, and Utah reflect sponsors' recognition of the need to balance the risks to employees and the risks to taxpayers. These hybrids consist of slimmed-down defined benefit plans and defined contribution plans operating in "parallel." A preferable approach may be a "stacked" arrangement. Meaningful defined benefit plans could remain as a secure base for the typical public employee, and defined contribution plans could be "stacked" on top to provide additional retirement income for those at the higher end of the pay scale. Such an approach would ensure a more equitable sharing of risks and would also prevent headlines generated by the occasional inflated public pension benefit.

Endnotes

1. Although, in theory, taxpayers bear the risk, in the wake of the recent financial collapse employers and employees have shared the burden. From 2008 to 2011, 20 states increased pension contributions for either new or existing employees, while five states reduced benefits for current employees and an additional three eliminated or reduced the cost-of-living adjustment for current retirees. In several instances–Colorado, Minnesota, and South Dakota are widely-publicized examples–the state's actions have been taken to court. See National Conference of State Legislatures (2008-2011) for more details.
2. The estimates of investment management expenses are from Lipper (2008).
3. Under many state plans, vesting does not occur for 10 years, and employees who leave receive only their contributions and some minimal amount of credited interest.
4. TIAA-CREF is a notable exception.

5. In many cases, closing an existing defined benefit plan to new hires and switching to a defined contribution plan increases short-term costs. The Governmental Accounting Standards Board (GASB) Statement Number 25 states that closed plans using the level percent of payroll method for calculating the annual required contribution (ARC) must acknowledge that covered payroll is decreasing. This recognition frontloads costs. As a result, most closed plans use the level dollar method of amortizing the unfunded liability. However, the ARC under the closed plan is still frontloaded relative to the ARC under the ongoing plan. Moreover, market gains from future new hire contributions that would have been used to offset the unfunded liability are now sequestered in the new defined contribution plan. See California Public Employees' Retirement System (2005); Michigan House Fiscal Agency (2009); Retirement Systems of Minnesota (2011); and The Segal Company (2010) for more information.
6. For a more detailed discussion of the cost efficiencies of defined benefit pension plans, see Almeida and Fornia (2008).
7. The defined contribution aspects described-individual investment direction, high expense compared to defined benefit plans, flexibility over payout, and lack of annuitization-reflect how most defined contribution plans are currently designed. A defined contribution plan could be designed to address many of the current downsides. For example, MyFRS in Florida is a low-fee defined contribution fund, while the Texas Municipal Retirement System is a cash balance plan that annuitizes the balances of individual member accounts.
8. Public sector workers often have optional 403(b) and/or 457 defined contribution plans that allow them to put aside a portion of their pay on a tax-deferred basis to augment their public pension. These supplementary plans are not the topic of this *brief*. Rather, the focus is on states where the nature of the *primary* plan has changed. For a discussion of early defined contribution activity, see Munnell et al. (2008).
9. In Nebraska, the primary Public Employee Retirement System was a defined contribution plan from 1967 to 2002. It was closed to new employees and replaced with a cash balance plan on January 1, 2003, over concerns that the defined contribution plan was producing lower returns than the defined benefit plans (see Nebraska Public Employees' Retirement Systems, 2002, for more details). A cash balance plan is a defined benefit plan that maintains notional individual accounts throughout the asset accrual phase. Similarly, the West Virginia Teachers plan, which became a primary defined contribution plan in 1991, switched back to a primary defined benefit plan in 2005. The Texas Municipal Retirement System maintains a cash balance plan. The District of Columbia requires its general government employees to join a primary defined contribution plan, but our analysis is limited to states.
10. These states were Colorado, Florida, Montana, Ohio, South Carolina, and Washington. Except in Washington and Ohio, the options are either a traditional defined benefit plan or a defined contribution plan. Washington offers a choice of a defined benefit plan or a hybrid plan. Ohio employees can choose from a defined benefit plan, a defined contribution plan, or a hybrid plan. In all cases, the defined benefit plan is the default for those who do not actively make a selection.
11. Mandatory defined benefit plans are primary plans that require employees to join. Mandatory defined contribution plans are primary plans that require employees to join. Mandatory hybrid plans require employees to join a plan with both a defined benefit and a defined contribution component. "Choice" plans typically allow employees to pick either a primary defined contribution plan or a primary defined benefit plan.
12. For example, from January 1, 1995, to December 31, 1999, the S&P 500 had an average annual return of nearly 30 percent. For a discussion of early defined contribution activity, see Munnell et al. (2008). This study looked at the effect of economic and political factors on the probability of introducing a defined contribution plan for public employees. It found that Republican leadership-with its emphasis on individual control over investments and plan portability-was the leading predictor of plan changes.
13. In the private sector, when a new plan is adopted, the existing defined benefit plan is generally frozen. Existing employees can retain the benefits earned but are not permitted to accrue any further service credits. In the public sector, when a new plan is adopted, existing employees generally have a legal right to continue to participate in the previous plan and only employees hired after the date the plan is adopted are required to participate in the new plan.
14. Authors' calculations from the U.S. Census Bureau (2008) and *Public Plans Database* (2009).
15. The issue is under discussion in Alabama, Connecticut, Nevada, North Carolina, Tennessee, and Wisconsin. Legislation to introduce a defined contribution plan for new hires recently passed the Kentucky Senate, but has not yet been acted on by the House of Representatives. Similar proposals are currently under consideration in Illinois and Oklahoma, while a defined contribution bill was defeated in North Dakota. See Frazier (2010); Fehr (2010); National Conference of State Legislatures (2011); Steyer (2010); and Preston and McNichol (2010).
16. In the public sector, the only 401(k)s are grandfathered plans that were established 5/6/86 or before, so Georgia had originally established a 401(k) plan before 1986 as an optional supplement to its primary defined benefit plan. See PlanMember Financial Corporation (2010).
17. The Board of Trustees can increase the benefit factor in the future up to 2 percent if funds are available.
18. Michigan House Fiscal Agency (2010).
19. Governor of Michigan (2010) and Michigan Association of School Boards (2010).
20. Liljenquist (2010).
21. Madrian and Shea (2001); Choi et al. (2004); and Gale, Iwry, and Orszag (2005).
22. Authors' estimates from the Actuarial Valuations of the 14 largest plans.
23. The Internal Revenue Code contains a maximum compensation limit for defined contribution plans. This limit is $245,000 in 2011. It is indexed for inflation and increased in $5,000 increments. A similar procedure could be used for stacked plans.
24. This figure, which comes from the Federal Reserve's 2007 *Survey of Consumer Finances*, also includes IRA assets as they typically come from 401(k)rollovers during a job switch.
25. A well-designed defined contribution plan would set the combined employee-employer contribution at a level to achieve, in combination with a defined benefit plan, a targeted replacement rate. It would also have the default payment at retirement be an annuity, with the ability of participants to opt out if such an arrangement did not meet their needs. One reviewer also suggested that the plan might guarantee the employee's contribution regardless of investment performance to encourage participation.
26. Most of the public sector defined contribution plans are 401(a) money purchase plans with mandatory employee contributions. As noted earlier, governments generally cannot have 401(k) plans, and since 457(b) plans are subject to contribution limits, sponsors may be reluctant to crowd out supplemental saving. See Powell (2011) for a more thorough discussion of the nondiscrimination tax rules for governmental plans.

