M E M O R A N D U M

April 8, 2011

TO: Stephen B. Farber, Council Staff Director

FROM: Karen Orlansky, Director
Office of Legislative Oversight

SUBJECT: **County Executive's FY12 Recommended Budget: Overview of Proposed Changes to County Government Employees' Retirement, Health, and Life Insurance Benefits**

This memorandum responds to your request for an overview of changes in the County Executive's FY12 Recommended Operating Budget to retirement, health insurance (including medical, prescription drug, dental, and vision coverage), and life insurance benefits for County Government employees.

Part A, Policy Issues, summarizes the key policy issues and related questions raised by the County Executive's proposed changes to the retirement and health benefits of County Government employees.

Part B, Summary of County Executive's Proposals, describes the Executive's recommended changes to retirement, health, life insurance, and long-term disability benefits. It highlights changes from the status quo and provides the Executive's estimated FY12 savings associated with specific changes.

Part C, Impact on Employees, contains illustrative examples of the financial impact the Executive's recommended changes to retirement and health benefits would have on individual employees.

A. Policy Issues and Related Questions Raised by the Executive's Proposals

The Executive's proposed changes to the benefits of County Government employees raise multiple policy issues and related questions for the Council to consider as part of its budget deliberations. Staff recommends that the Council's review of the Executive's proposed changes include explicit discussion of:

- The policy issues underlying the Executive's proposals; and
- The FY12 and future year fiscal impact of the proposed changes on individual County Government employees as well as on the County Government's costs.

The Council may want to consider dividing its discussion of employee benefit changes into two phases. The first phase would address where the County should "land" with respect to the parameters of employee benefits, e.g., level of benefits, division of costs between the County and its employees. The second phase would address whether to implement the changes all at once or over a multiple year time period. (The Executive's FY12 budget assumes that all benefit changes are implemented as of July 1, 2011.)

The table on the following page contains an initial list of the underlying policy questions that staff recommends the Council consider during its review of the County Executive's budget.

POLICY ISSUES AND RELATED QUESTIONS	OBSERVATIONS ON THE CE'S PROPOSALS FOR CHANGING COUNTY GOVT. EMPLOYEES' BENEFITS
General	
1. Should employees in all County agencies be offered a comparable package of retirement and health benefits? If not, then what factors should determine how the benefits differ?	Unless similar changes to employee benefits are implemented by the other agencies, the CE's proposals (if implemented) would increase the disparity among benefit packages provided to employees across the County-funded agencies.
2. Should changes implemented in FY12 be part of a multi-year plan designed to achieve an explicitly stated policy goal, e.g., limiting benefit costs to a set percent of personnel costs; modeling County benefits after those of the federal government?	The CE states that his proposals to restructure employee benefits will reduce costs. The CE does not indicate how these changes fit into a long-term compensation policy.
3. Should there be a limit established on the increased costs of benefits shifted to employees in one year? Over time?	In FY12, under the CE's proposals, an employee will pay between $370 and $3,700 more for the same health insurance coverage. In addition, defined benefit plan members will be required to contribute an additional 2% of their salaries towards their pension.
4. Should a portion of the County's structural budget problem be addressed by changing the compensation package for new hires?	The CE's FY12 budget does not include any proposals for modifying either the salaries or the benefits for employees not yet hired.
Retirement/Pension Benefits	
5. When considering changes to retirement benefits, should the County seek equivalent savings from employees in the defined contribution plan, which currently costs the County substantially less than the defined benefit pension plans?	The CE's proposal would result in an annual 2% salary "loss" for all employees. Defined benefit plan members would contribute 2% more of their salary; RSP & GRIP plan members would lose a retirement account contribution equal to 2% of salary.
Health Insurance Benefits for Active Employees	
6. In total, what portion of health insurance benefit costs (medical, prescription drug, dental, and vision) should the County Government cover for its employees?	The CE's proposed changes to health insurance would reduce the overall share paid for by the County from about 80% to about 60% of the total cost in FY12.
7. Should all employees pay the same percent share of their health insurance costs? If not, should an employee's cost share vary by his/her: • Annual salary? • Level of coverage (e.g., single, family)? • Plan choice (e.g., HMO, POS)?	Under the CE's proposals, the actual cost share of health insurance paid by employees would range from 30% to 58% of the combined premium. Further, for most employees (because of the added salary-based premium), the CE's pricing results in higher cost shares paid by those enrolled in the least expensive health plans, i.e., single or HMO coverage.
8. Should the cost of health care to County Government retirees be more, less, or the same as that for active employees?	Today, most retirees pay a higher cost share than active employees. Under the CE's proposals, most active County employees would end up paying more than retirees for group insurance.

B. Summary of County Executive's Proposed Changes to Employee Benefits

The Executive proposes a series of modifications to County Government employee benefits. The table below summarizes the Executive's proposed changes and shows his estimated FY12 savings that would result from implementation of the proposal. The proposed changes, if implemented, would produce recurring savings in future years. The Executive recommends implementing all changes on July 1, 2011.

Table 1: Summary of Executive's Proposed Changes to County Government Employees' Benefits

Benefit Type	County Executive's Proposal	CE Estimated FY12 Savings
Retirement	**Pension (Defined Benefit) Plans.** Employees would contribute an additional 2% of salary towards their pensions.	$6,044,180
	Retirement Account (Defined Contribution[1]) Plan. The employer's contribution to employee retirement accounts would be reduced by 2%.	$4,860,290
Health (Medical/ Prescription/ Dental/Vision)	**Minimum 30% Cost Share.** Employees' cost share of medical, prescription drug, dental and vision insurance premiums would increase from a minimum of 20% to a minimum of 30%.	$8,229,530
	Additional Salary-Based Charge. Employees with an annual salary between $50,000 and $89,999 who enroll in a medical and/or prescription drug plan would pay an additional $910 per year. Employees with an annual salary of $90,000 and above who enroll in a medical and/or prescription plan would pay an additional $1,560 per year.	$7,418,000
Prescription Drug	**Generics.** Employees who buy a brand name drug when a generic equivalent is available would always pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent. Currently, this requirement is waived if a physician prescribes a brand drug and writes "dispense as written" on the prescription.	$1,200,000
	Lifestyle Drugs. The County would eliminate coverage for medications used to treat erectile dysfunction.	$400,000
	Mail-Order Copays. The copay for mail order prescriptions (up to a 90-day supply) would increase from one time to two times the copay for a 30-day supply purchased through a retail pharmacy.	$200,000
Life Insurance	**30% Cost Share and Benefit Level.** The life insurance benefit provided to all employees would be reduced from two times to one time annual salary. Employees' cost share would increase from 20% to 30% of premium.	$1,200,000
Long-Term Disability	**30% Cost Share.** Employees' cost share for long-term disability insurance would increase from 20% to 30% of premium.	$48,000

[1] In this memo, the term, "defined contribution" plan, includes both the Retirement Savings Plan (RSP) and the Guaranteed Retirement Income Plan (GRIP).

The next three pages provide further detail on the two proposed changes that would have the greatest effect on the cost of benefits to County Government employees: retirement and health insurance benefits.

1. Executive's Proposed Retirement Plan Changes

The County Government will pay $124 million (from tax supported and non-tax supported funds) for employee retirement benefits in FY11: $105 million for the defined benefit plan and $19 million for the defined contribution plan. Currently, the defined benefit and the defined contribution plans have approximately the same number of enrollees. While defined benefit plans are more generous to employees and cost the County significantly more than defined contribution plans, the Executive proposes that employees in both plan types forego identical amounts (2% of salary).

a. Defined Benefit Plans: The County Executive has proposed that all employees in a defined benefit plan contribute an additional 2% of salary annually. As shown in the table below, the impact of the Executive's proposal varies among different employee groups.