References

Almeida, Beth, and William B. Fornia. 2008. "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans." Washington, DC: National Institute on Retirement Security.

California Public Employees' Retirement System. 2005. "The Myths and Realities of Defined Benefit and Defined Contribution Plans." *Research Brief.* Available at: http://www.calpers.ca.gov/eip-docs/member/retirement/info-sources/defined-bene-facts.pdf.

Choi, James J., David Laibson, Brigitte C. Madrian, and Andrew Metrick. 2004. "For Better or for Worse: Default Effects and 401(k) Savings Behavior." In *Perspectives on the Economics of Aging*, edited by David A. Wise, 81-125. Chicago, IL: University of Chicago Press.

Frazier, Trish. 2010. "Pension Issues Heat Up." Oklahoma Public Employees Association. Available at: http://opea.org/pension-issues-heat-up.

Fehr, Stephen C. 2010. "Election Adds Pressure to Change Public Pensions." *Stateline* (November 4).

Gale, William G., J. Mark Iwry, and Peter R. Orszag. 2005. "The Automatic 401(k): A Simple Way to Strengthen Retirement Saving." *Tax Analysts*.Washington, DC: Urban Institute.

Governmental Accounting Standards Board. 1994 (November). Statement No. 25: "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans."

Governor of Michigan. 2010. "Michigan to Reform State Employee and Public School Retirement Systems." *GovMonitor* (March 12). Lansing, MI.

HR Investment Consultants. 2009. *401k Averages Book, 8th Edition*. Baltimore, MD.

Liljenquist, Daniel R. 2010. "New Public Employees' Tier II Contributory Retirement Act." S.B. 63 Utah State Legislature. Salt Lake City, UT.

Lipper, Inc. Custom Report: "Boston College Mutual Fund Expense Report." Obtained through personal communication.

Madrian, Brigitte C. and Dennis F. Shea. 2001. "The Power Of Suggestion: Inertia in 401(k) Participation and Savings Behavior." *Quarterly Journal of Economics* 116(4): 1149-1187.

Michigan Association of School Boards. 2010. "Retirement Reform: An Analysis of Public Act 75–MPSERS Reform. Lansing, MI.

Michigan House Fiscal Agency. 2009. "Memorandum: Converting MPSERS from a Defined Benefit (DB) to a Defined Contribution (DC) System." Lansing, MI. Available at: http://house.michigan.gov/hfa/PDFs/MPSERS.pdf.

Michigan House Fiscal Agency. 2010. "A Summary of Senate Bill 1227 as Enacted." Lansing, MI.

Munnell, Alicia H., Alex Golub-Sass, Kelly Haverstick, Mauricio Soto, and Gregory Wiles. 2008. "Why Have Some States Introduced Defined Contribution Plans?" *State and Local Pension Plans* 3. Chestnut Hill, MA: Center for Retirement Research at Boston College.

National Conference of State Legislatures. 2008-2011. "State Pensions and Retirement Legislation 2008-2010." Washington, DC. Available at: http://www.ncsl.org/Default.aspx?TabID=756&tabs=951,69,140#140.

Nebraska Public Employees' Retirement Systems. 2002. "Retirement Roundup." Volume 17, No. 5. Lincoln, NE. Available at: http://www.npers.ne.gov/public/newsletter/newsletter-stsummer%202002.pdf.

PlanMember Financial Corporation. 2010. "Employer Retirement Plan Comparison Chart: 403(b), 401(k) and 457(b) Plans." Available at: https://pdfs.planmember.com/PDFs/PMPARTNERSREGREPSGLOBALFORMS/SalesandMarketing/EmployerPlans_ComparisonChart_11012010.pdf.

Powell, David. 2011. "Church and Governmental Plans." *Tax Management Portfolio 372*. Arlington, VA: BNA Tax and Accounting.

Preston, Darrell and Dunstan McNichol. 2010. "Nevada Switch to 401(k)-Style Pension Adds $1.2 Billion Cost, Study Says." *Bloomberg News* (December 16).

Public Plans Database. 2008-2009. Center for Retirement Research at Boston College and Center for State and Local Government Excellence.

Retirement Systems of Minnesota. 2011. "Retirement Plan Design Study: Minnesota Public Retirement Systems." Available at: http://www.mnpera.org/vertical/Sites/%7BCB6D4845-437C-4F52-969E-51305385F40B%7D/uploads/%7BD16C3235-5CC9-4519-97C0-E66263986866%7D.PDF.

Steyer, Robert. 2010. "New DC Plan Among Connecticut Governor's Ideas." *Pensions and Investments* (September 8).

The Segal Company. 2010. "Public Employees' Retirement System of the State of Nevada: Analysis and Comparison of Defined Benefit and Defined Contribution Retirement Plans." Available at: http://www.nvpers.org/public/documentation/2010-DB-DC%20Study%20By%20Segal.pdf.

U.S. Board of Governors of the Federal Reserve System. *Survey of Consumer Finances*, 2007. Washington, DC.

U.S. Census Bureau. 1957-2008. *Employee-Retirement Systems of State and Local Governments*. Washington, DC. Available at: http://www.census.gov/govs/retire.