Table 2: Executive's Proposed Increases in Employee Defined Benefit Contributions

Employee Group	Current Employee Contribution (% of salary) [2]	CE Proposed Employee Contribution (% of salary)	% Increase in Employee Contribution
Non-Public Safety (hired before 10/1/94)	4%	6%	+50%
Police and Deputy Sheriff/Corrections	4.75%	6.75%	+42%
Fire & Rescue	5.5%	7.5%	+36%

b. Defined Contribution Plans: Currently, the County Government contributes 8% of salary into a retirement account for most employees in a defined contribution plan.[3] The Executive proposes reducing the employer contribution to 6% of salary, a 25% reduction in the employer's contribution. Unlike the proposed defined benefit changes, the Executive's defined contribution proposal would not reduce take home pay but would reduce the amount of money available upon retirement.

Table 3: Executive's Proposed Reduction in Annual Retirement Account Contributions

Employee Group	Current Employer Contribution (% of salary)	CE Proposed Employer Contribution (% of salary)	% Reduction in Employee Contribution
Non-Public Safety (hired after 10/1/94)	8%	6%	-25%
Non-Represented Public Safety (hired after 10/1/94)	10%	8%	-20%

[2] Employees in the ERS who earn more than the Social Security Wage Base ($106,800 in 2012) contribute a higher percentage toward their pensions for salary earned above the Social Security Wage Base.
[3] A small number of non-represented public safety employees participate in a defined contribution plan in which the employee contributes 3% of salary and the County contributes 10% of salary.

2. Executive's Proposed Health Insurance Benefit Changes

In FY11, the County Government will pay about $90 million (from tax supported and non-tax supported funds) for employee health (medical, prescription drug, dental, and vision) insurance premiums.

a. Proposed Cost Share Changes: Currently, County Government employees pay at least 20% of health benefit premiums.[4] The Executive proposes a new two-part health care pricing approach.

(1) All employees would pay at least 30% of medical, prescription drug (standard), dental, vision, life, and long-term disability insurance premiums; AND

(2) Most employees who enroll in a medical and/or prescription plan would pay an additional salary-based charge.

Table 4: Executive Recommended Changes to MCG Employee Health Benefit Cost Share

Salary Level	Percent of Workforce *	Current Minimum Employee Health Premium Contribution [4]	CE's Proposed Minimum Annual Employee Health Premium Contribution
Under $50,000	20%	20% of premium	30% of premium
$50,000 - $89,999	65%		30% of premium + $910
$90,000+	16%		30% of premium + $1,560

* Source: *Personnel Management Review*, Montgomery County Office of Human Resources, April 2011.

b. Actual Cost Share: If the Executive's proposals are implemented, employees will pay an actual cost share ranging from **30% to 58%** of the total combined premium for medical, prescription drug, dental, and vision coverage. Because the salary-based charge proposed by the Executive does not vary based on plan choice (e.g., HMO vs. POS) or level of coverage (e.g., single vs. family), employees subject to the added charge will pay a higher percent of the total premium if enrolled in a less expensive plan (e.g., single coverage, HMO plans).

Table 5: Employee Cost Share for Combined Health Insurance Premium*
Current vs. Executive's Proposal

Salary Level	% of Annual Premium Paid by Employee [5]	
	Current Range	Range Under CE's Proposal
Under $50,000	20% to 32%	30% to 37%
$50,000-$89,999		34% to 49%
$90,000+		37% to 58%

*Includes costs for medical, prescription, dental, and vision coverage using calendar year 2011 premium rates.

[4] Non-represented employees hired since 10/1/94 ("Select" plan members) pay 24% of premiums. Also, an employee who chooses the "high option" prescription plan pays an additional 8% of total health insurance premium costs.
[5] The highest employee cost share under current pricing and as proposed by the Executive reflects the cost of high option prescription coverage.

c. Cost Share Increases Translated into Dollars: The Executive's proposal will require County Government employees to pay more to retain their current health care coverage. Employees in a higher cost plan (e.g., Carefirst High Option POS) could mitigate their additional cost of health insurance by switching to a lower cost plan (e.g., Kaiser HMO).

The following table shows the dollar amount of employee health benefit cost under current practice and as proposed by the Executive. The table shows the range of increase in employee health costs if employees stay in their current choice of health and prescription drug plans. The data include costs for medical, prescription drug, dental, and vision coverage using calendar year 2011 premium rates.

Table 6: Annual Employee Health Insurance Premium Costs
Current vs. Executive's Proposal

Salary Level	Annual Employee Health Insurance Premium Costs*		
	Current Range	**Range Under CE's Proposal**	**Increase**
Under $50,000	$1,237 to $7,290	$1,855 to $8,587	$371 to $2,163
$50,000-$89,999		$2,765 to $9,497	$1,281 to $3,073
$90,000+		$3,415 to $10,147	$1,931 to $3,723

*Includes costs for medical, prescription, dental, and vision coverage using calendar year 2011 premium rates.

Currently, employees pay different costs for their health benefits based on their plan choices (e.g., HMO vs. POS, standard vs. high option) and level of coverage (e.g., single vs. family). The changes proposed by the Executive would continue price differentials based on plan choices and level of coverage, but would add an employee's annual salary as a factor that determines the actual cost share and dollar amount paid for health benefits. The final section of this memo (beginning on the following page) illustrates how the changes proposed by the County Executive would impact individual employees.

C. Impact on Employees – Illustrative Examples

This section provides five examples to illustrate the effects of the Executive's proposed retirement and health care benefits changes on five hypothetical employees at different salary levels as listed below.

Example	Job Title	Annual Salary	Salary-Based Health Care Charge Category
1	Ride On Bus Operator	$45,000	Under $50,000
2	Code Enforcement Inspector	$55,000	$50,000 - $89,999
3	Police Sergeant	$85,000	$50,000 - $89,999
4	Senior Information Technology Specialist	$95,000	$90,000 +
5	Assistant County Attorney III	$115,000	$90,000 +

The examples on the following pages show how the Executive's retirement proposal would increase employees' pension contribution costs (for defined benefit plan participants) or retirement account contributions (for defined contribution plan participants). For health care benefits, the examples illustrate the effects of the Executive's proposals on employees with either single or family coverage enrolled in a relatively low cost plan (Kaiser HMO) and enrolled in relatively high cost plans (Carefirst point of service medical combined with Caremark high option prescription).

In reviewing the examples, please note:

- All health care premium costs reflect Calendar Year 2011 rates.
- The cost changes assumes that the employees retain their current health care choices.
- Employee "actual" cost share includes combined health premium costs plus the additional salary-based charge for employees earning $50,000 or more.
- The County provides two different high option prescription plans with different premiums and copays. Employees represented by MCGEO or IAFF are offered a plan with $4 (generic) or $8 (brand) drug copays while FOP and non-represented employees are offered a plan with $5 and $10 copays.
- The examples shown on the following pages do not encompass all the possible combinations of health plan choices available to County Government employees. Table 5 of this memo (page 5) of this memo shows that if the Executive's proposed changes were implemented, employees would pay a cost share ranging from 30% to 58% of the total combined health insurance premium. The high end of this range, 58%, would apply to an employee earning $90,000 or more, who opts for single coverage in the United Healthcare HMO and the Caremark High Option prescription plan.

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:

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[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 examples 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.

Attachments	**Begins at**
Additional Information about Current Retirement Benefits, Office of Legislative Oversight Memorandum (March 2011)	©1
County Government and MCPS Data on Employee Recruitment, Hiring, and Turnover, Office of Legislative Oversight Memorandum (March 2011)	©14
Summary of Changes to State of Maryland Pension Plans, Office of Legislative Oversight	©19
Survey of Public Pension Benefits in Maryland, Bolton Partners, Inc. (August 2010)	©20
A Role for Defined Contribution Plans in the Public Sector by the Center for State and Local Government Excellence (April 2011)	©29
New Pension Math, Governing (April 2010)	©43
"States Want More in Pension Contributions," *The New York Times*, June 15, 2011	©44
"Amid Backlash and budget deficits, government workers' pensions are targets," *The Washington Post*, October 6, 2010	©47
Key Elements of State Hybrid Retirement Plans, National Association of State Retirement Administrators (November 2010)	©50

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.