38

Appendix. Primary Defined Contribution Plans

Table A1. *Characteristics of Primary Defined Contribution Plans, 2009*

Plan name	Legislative date	Participants 2007	Participants 2009	Assets ($ in millions) 2007	Assets ($ in millions) 2009
Mandatory defined contribution plans					
Alaska PERS	2005	2,862	7,516	9	41
Alaska TRS	2005	646	1,997	6	27
Michigan SERS	1996	24,043	26,044	2,547	2,207
Mandatory hybrid plans					
Georgia-GSEPS	2008	0	2,105	0	311
Indiana PERF-ASA	1997	213,984	223,561	2,707	2,669
Indiana TRF-ASA	1997	122,107	164,590	4,605	3,901
Michigan-MPSERS	2010	0	11,617	0	0
Oregon PERS-IAP	2003	43,541	59,073	1,877	2,109
Utah-Tier II Contributory Hybrid	2010	0	0	0	0
Choice of primary plan					
Colorado PERA-PERAChoice	2004	489	3,039	3	37
Florida RS-PEORP	2000	98,070	121,522	3,687	4,075
Montana PERS-DCRP	1999	1,913	2,345	41	44
Ohio PERS-Combined Plan	2002	6,905	7,354	157	223
Ohio PERS-Member Directed Plan	2002	8,579	9,824	124	201
Ohio STRS-Member Directed and Combined Plans	2001	11,863	12,829	283	297
South Carolina-ORP	2000	26,873	31,968	502	561
Utah-Tier II Defined Contribution	2010	0	0	0	0
Washington PERS- 3	1999	27,605	31,123	1,348	1,188
Washington SERS-3	1998	37,854	38,585	1,052	918
Washington TRS-3	1998	57,667	60,146	3,971	3,419
Total		**685,001**	**815,238**	**22,916**	**22,230**

Note: Michigan SERS 2009 assets reflect 2008 levels. MPSERS has not yet reported 2009 asset levels. Ohio STRS does not separate assets for the Member Directed and Combined Plans in its financial reports.

Source: Public Plans Database (2007 and 2009).

39

49

CENTER FOR STATE & LOCAL GOVERNMENT EXCELLENCE

Board Of Directors

SLGE Staff

Elizabeth K. Kellar
President and CEO

Joshua M. Franzel, PhD
Vice President, Research

Alex Brown
Research and Policy Analyst

Amy M. Mayers
Communications Manager

Bonnie J. Faulk
Program Assistant

41

CENTER FOR STATE & LOCAL GOVERNMENT EXCELLENCE

Helping state and local governments become knowledgeable and competitive employers

About the Center for State and Local Government Excellence

The Center for State and Local Government Excellence helps state and local governments become knowledgeable and competitive employers so they can attract and retain a talented and committed workforce. The Center identifies best practices and conducts research on competitive employment practices, workforce development, pensions, retiree health security, and financial planning. The Center also brings state and local leaders together with respected researchers and features the latest demographic data on the aging work force, research studies, and news on health care, recruitment, and succession planning on its web site, www.slge.org.

The Center's five research priorities are:

- Retirement plans and savings
- Retiree health care
- Financial education for employees
- Talent strategies and innovative employment practices
- Workforce development

777 N. Capitol Street NE | Suite 500 | Washington DC 20002-4201 | 202 682 6100 | info@slge.org

42

11-199

New Pension Math

Nationwide, public officials scramble to change new-hire benefits formulas.

Girard Miller | April 2010

In most states, the benefits formulas for active employees are untouchable. The only way to chip away at pension-funding problems is to fiddle with formulas for new employees, partly because unions are more willing to give way on benefits for new hires. Newbies don't vote on today's contract and don't pay dues yet--and union leaders may figure they'll get the benefits restored when the economy improves.

For most public officials, there is great confusion about what would be a fair benefits formula for new employees. Here are some pension math basics:

Cost-sharing. Let's assume the pension fund requires employees to contribute 5 percent of their salary, the national average, to the pension plan. A good case can be made that new employees should pay half of their pension benefits' normal costs, which helps assure they have skin in the game when it comes time to talk about future benefits increases. One of the first issues to address is the employee contribution rate. If the rate is less than half of what the actuary says would be the normal cost of new hires' benefits, it's time to put that issue on the table.

Retirement age. Public employees in many states receive lifetime pensions and sometimes medical benefits long before Social Security's normal retirement age-and usually much earlier than their private-sector counterparts who pay the taxes. Putting aside the special cases of police officers and firefighters whose exposure to danger would justify an earlier retirement age, there's little reason for new hires to begin full pension benefits before reaching the Social Security retirement age (now 66 or 67 for baby boomers). Benefits formulas for new employees should start there and allow an earlier retirement with actuarially reduced benefits--just like Social Security requires of early retirees.

Multiplier math. During the Internet bubble years of 1999-2000, many public plans awarded generous increases in the "multiplier"--the percentage used to calculate pension benefits. (For example, a 2 percent multiplier times 30 years of service times a $50,000 final average salary equals a $30,000 annual pension.) Today many pension plans and employers are finding that their multipliers are unsustainable and often unjustified.

If employees are eligible for Social Security, as most are, a multiplier of 1.7 percent would provide a 30-year employee with a pension of one-half of his or her final salary. When that is combined with Social Security and income from personal savings, average retirees will be able to replace their earnings because they no longer will be making pension and Social Security contributions or putting money into a savings account. And hopefully they pay off the mortgage early in the retirement years, thereby reducing living costs. The usual rule of thumb is 85 percent replacement income will sustain a retiree, as long as the retiree has some inflation protection from the pension plan and Social Security.