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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.

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[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

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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*

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

* 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 <u>hypothetical employees</u> 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]

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[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.

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.

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[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%**

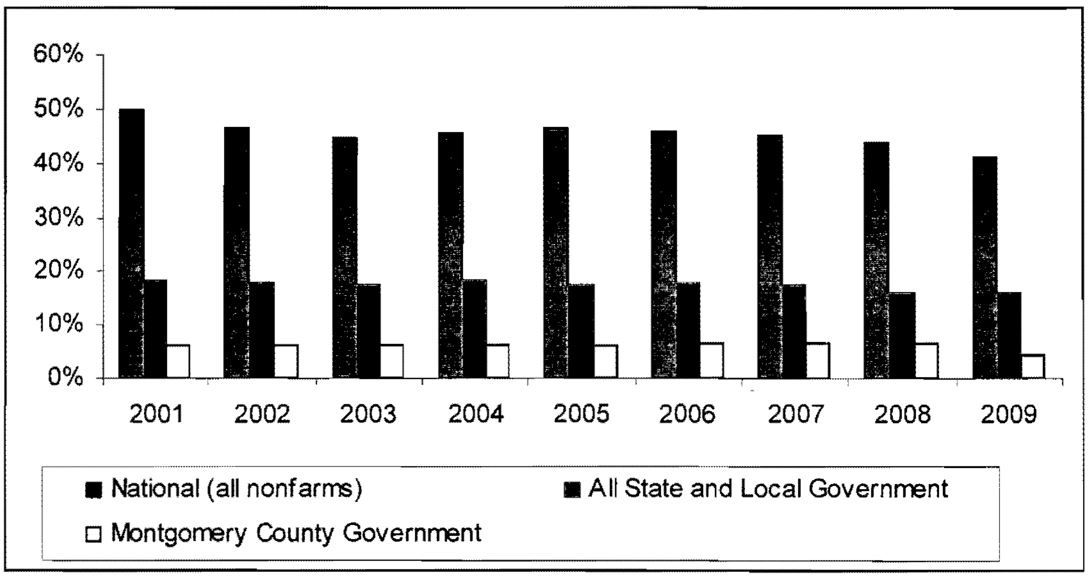
Source: MCPS Office of Human Resources and Development

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.)

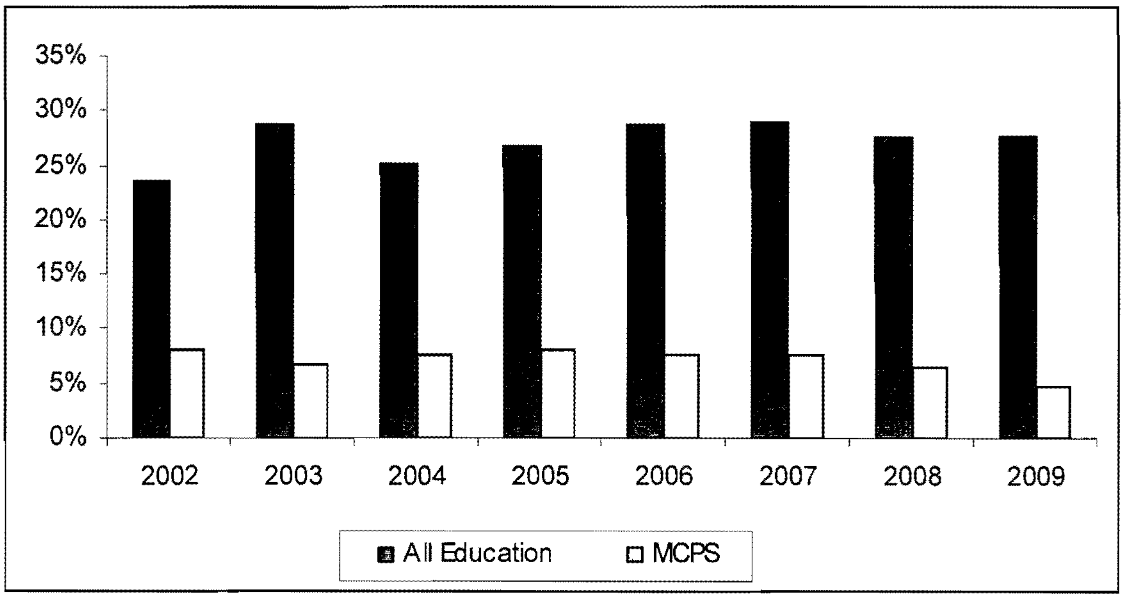
County Government Employee Turnover Rates, Voluntary and Retirement-Based, 2001-2009

	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

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	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

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Survey of Public Pension Benefits in Maryland

Ann M. Sturner, FSA

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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.

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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.

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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.*

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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

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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%

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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

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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

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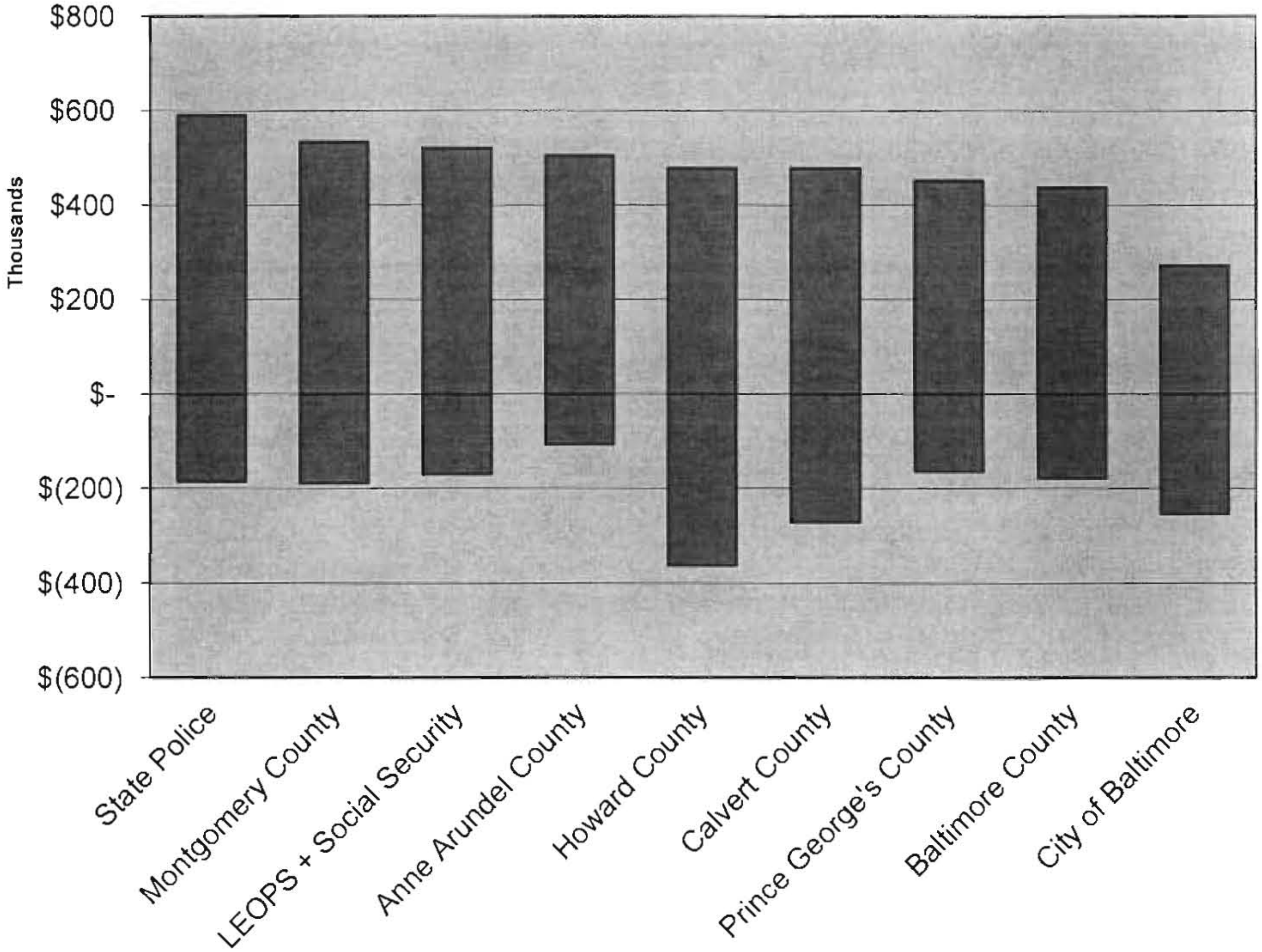
Value of Benefits at Retirement for Police Officers (Blue = Employer Provided, Red = Employee Provided)



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CENTER FOR STATE &
LOCAL GOVERNMENT
EXCELLENCE

ISSUE BRIEF

A Role for Defined Contribution Plans in the Public Sector

April 2011

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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.