For public employers outside of Social Security, a multiplier of 2.5 percent is a reasonable benefit level as long as employees pay at least 10 percent of salary into the plan. After all, they're not paying Social Security taxes of 6.2 percent, which makes 10 percent a bargain for them. Many such public employees still find a way to qualify for some Social Security benefits through side jobs and prior or post careers.

As for public safety employees, a multiplier of 2.3 percent plus Social Security and personal savings will generally provide a sufficient replacement ratio--again depending on how early the employee becomes eligible for retirement. At this level, the employee's matching share of normal costs will likely be in the high single digits, if not greater.

Retiree medical benefits. An equally important issue to address with new hires is their retiree medical package. Some employers are now limiting that benefit to post-Medicare supplements only and putting a consumer price index or dollar cap on the benefit to prevent future runaway medical costs. Limiting retiree medical benefits this way reinforces the higher retirement ages needed to sustain pension plans past 2030.

With these reforms, most plans can provide a sufficient benefit. Only a financial analysis can determine if the benefit package would be sustainable and affordable to both the employer and the new hires.

43

June 15, 2011

States Want More in Pension Contributions

By STEVEN GREENHOUSE

First came the pay freezes and unpaid furloughs. Then came the higher contributions for health insurance. Now, in the most definitive sign yet that the era of generous compensation for public-sector employees is ending, workers in more than half the states face the prospect of paying more of their salary toward their pensions.

So far this year, eight states, including Wisconsin and Florida, have decided to require government employees to contribute more, sometimes far more, to their pensions. Governors and legislators in 10 other states, including California and Illinois, are proposing their own pension changes as they grapple with budget deficits and underfunded pension plans.

Government employees' unions are not accepting these changes without a fight, complaining that the increased pension contributions often amount to a significant cut in take-home pay.

A burst of labor opposition in New Jersey is threatening a tentative deal between the Republican governor, Chris Christie, and Democratic legislative leaders that would require government employees to contribute at least one percentage point more of their pay toward their pensions. One powerful union warned Democratic lawmakers not to join Mr. Christie's "war on the middle class."

But even many of labor's traditional allies are demanding pension changes. Last week, New York's governor, Andrew M. Cuomo, a Democrat, proposed that all future state and New York City employees pay 6 percent of their salary toward their pensions, double the current 3 percent. Oregon's Democratic governor is pushing state and local employees to contribute as much as 6 percent of pay, up from zero at present. Twelve states, including Arizona, Michigan, Minnesota and Virginia, imposed higher employee contributions in 2010. That leaves just a handful of states where employees do not contribute toward their pensions.

"You can call this an exponential increase in activity to have state employees contribute more," said Ronald

44

Snell, a pension expert with the National Conference of State Legislatures. “Before 2010, this hardly ever happened.”

States are demanding the higher contributions as they reach for new ways to cut budget deficits. The easy savings, like furlough days, have been achieved, and now lawmakers are tackling more complicated cost issues like the long-term shortfalls in their pension funds.

The Pew Center on the States estimates there is a more than $1 trillion funding gap for government workers’ retirement benefits in the 50 states. At the same time, many voters resent that public employee pensions are generally better than their own.

“States have less revenues coming in and higher bills for their pensions, and it’s really focused their attention,” said Susan K. Urahn, managing director of the Pew center, a nonpartisan research group.

Alabama, Arizona, Kansas, Maryland, Mississippi and Oklahoma have all acted this year to require employees to pay more.

In one of the most extreme proposals, a legislative committee in Illinois, daunted by the state’s estimated $80 billion pension shortfall, voted to have state workers either contribute 17 percent of their pay toward their pensions or accept less generous pension benefits.

According to the Pew Center, actuarial reports say the 50 states should have contributed $117 billion in 2009 toward their pension plans to help bring them to full funding, two and a half times more than they contributed a decade ago and well over the $73 billion they actually contributed in 2009.

Requiring employees to divert 3 to 6 percent of their paychecks toward funding their pensions will help, though it will not come close to solving the short-term budget problems in most states, Ms. Urahn said. But every bit helps. In Wisconsin, for example, Gov. Scott Walker said the state government would save $226 million a year from state employees’ paying a 5.8 percent contribution previously paid by the state.