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

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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.

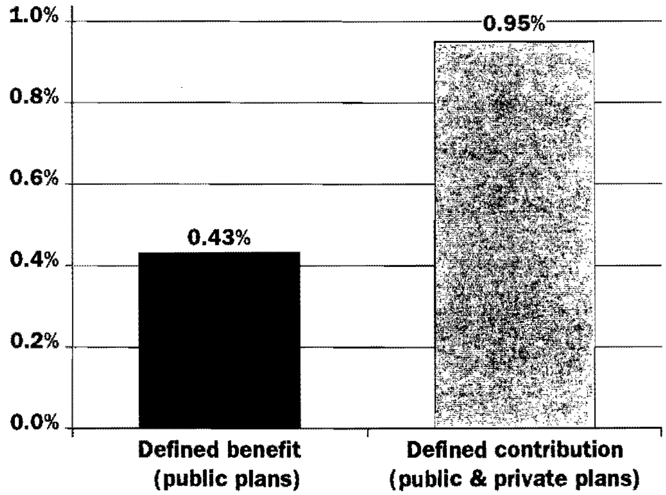
Costs

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. Transfer-

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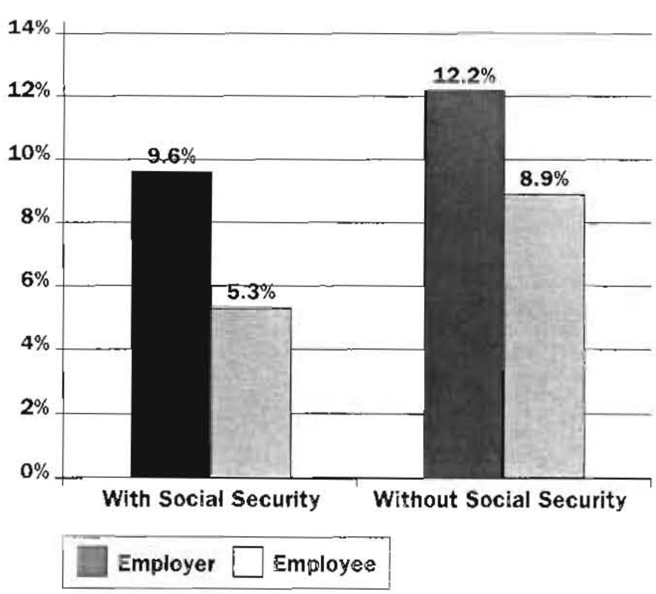
ring the burden to the employee provided a major economic incentive in the private sector to move from defined benefit plans (where employees make no contributions) to 401(k) plans (where employees make the bulk of the contributions). But, in the public sector, many employees already make substantial 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*



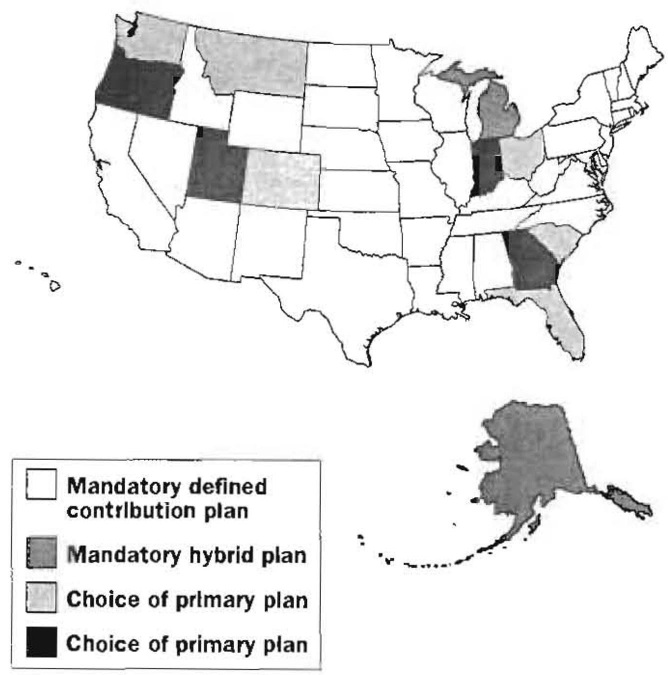
Source: Public Plans Database (2009).

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.

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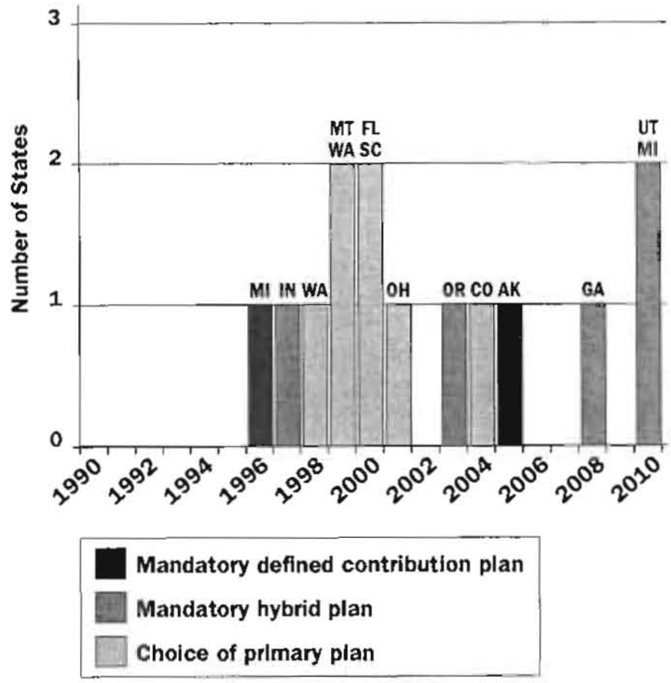
Figure 4. *Introduction of State Defined Contribution Plans, by Year*



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 only 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

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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.

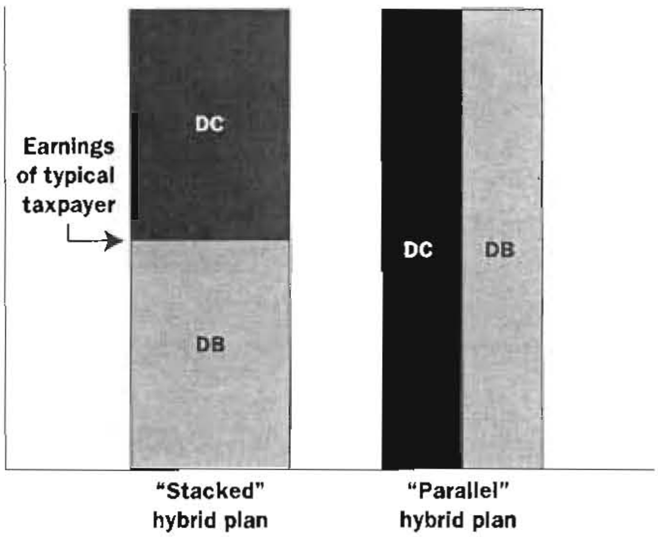
A Better Mousetrap?

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.

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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.

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Appendix. Primary Defined Contribution Plans

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

		Participants		Assets ($ in millions)	
Plan name	**Legislative date**	**2007**	**2009**	**2007**	**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).

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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.

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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

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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

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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."

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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

AGENDA ITEM #13
May 17, 2011

Worksession

MEMORANDUM

May 16, 2011

TO: County Council

FROM: Stephen B. Farber, Council Staff Director SBF
Karen Orlansky, KO Director, Office of Legislative Oversight

SUBJECT: Group Insurance and Retirement Benefits for All Agencies

At this worksession the Council will review two major benefits issues that affect FY12 and beyond. The first issue is **structural changes to employee group insurance and retirement benefits**. The discussion will focus on the Council's alternative to the Executive's proposal. See Council President Ervin's memo on ©1-19.

The second issue is **pre-funding retiree health benefits, or OPEB (Other Post Employment Benefits)**. The discussion will focus on ways to develop a more coherent and consistent approach for all County agencies. See Council President Ervin's memo on ©20-21.

The Council's proposal on group insurance and retirement benefits concentrates on the two largest tax supported County agencies, Montgomery County Government and Montgomery County Public Schools. The Council's continuing work on these issues will also include the two other tax supported agencies, Montgomery College and M-NCPPC.

The College has long had a more restrictive employer-employee premium split (75/25) than the other agencies, its plan design is also more restrictive, and it recently adopted a more restrictive policy on eligibility for retiree health benefits. In addition, College employees who participate in the State pension system will be affected by the State's recent changes to retirement benefits. M-NCPPC, a bi-county agency, is also reviewing its group insurance and retirement benefits. At the May 12 bi-county meeting the two Councils requested the Commission to "explore making changes...that are comparable to the two counties' changes."

On May 9 the Council supported a series of recommendations on compensation and benefits for all agencies made by the Government Operations and Fiscal Policy Committee. See ©22-23 for a summary of the Committee recommendations.[1] As the summary noted, final Council action on the issues under review at this worksession may affect the FY12 funding level of certain County retirement programs and non-departmental or other accounts. We will work with Executive staff to make whatever adjustments the Council's decisions require.[2]

The Government Operations and Fiscal Policy Committee will continue to take the lead as the Council reviews these issues. Assistance will also come from the Task Force on Employee Wellness and Consolidation of Group Insurance Programs. See ©24-26 for Council Resolution No.17-107, which established the task force.

Attachments	**Begins on**
Memorandum from Council President Ervin on Council's Alternative to the Executive's Proposal on Employee Benefits, 5/16/11	©1
Memorandum from Council President Ervin on Pre-funding Retiree Health Benefits, 5/16/11	©20
Summary memorandum from Council Staff Director Farber on Compensation and Benefits for All Agencies, 5/9/11	©22
Council Resolution No. 17-107, Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs, adopted 4/26/11	©24

[1] See http://montgomerycountymd.granicus.com/MetaViewer.php?view_id=6&clip_id=1329&meta_id=20516 for the complete packet.

[2] On May 5 the Government Operations and Fiscal Policy Committee unanimously approved a technical adjustment included in the Executive's April 25 budget adjustments. The adjustment is a cost decrease of $1,036,280 in the Employee Health Benefits Self-Insurance Fund. The decrease results from aligning the fund with proposed prescription drug plan design changes.

MONTGOMERY COUNTY COUNCIL
ROCKVILLE, MARYLAND

OFFICE OF THE COUNCIL PRESIDENT

MEMORANDUM

May 16, 2011

TO: County Council

FROM: Valerie Ervin, Council President

SUBJECT: **Council's Package: An Alternative to the Executive's Proposal on Employee Benefits**

The budget decisions before the Council this year pose difficult trade-offs. This Council is committed to balancing the budget while treating our valued public employees fairly and equitably, funding high priority services for our residents, protecting taxpayers, and taking decisive action to address the County's structural budget deficit.

Employee compensation accounts for the largest portion of agency spending. The Council's decisions regarding employee pay and benefits are some of the most significant ones before us this year. I commend the County Executive for addressing the rising cost of benefits by recommending changes to retirement and group insurance benefits for County employees in his FY12 Recommended Operating Budget. However, the Council's review of the Executive's proposal raised concerns about a number of his recommendations; specifically:

- The Executive's proposal disproportionately increased the cost of benefits paid by County Government employees, which further increased the disparity in benefit packages across agencies.
- The Executive's proposed July 1, 2011 implementation date for health benefit changes would have required a rushed (off-cycle) open season, disrupted employees' current year health plan choices, and caused abrupt and large reductions in take-home pay for most County Government employees.
- The Executive did not propose changes in the package of retirement and retiree health benefits offered to new hires, such as those adopted this year by the General Assembly for State-run plans.

On behalf of the Council, this memorandum presents a package of changes to employee benefits that addresses concerns raised about the Executive's proposal while producing savings from structural changes that exceed those identified by the Executive. The table below shows estimated FY12 and cumulative FY12-FY17 savings for the Council's package vs. the Executive's budget proposal.

Savings from Executive's Proposal vs. Council's Package

Executive's Proposal		Council's Package	
FY12	FY12-FY17	FY12	FY12-FY17
$29.60	$214.83	$33.15	$273.10

Specific characteristics of the Council's package are described below.

1. **Achieves greater equity among agency employees.** The Council's package proposes structural changes to employee benefits that reflect a more equitable sharing of costs beyond the cohort of County Government employees.

2. **Postpones implementation of all group insurance changes from July 1, 2011 to January 1, 2012.** This modification to the Executive's proposal avoids disrupting employees' current year health benefit plans and allows time for agency staff to plan for an unhurried open season this fall, adhering to the County's regular schedule. Employees will now have ample opportunity to study their alternatives and make informed choices.

3. **Mitigates the large group insurance cost increases proposed by the Executive for County Government employees and introduces a pricing incentive for lower cost plans.** In comparison to the Executive's proposal, the Council's package eliminates the salary-based surcharges, reduces the proposed premium cost share increases, and adopts incentive pricing for lower cost HMO plans, a proven cost containment practice already used by MCPS.

4. **Modifies the Executive's proposed design changes to the County Government's stand-alone prescription drug plan.** The Council's package maintains the current copay structure for mail-order drug purchases (to promote mail-order use) and directs the Executive to implement a program offered by CVS/Caremark that provides favorable copays for maintenance drugs purchased at CVS retail pharmacies. The Council's package also adds a waiver provision to the Executive's proposal regarding mandatory generic drugs and limits (as opposed to eliminate) coverage for drugs that treat erectile dysfunction.

5. **Follows the lead of the General Assembly to tighten the eligibility requirements and adjust the cost share for retiree health benefits for new hires.** The Council's package includes this structural change for new employees, hired on or after July 1, 2011. This change will reduce the County's OPEB liability beginning in FY13. In contract, the Executive did not propose changes to retiree health benefits for new hires.

6. **Reduces the impact on County Government employees who receive a defined contribution retirement benefit.** Recognizing that defined contribution retirement plans cost the County substantially less per employee than defined benefit plans, the Council's package applies the 2% reduction in the County's contribution to an employee's defined contribution retirement account <u>only in FY12</u>. This contrasts to the Executive's proposal, which would have reduced the County's contribution by 2% permanently.

7. **Follows the lead of the General Assembly in making structural changes to the defined benefit pension benefits, but phases in higher employee contributions over two years.** Similar to the changes adopted by the State, the Council's package modifies the cost-of-living adjustment provision for the County's defined benefit pension. The Council's package similarly adopts a 2% increase in employee contributions, but phases it in over two years. This year the General Assembly also changed the structure of the defined benefit pension for new hires. In June, the Council will consider changes to the structure of the County Government's defined benefit plan for new hires, to become effective by October 1, 2011.