Over time, the budgetary savings can be substantial. Because of New York’s constitutional limits on changing current workers’ pensions for the worse, Mr. Cuomo is proposing increased pension contributions for new employees only. But even so, his office says this change would save New York State and public employers outside New York City $50 billion over 30 years.

“The pension system as we know it is unsustainable,” Mr. Cuomo said last week. He added that his proposal would “bring government benefits more in line with the private sector while still serving our employees and

45

protecting our retirees."

Many government employees and their unions are fuming about these pension changes, saying that they have become scapegoats for state fiscal problems. Denis M. Hughes, president of the New York State A.F.L.-C.I.O., said Mr. Cuomo should consider other alternatives before demanding higher pension contributions.

"It would be fairer to raise taxes on the rich than to hit struggling middle-class workers like that," he said. He argued that it would be awkward and bad for employee morale if a group of employees hired on a given day had to pay 6 percent of salary toward their pensions, while a group hired the week before had to pay just 3 percent.

Increased pension contributions are just part of the hit that many public sector workers have been asked to take. Wage freezes, unpaid furlough days and higher health insurance contributions are common, and many states have taken steps beyond raising worker contributions to cut their pension obligations. Those include delaying the age for full retirement, adopting a less generous formula for pension calculations and requiring more years of work before pensions are vested.

Heather Conroy, executive director of Oregon's largest local of the Service Employees International Union, estimates that her members' take-home pay could be cut by 12 to 20 percent if workers were required to begin paying 6 percent toward their pensions above and beyond other concessions being demanded.

"This is going to be very painful to our members," Ms. Conroy said. "Not many workers can afford to contribute 6 percent of their pay toward their pensions."

Unions have long argued that government employees contribute more toward their pensions than the public believes. They note that workers often gave up raises or made other concessions in previous years in exchange for having the state pick up their pension contributions.

But with tales of six-figure pensions and public employees comfortably retiring in their early 50s, many lawmakers say it is outrageous that some of these workers pay nothing out of pocket toward their pensions.

Oregon's governor, John Kitzhaber, defended his proposal, saying he wanted to negotiate a pact that shared responsibility for health and pension benefits in a "fair and affordable total compensation package." He added, "It's about shared responsibility within a very limited budget."

The Washington Post

Amid backlash and budget deficits, government workers' pensions are targets

By Michael A. Fletcher
Washington Post Staff Writer
Wednesday, October 6, 2010; 2:45 AM

PHILADELPHIA - Faced with deep budget deficits and overextended pension plans, state and local leaders are increasingly looking to trim the lucrative retirement benefits that have long been associated with government employment.

Public employees are facing a backlash that has intensified with the nation's economic woes, union leaders say, because of their good job security, generous health-care and pension benefits, and right to retire long before most private-sector workers.

In California, where an estimated 80 cents out of every government dollar goes to employee pay and benefits, Gov. Arnold Schwarzenegger (R) has proposed a two-tier system of pensions that offers new state workers reduced benefits with tighter retirement formulas. He also wants state workers to kick in higher pension contributions to help deal with California's staggering deficit.

New Jersey Gov. Chris Christie (R) calls reform of public employee pensions essential to fixing the state's enormous fiscal problems. Michigan Gov. Jennifer M. Gran-holm (D) recently signed a change to her state's teacher pensions that increases employee contributions. Illinois has pushed back the retirement age for new employees. Detailing his agenda for New York, Democratic gubernatorial nominee Andrew M. Cuomo has said, "We simply can't afford to pay benefits and pensions that are out of line with economic reality."

Locally, a special commission is scheduled to meet Thursday in Annapolis to examine options for Maryland's $34 billion pension fund, which is just 65 percent funded and has been called a "credit challenge" by Moody's. The state has not yet gone after public employees; neither has Virginia, where the state pension fund is projected to be underfunded in the near future.

Here in Philadelphia, Mayor Michael Nutter has proposed ending a popular pension enhancement called the Deferred Retirement Option Plan, which has allowed many city workers to walk away from their jobs with six-figure payments in addition to their pensions.

"Government workers are the new privileged class," said James E. MacDougald, a retired business executive who formed a research and activist group, Free Enterprise Nation, to call attention to the financial burden posed by government workers.

Benefits to envy

The move to curtail retirement benefits for public-sector workers is fueled both by stark budget realities and by the resentment felt by private-sector workers who have seen their pay diminish in recent years.

Public employment was once viewed as less rewarding than work in the private sector, but that has changed. State and local government employees earn an average of $39.74 an hour in wages and benefits, about 45 percent more than private-sector workers, whose total compensation averages $27.64 an hour, according to the Labor Department.