8. **The Council fully recognizes that decisions regarding the benefits offered to MCPS employees are the Montgomery County Board of Education's to make**. The Council's package identifies the savings that would result if the Board of Education takes certain actions regarding the structure of employee retirement and health benefits. Specifically, the Council's package identifies savings associated with implementing changes to MCPS' locally-funded pension plans (Core and Supplement) that parallel those made by the State to the teachers' pension plan, and potential savings from adjusting the current 95/5 and 90/10 employer/employee health premium cost shares by five points.

The first attachment to this memo (©4-6) summarizes the FY12 and cumulative six-year savings (FY12-17) associated with each component of the Council's package compared to the Executive's budget proposal. Other attachments:

- Show year-by-year savings estimates for the Council's package and the Executives' proposal;
- Provide further details about the Executives' proposal and the Council's package; and
- Summarize actions required to implement the Council's package of changes to benefits for County Government employees.

Comparison of Executive's Proposal and Council's Package
Agency: County Government

GROUP INSURANCE

Implementation Date: Executive's estimates assumed July 1, 2011. Council assumes January 1, 2012

Benefit	Executive's Proposal	Council's Package	Savings ($ in millions)			
			Exec. Proposal		Council's Package	
			FY12	FY12-FY17	FY12	FY12-FY17
Health Insurance – Employee Cost Share	Increase from 80/20 to 70/30 for all medical, dental, vision, & standard prescription drug; add salary-based surcharge.	Keep HMOs at 80/20; change POS (Carefirst), dental, vision, & standard prescription drug plans to 75/25; eliminate salary-based surcharge.	$15.65	$120.72	$2.10	$30.29
Prescription Drug Coverage	Mandate the use of generic instead of brand name drugs when generic equivalent is available (or employee pays generic drug copay <u>plus</u> the difference between brand name and generic drug costs); eliminate coverage for erectile dysfunction medications.	Add waiver provision for medically necessary brand name drugs; limit (not eliminate) coverage for erectile dysfunction medications.	$1.60	$12.34	$0.70	$9.71
Prescription Drug Copays	Increase copay for mail-order prescriptions from one time to two times the copay for retail purchase.	Maintain current copays for mail-order prescriptions; add provision to allow purchase of maintenance drugs at CVS retail pharmacy for mail-order copay.	$0.20	$1.54	--	--
Life Insurance	Reduce coverage from two times to one time annual salary; increase cost share from 20% to 30% of premium.	Adopt Executive's proposal for coverage reduction; limit cost shift to 75/25.	$1.20	$9.26	$0.60	$8.66
Long-Term Disability	Increase cost share from 20% to 30% of premium.	Limit cost shift to 75/25.	$0.05	$0.37	$0.01	$0.09

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Comparison of Executive's Proposal and Council's Package
Agency: County Government (continued)

Benefit	Executive's Proposal	Council's Package	Savings ($ in millions)			
			Exec. Proposal		Council's Package	
			FY12	FY12-FY17	FY12	FY12-FY17
RETIREMENT Implementation Date: July 1, 2011						
Defined Contribution Retirement	Reduce employer's contribution by 2%.	Reduce employer contribution by 2% in FY12 only.	$4.86	$31.47	$4.86	$4.86
Defined Benefit - Employee Contribution	Increase employee contribution by 2%.	Phase in higher employee contribution; 1% in FY12, 2% in FY13 and beyond.	$6.04	$39.13	$3.02	$36.11
Defined Benefit - COLA Provision	No recommendation in Executive's FY12 budget.	Cap future COLAs for new hires and current employees (for years not yet served) at 2.5%.	--	--	$3.15	$18.90
Defined Benefit - New Hires	No recommendation in Executive's FY12 budget.	In June, consider changes to structure of defined benefit plan for employees hired on or after 10/1/11.	--	--	TBD	
RETIREE HEALTH Implementation Date: Changes apply to employees hired on or after July 1, 2011						
Retiree Health	No recommendation in Executive's FY12 budget.	Change eligibility and cost share for new hires.	--	--	Reduction in OPEB liability begins in FY13	
		COUNTY GOVERNMENT SUBTOTALS	**$29.60**	**$214.83**	**$14.45**	**$108.63**

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Council's Package
Agency: MCPS

The Council recognizes that decisions about MCPS employee benefits are the Board of Education's to make. As stated in his March 15 budget transmittal memo, the Executive recommended that all agencies adjust employee health insurance and retirement benefit structures "to promote equity among locally funded public employees." This page identifies savings that would result if the Board of Education takes action to modify employee benefit structures according to the examples described in the table below.

Benefit	Examples of Change	Savings ($ in millions)			
		Exec. Proposal		Council's Package	
		FY12	FY12-FY17	FY12	FY12-FY17
Health Insurance – Employee Cost Share	Beginning on January 1, 2012, change the employer/employee cost share for HMOs from 95/5 to 90/10; change the cost share for all other plans from 90/10 to 85/15.	--	--	$7.00	$91.06
Locally-Funded Defined Benefit Retirement: Core and Supplement	Change locally-funded pension plans (Core and Supplement) to parallel changes made by the State to the teachers' pension plan that increase employee contributions and cap future COLAs for new hires and current employees.	--	--	$11.70	$73.41
	MCPS SUBTOTALS	--	--	**$18.70**	**$164.47**

COMPARISON OF TOTAL SAVINGS
($ in millions)

	FY12	FY12-FY17
Executive's Proposal:	**$29.60**	**$214.83**
Council's Package:	**$33.15**	**$273.10**

Council's Package: Estimated Six-Year Savings (By Year)

($ in millions)

Retirement changes take effect on July 1, 2011
All group insurance changes take effect on January 1, 2012

Council's Package	FY12	FY13	FY14	FY15	FY16	FY17	6-Year
COUNTY GOVERNMENT							
Health Insurance – Employee Cost Share: Keep HMOs at 80/20; change POS (Carefirst), dental, vision, & standard prescription drug to 75/25; eliminate surcharge.	$2.10	$4.62	$5.08	$5.59	$6.14	$6.76	$30.29
Prescription Drug Coverage / Copays: Maintain current copays for mail-order prescriptions; add waiver provision for mandatory generic requirement; limit (not eliminate) coverage for erectile dysfunction medications.	$0.70	$1.47	$1.62	$1.79	$1.97	$2.16	$9.71
Life Insurance: Adopt CE proposal for coverage reduction; limit cost shift to 75/25.	$0.60	$1.32	$1.45	$1.60	$1.76	$1.93	$8.66
Long-Term Disability Cost Share: Limit cost shift to 75/25.	$0.01	$0.01	$0.01	$0.02	$0.02	$0.02	$0.09
Defined Contribution Retirement: Reduce employer contribution by 2% in FY12 only.	$4.86	$0.00	$0.00	$0.00	$0.00	$0.00	$4.86
Defined Benefit Retirement – Empl. Contribution: Phase in higher employee contribution; 1% in FY12, 2% in FY13 and beyond.	$3.02	$6.21	$6.39	$6.60	$6.82	$7.07	$36.11
Defined Benefit Retirement – COLA Provision: Cap future COLAs for new hires and current employees (for years not yet served) at 2.5%.	$3.15	$3.15	$3.15	$3.15	$3.15	$3.15	$18.90
Defined Benefit Retirement – New Hires: In June, consider changes to structure of defined benefit plan for employees hired on or after 10/1/11.	To be determined						
Retiree Health: Change eligibility and cost share for new hires	Reduction in the County's OPEB liability begins in FY13						
County Government Subtotals	**$14.45**	**$16.78**	**$17.70**	**$18.75**	**$19.86**	**$21.09**	**$108.63**
MCPS							
Health Insurance – Employee Cost Share: Decisions about MCPS employee benefits are the Board of Education's to make. See example of changes on page ©6.	$7.00	$14.47	$15.62	$16.86	$18.21	$18.90	$91.06
Defined Benefit Retirement (Locally-funded Core and Supplement Plans): Decisions about MCPS employee benefits are the Board of Education's to make. See example of changes on page ©6.	$11.70	$11.89	$12.09	$12.32	$12.57	$12.84	$73.41
MCPS Subtotals	**$18.70**	**$26.36**	**$27.71**	**$29.18**	**$30.78**	**$31.74**	**$164.47**
TOTALS	**$33.15**	**$43.14**	**$45.41**	**$47.93**	**$50.64**	**$52.83**	**$273.10**

Further Details of Council's Package

Implementation dates: All group insurance changes take effect on January 1, 2012. Retirement changes take effect on July 1, 2011.