The difference reflects the higher proportion of professional jobs in the public sector, the Labor Department says. Government workers tend to be better educated than private-sector workers, unions add. And public employees typically receive better retirement benefits than their private-sector counterparts.

The vast majority of private workers rely on defined-contribution retirement plans such as 401(k)s, while 84 percent of public-sector workers have access to guaranteed pensions, which are more expensive to employers.

Mayors, governors and other political leaders have long avoided cutting the benefits of government workers, whom they often rely on for political support. But now the benefits are often seen as overly generous in a time of scarce resources.

Studies have found the nation's 2,500 public employee pension plans to be underfunded by as much as $3 trillion. Steep investment losses during the recession have left less than half of the state retirement systems adequately funded, according to a recent report by Bloomberg.

Even as they trim vital services, state and local governments are devoting an increasing share of their budgets to paying for employee retirement costs.

Meanwhile, a long-running series of Gallup polls has found slowly eroding support among the public for labor unions, which represent many government employees. That support dipped markedly in the past two years, a decline that Gallup analysts attribute to a belief that President Obama's policies preserved public-sector jobs while private-sector workers endured punishing cuts.

"A lot of people are saying: 'Wait a minute. I lost my benefits, and these guys who work for the city still have theirs,' " said Bill Rubin, an adviser to the president of the American Federation of State, County and Municipal Employees District Council 33 in Philadelphia and a vice chairman of the city's pension fund. "We have to educate people."

Union leaders say their members are being asked to pay for the mistakes made by politicians who chose not to adequately contribute to pension plans and by Wall Street firms whose disastrous bets led to big investment losses.

Philadelphia's problems

Philadelphia's pension plan is only about 45 percent funded, a shortfall that has caused Nutter to question the viability of the guaranteed pensions enjoyed by the city's 24,000 employees. "We can no longer sustain a defined-benefit pension program," he said last month at a conference in New York. "We're trying to move to a defined-contribution plan."

In the meantime, he wants to end the Deferred Retirement Option Plan (DROP), a proposal being weighed by the City Council. A recent study - disputed by Philadelphia's municipal worker unions - found that the program has cost the city's already dangerously depleted pension fund $258 million since its inception 11 years ago.

DROP allows employees to pick a retirement date up to four years in the future. That decision freezes workers' pension benefits but allows them to begin accumulating payments that are set aside in an account that pays 4.5 percent interest while they continue working. When they retire, they get the money in the account and start collecting their monthly pensions.

Many Philadelphia retirees see the payouts as compensation for a career of mediocre pay and raises.

"This allows the working-class and middle-class person to get a little something before they retire," said Dianne Gatson, who retired this year after 24 years, most of them as an analyst in the city's AIDS program.

Gatson, who has a master's degree and is working on her PhD, said her top salary was close to $60,000 a year. When she retired, she received a DROP payment of about $100,000 to go along with her $2,000-a-month pension.

Union leaders say many Philadelphians developed a dim view of the program after learning that some top officials had received or were in line for exorbitant payouts. Half a dozen City Council members are in the program and are eligible to collect a total of $2.3 million, according to local news reports.

Those extreme cases may rile the public, union leaders say, but they do not reflect the benefits received by most workers, whose DROP payments average just over $100,000.

Chuck Donaldson, 62, a retired recreation supervisor who started out as a middle-school English teacher, retired three years ago. He received a DROP payment of $176,000 and a $3,300-a-month pension after a 37-year city career in which he earned a top salary of $63,000 a year.

"I remember a lot of years when we got zero as a raise," he said. "It's all relative. This is nothing like the golden parachutes all those executives get. Although it probably looks pretty good to someone who is not working."

Key Elements of State Hybrid Retirement Plans

National Association of State Retirement Administrators

NASRA

	Georgia ERS	Indiana PERF and TRF	Michigan PSRS	Ohio PERS	Ohio STRS	Oregon PERS	Washington DRS	Utah RS
Applicable Groups	Mandatory for all new members 1/1/09 and after. Current membership may opt-in any time. Participants may opt out of the DC plan.	Mandatory for all participants	Mandatory for all new hires after 7/1/2010	Optional for new hires and non-vested workers since 2002	Optional for new hires and non-vested workers since 2001	Mandatory for new hires since August 2003	Optional	New hires as of 7/1/11 can choose hybrid or DC plan
Normal retirement age/yrs of service	60/10; any/30; early (reduced) any/25;certain law enforcement 55/10	65/10, 60/15, Rule of 85 at age 55	60/10	60/5, 55/25, any/30	60/5	65/any, 58/30; 60/any, 53/25 for public safety	65/5	65/4; 60/20; 62/10; any/35; any/25 for public safety
DB plan multiplier	1.00%	1.10%	1.50%	1.0%; 1.5% for years in excess of 30	1.00%	1.5%; 1.8% for public safety	1.00%	1.5%; 2.0% for public safety
Employer funds DB plan benefit?	Employee contributes 1.25%; employer funds remainder	Yes for PERF and new TRF hires since '96; no for pre-'96 TRF hires	Yes	Employer contributes to DB, D&D and retiree health care. 5-yr vesting period for ER contributions	Yes	Yes	Yes	Yes, up to 10%; 12% for public safety
Social security?	Yes	Yes	Yes	No	No	Yes	Yes	Both
Employer contributes to DC plan	100% match on employees' 1st 1% of salary; 50% match on next 4% of salary	Employers may elect to make EE contributions, which vest immediately. The State makes contributions for its employees.	50% match up to 2% of salary	ER contributions are divided among DB, DC, D&D and retiree health care. Five-year vesting period for ER contributions	ER contributions are divided among DB portion, DB UAAL, and retiree health care. 5-year vesting period for ER contributions	Employers may elect to make employees' contribution	No	Yes up to 10% (12% for public safety), less the amount contributed to the DB plan

Key Elements of State Hybrid Retirement Plans

National Association of State Retirement Administrators

NASRA

	Georgia ERS	Indiana PERF and TRF	Michigan PSRS	Ohio PERS	Ohio STRS	Oregon PERS	Washington DRS	Utah RS
Employee DC plan contribution	Minimum 1.0%	3.00%	2% auto enrollment	10.0% minus 0.1% admin fee	10.00%	6.00%	5% to 15%, depending on EE	Non-contributory
DC plan investment options	13 options ranging from conservative to aggresssive, plus 5 lifecycle funds.	Seven options administered by the fund, ranging from conservative to aggressive, and 10 target date funds.	Three investment options	Six OPERS-sponsored options ranging from conservative to aggressive.	Eight STRSOH-sponsored options ranging from conservative to aggressive and a guaranteed return option	All DC plan contributions are invested in the DB plan fund	Either the Total Allocation Portfolio, which mirrors DB plan fund, or 10 self-directed funds ranging from conservative to aggressive plus balanced funds	Eleven investment options
Default DC plan investment options	Lifecycle funds based on age.	The Guaranteed Fund, which earns a rate established annually by the Board. The current rate for the Guaranteed Fund is 6.0%.	SSgA Target Retirement Fund that matches the year the participant will be eligible to retire	Target date fund closest to the year the participant will turn 65	Money market fund	DB plan fund	Total Allocation Portfolio, which mirrors the DB plan fund	Medium Horizon Fund generally balanced between stocks and bonds

Key Elements of State Hybrid Retirement Plans

National Association of State Retirement Administrators

NASRA

	Georgia ERS	Indiana PERF and TRF	Michigan PSRS	Ohio PERS	Ohio STRS	Oregon PERS	Washington DRS	Utah RS
DC plan withdrawal options	Rollover, annuity, lump-sum, partial lump-sum, installments	Annuity, rollover, partial lump sum and annuity, deferral until age 70 ½	Lump sum, consolidation from other plans, direct rollover to an IRA, periodic distribution	Annuity, including PLOP; partial distributions; payments for a guaranteed period; monthly payments of a designated amount; deferral until age 70½	Annuity, including PLOP; lump sum and rollover	Lump-sum payment or in equal installments over a 5, 10, 15, or 20-year period.	DB plan fund: lump sum, direct rollover, scheduled payments and a personalized payment schedule. Self-Directed: same as DB plan fund, plus annuity purchase	After four-year vesting period: lump sum, partial balance, periodic distribution, direct rollover, direct rollover to an IRA
Info online	www.ersga.org	www.in.gov/perf and www.in.gov/trf	https://stateofmi.ingplans.com/eportal/welcome.do	www.opers.org	www.strsoh.org	oregon.gov/PERS (Click on OPSRP & IAP	www.drs.wa.gov (Go to "my plan 3 account")	http://www.urs.org/

See also:

Hybrid and defined contribution plans as the primary or optional state retirement benefit, NASRA <www.nasra.org/resources/hybriddc.pdf>

For questions or comments, contact Keith Brainard keithb@nasra.org 512-868-2774