Benefit Type	Council's Package	Comparisons to Executive's Proposal & General Assembly's Actions	Estimated FY12 Savings
County Government			
Health Benefits for Active Employees	**Premium Cost Share.** Adopt preferential pricing for lower cost plans by maintaining employee cost share at 20% for HMOs; and increasing employee cost share for the POS medical plan (CareFirst) as well as dental, vision, and stand-alone standard prescription drug plans from 20% to 25%. Maintain the current practice of allowing employees to "buy-up" and purchase high option prescription coverage.	The Council's package reduces the Executive's proposed cost share increase to employees, eliminates the salary-based surcharge, and adopts a cost containment strategy - already used by MCPS - of preferential pricing for lower cost HMOs.	$2,100,000
Prescription Drug (plan design changes)	**Coverage changes.** Employees who buy a brand name drug when a generic equivalent is available pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent, unless the physician supplies a letter of medical necessity. In addition, employees would receive limited coverage of erectile dysfunction drugs.	The Council's package moderates the Executive's proposal by including a generic drug waiver provision based on medical necessity and limiting (not eliminating) erectile dysfunction drug coverage. This modification results in a plan design that parallels MCPS' current practice.	$703,000
	Mail-Order Copays. Maintain the current copay for mail order prescriptions up to a 90-day supply (instead of increasing from one time to two times the copay for a 30-day supply purchased at a retail pharmacy). In addition, apply mail-order copay to direct purchase of long-term maintenance drugs (up to a 90-day supply) at CVS retail pharmacies.	The Council's package eliminates the Executive's proposal to double the copay for mail order prescriptions, and adds the provision on maintenance medication purchased at CVS retail pharmacies (not included by the Executive).	None
Life Insurance	**Cost Share and Benefit Level.** The life insurance benefit provided to all employees is reduced from two times to one time annual salary. Employees' cost share increases from 20% to 25% of premium.	This structural change in benefit level was proposed by the Executive; the Council's package reduces the Executive's proposed cost share increase to employees.	$600,000
Long-Term Disability	**Cost Share.** Employees' cost share for long-term disability insurance increases from 20% to 25% of premium.	The Council's package reduces the Executive's proposed cost share increase to employees.	$12,000

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Further Details of Council's Package (continued)

Benefit Type	Council's Package	Comparison to Executive's Proposal & General Assembly's Actions	Estimated FY12 Savings
Retirement: Defined Contribution Plan	**Defined Contribution**. The County reduces its contribution to employee retirement accounts from 8% to 6% in FY12 only.	The Council's package modifies the Executive's proposal by making the defined contribution reduction a one-time as opposed to a permanent change. MCGEO included this one-time change in its last best final offer.	$4,860,000
Retirement: Defined Benefit Plan	**Defined Benefit - employee contribution.** In FY12, employees contribute an additional 1% of salary towards their pensions; in FY13 employee contributions increase another 1% for a total of 2%.	The Council's package phases in the Executive's proposed increase of 2% in employee contributions over two years. This year, the General Assembly similarly increased employee contributions to State-run pension plans by 2%.	$3,022,090
	Defined Benefit - COLA provision. The County caps future COLAs for new hires and for current employees (for years not yet served) at 100% of CPI up to a maximum annual increase of 2.5%.	This year, the General Assembly adopted a reduced COLA provision for new hires and current employees (for years not yet served) who participate in the State-run pension plans. This structural change was not proposed by the Executive.	$3,150,000
	Defined Benefit – structure of benefit for new hires. In June, the Council will also consider changes to the structure of the defined benefit plan components (e.g., vesting period, pension formula) for new public safety hires, with the goal of having changes in place by October 1, 2011.	This year, the General Assembly adopted changes to the structure of the defined benefit pension for new hires enrolled in State-run pension plans. This structural change was not proposed by the Executive.	FY12 and future year savings will depend on changes adopted
Retiree Health Benefits	**Eligibility and Cost Share.** For employees hired after July 1, 2011, eligibility for retiree health benefits increases to a minimum of 10 years of service for a cost share of 50/50, and 25 years of service to receive the maximum cost share of 70/30. For each year of service in-between 10 and 25, the County's share increases 1.33%.	This year, the General Assembly adopted changes to retiree health eligibility and cost share. This structural change was not proposed by the Executive.	Reduction in the County's OPEB liability begins in FY13
		Subtotal: FY12 MCG Savings	$14.45 million

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Further Details of Council's Package (continued)

The Council recognizes that decisions about MCPS employee benefits are the Board of Education's to make. As stated in his March 15 budget transmittal memo, the Executive recommended that all agencies adjust employee health insurance and retirement benefit structures "to promote equity among locally funded public employees." This page identifies savings that would result if the Board of Education takes action to modify employee benefit structures according to the examples described in the table below.

Benefit Type	Examples of Change	Estimated FY12 Savings
Montgomery County Public Schools		
Health Benefits for Active Employees	**Premium Cost Share:** Employees' cost share for HMOs increases from 5% to 10%; employees' cost share for all other plans increases from 10% to 15%. This structural change assumes a continuation of MCPS' cost containment practice of preferential pricing for HMOs.	$7,000,000
Retirement: Locally-Funded Plans (Core and Supplement)	**Defined Benefit.** Board of Education adjusts pension benefits in the locally-funded Core plan to parallel changes made by the General Assembly to the State-run pension plans (increase employee contributions and cap future COLAs for new hires and current employees), and increases the employee contribution to the locally-funded Supplement to maintain the same proportion of employee contributions for the Supplement and for State and local Core plans. This structural change is consistent with the Board of Education's past practice of applying changes made by the State to the Teachers' Retirement/Pension Systems to the MCPS-run and locally-funded pension plans.	$11,700,000
	Subtotal: FY12 MCPS Savings	$18.70 million

COMPARISON OF TOTAL SAVINGS
($ in millions)

	FY12	FY12-FY17
Executive's Proposal:	**$29.60**	**$214.83**
Council's Package:	**$33.15**	**$273.10**

Examples of Health Benefit Changes for County Government Employees: Executive's Proposal vs. Council's Package

The table below summarizes the range of health cost increases to employees from the Council's package compared to the Executive's proposed health benefit changes.

- The Council's package maintains the HMO cost share at 80/20; increases the cost share for POS medical (Carefirst), dental, vision, and stand-alone prescription drug plans to 75/25; and eliminates the proposed salary-based surcharge.
- The Executive proposed shifting to a 70/30 cost share for all plans plus an additional salary-based surcharge.

Examples of FY12 Additional Cost to Employees from Health Benefit Changes Comparison of the Executive's Proposal to the Council's Package

Employee Salary	Increase to Health Benefit Costs from....	
	Executive's Proposal	Council's Package
$45,000	$400 to $2,359	$24 to $1,180
$55,000	$1,310 to $3,269	
$85,000	$1,310 to $3,269	
$95,000	$1,960 to $3,919	

To demonstrate the dollar impact on individual employees based on health plan choices, the tables beginning on the next page contain examples for the following four scenarios:

Example #1 – $45,000 annual salary with Kaiser HMO medical and prescription coverage;

Example #2 – $55,000 annual salary with Carefirst High Option POS and Caremark High Option prescription coverage;

Example #3 – $85,000 annual salary with United Healthcare HMO and Caremark High Option prescription coverage; and

Example #4 – $95,000 annual salary with Carefirst Standard POS medical and Caremark High Option prescription coverage.

Data Notes (applicable to both the summary comparison and the illustrative examples)

- All health insurance costs are based on projected 2012 premium rates (for medical, prescription, dental, and vision coverage) and assume employees stay in their current choice of plans.
- Cost to employees is calculated in pre-tax dollars. The reduction in take home pay would vary depending on the employee's income tax rate.
- The dollar increase and the "actual" employee cost share under the Executive's proposal include the salary-based surcharge (if applicable).

Example #1: Ride On Bus Operator
Annual Salary - $45,000

Medical & Prescription Plan: Kaiser HMO

Single Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical Prescription Drug	$1,237	$619	$0
Salary-based surcharge	*$0*	*$0*	*$0*
Dental	$86	$43	$22
Vision	$9	$5	$2
Health Benefit Total	**$1,332**	**$667**	**$24**
Employee "Actual" Cost Share	20%	30%	20%

Family Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical Prescription Drug	$3,662	$1,831	$0
Salary-based surcharge	*$0*	*$0*	*$0*
Dental	$276	$138	$69
Vision	$22	$11	$5
Health Benefit Total	**$3,960**	**$1,980**	**$74**
Employee "Actual" Cost Share	20%	30%	20%

Example #2: Code Enforcement Inspector
Annual Salary - $55,000

Medical Plan: Carefirst POS High Option / Prescription Plan: Caremark High Option 4/8

Single Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Curent Cost Share	Increase under Executive's Proposal	Increase under Council's Package
Medical	$1,204	$603	$301
Prescription Drug	$1,116	$160	$80
Salary-based surcharge	*$0*	*$910*	*$0*
Dental	$86	$43	$22
Vision	$9	$5	$2
Health Benefit Total	**$2,415**	**$1,721**	**$405**
Employee "Actual" Cost Share	27%	47%	32%

Family Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	Increase under Executive's Proposal	Increase under Council's Package
Medical	$3,508	$1,754	$877
Prescription Drug	$3,201	$456	$228
Salary-based surcharge	*$0*	*$910*	*$0*
Dental	$276	$138	$69
Vision	$22	$11	$5
Health Benefit Total	**$7,007**	**$3,269**	**$1,179**
Employee "Actual" Cost Share	27%	40%	32%

Example #3: Police Sergeant
Annual Salary - $85,000

Medical Plan: United Healthcare HMO / Prescription Plan: Caremark High Option 5/10

Single Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical	$1,027	$514	$0
Prescription Drug	$1,085	$160	$80
Salary-based surcharge	*$0*	*$910*	*$0*
Dental	$86	$43	$22
Vision	$9	$5	$2
Health Benefit Total	**$2,207**	**$1,632**	**$104**
Employee "Actual" Cost Share	28%	48%	29%

Family Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical	$3,140	$1,570	$0
Prescription Drug	$3,112	$456	$228
Salary-based surcharge	*$0*	*$910*	*$0*
Dental	$276	$138	$69
Vision	$22	$11	$5
Health Benefit Total	**$6,550**	**$3,085**	**$302**
Employee "Actual" Cost Share	28%	40%	29%

Example #4: Senior Information Technology Specialist
Annual Salary - $95,000

Medical Plan: Carefirst POS Standard Option / Prescription Plan: Caremark High Option 5/10

Single Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical	$1,344	$336	$56
Prescription Drug	$1,149	$96	$16
Salary-based surcharge	*$0*	*$1,560*	*$0*
Dental	$103	$26	$5
Vision	$11	$3	$0
Health Benefit Total	**$2,607**	**$2,021**	**$77**
Employee "Actual" Cost Share	31%	55%	32%

Family Coverage

Health Benefit	Projected FY12 Cost to Employee		
	Current Cost Share	**Increase under Executive's Proposal**	**Increase under Council's Package**
Medical	$3,915	$979	$163
Prescription Drug	$3,295	$273	$45
Salary-based surcharge	*$0*	*$1,560*	*$0*
Dental	$331	$83	$14
Vision	$26	$7	$1
Health Benefit Total	**$7,567**	**$2,902**	**$223**
Employee "Actual" Cost Share	31%	43%	32%

Examples of Health Benefit Changes for County Government Employees: Executive's Proposal vs. Council's Package

The table below summarizes the range of health cost increases to employees from the Council's package compared to the Executive's proposed health benefit changes.

- The Council's package maintains the HMO cost share at 80/20; increases the cost share for POS medical (Carefirst), dental, vision, and stand-alone prescription drug plans to 75/25; and eliminates the proposed salary-based surcharge.
- The Executive proposed shifting to a 70/30 cost share for all plans plus an additional salary-based surcharge.

Examples of FY12 Additional Cost to Employees from Health Benefit Changes
Comparison of the Executive's Proposal to the Council's Package

Employee Salary	Increase to Health Benefit Costs from….	
	Executive's Proposal	Council's Package
$45,000	$400 to $2,359	$24 to $1,180
$55,000	$1,310 to $3,269	
$85,000	$1,310 to $3,269	
$95,000	$1,960 to $3,919	

To demonstrate the dollar impact on individual employees based on health plan choices, the tables beginning on the next page contain examples for the following four scenarios:

Example #1 – $45,000 annual salary with Kaiser HMO medical and prescription coverage;

Example #2 – $55,000 annual salary with Carefirst High Option POS and Caremark High Option prescription coverage;

Example #3 – $85,000 annual salary with United Healthcare HMO and Caremark High Option prescription coverage; and

Example #4 – $95,000 annual salary with Carefirst Standard POS medical and Caremark High Option prescription coverage.

Data Notes (applicable to both the summary comparison and the illustrative examples)

- All health insurance costs are based on projected 2012 premium rates (for medical, prescription, dental, and vision coverage) and assume employees stay in their current choice of plans.
- Cost to employees is calculated in pre-tax dollars. The reduction in take home pay would vary depending on the employee's income tax rate.
- The dollar increase and the "actual" employee cost share under the Executive's proposal include the salary-based surcharge (if applicable).

Further Details of Executive's Proposal

Implementation date: Executive recommended that all benefit changes take effect on July 1, 2011.

Benefit Type	County Executive's Proposal	CE Estimated FY12 Savings
Health Benefits for Active Employees	**Minimum 30% Cost Share.** Employees' cost share of medical, prescription drug, dental and vision insurance premiums would increase from a minimum of 20% to a minimum of 30%.	$8,229,530
	Additional Salary-Based Charge. Employees with an annual salary between $50,000 and $89,999 who enroll in a medical and/or prescription drug plan would pay an additional $910 per year. Employees with an annual salary of $90,000 and above would pay an additional $1,560 per year.	$7,418,000
Prescription Drug Insurance (plan design changes)	**Generics.** Employees who buy a brand name drug when a generic equivalent is available would always pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent. Currently, this requirement is waived if a physician prescribes a brand drug and writes "dispense as written" on the prescription.	$1,200,000
	Lifestyle Drugs. The County would eliminate coverage for medications used to treat erectile dysfunction.	$400,000
	Mail-Order Copays. The copay for mail order prescriptions (up to a 90-day supply) would increase from one time to two times the copay for a 30-day supply purchased through a retail pharmacy.	$200,000
Life Insurance	**30% Cost Share and Benefit Level.** The life insurance benefit provided to all employees would be reduced from two times to one time annual salary. Employees' cost share would increase from 20% to 30% of premium.	$1,200,000
Long-Term Disability	**30% Cost Share.** Employees' cost share would increase from 20% to 30% of premium.	$48,000
Retirement	**Retirement Account (Defined Contribution) Plan.** The employer's contribution to employee retirement accounts would be reduced by 2%.	$4,860,290
	Pension (Defined Benefit) Plans. Employees would contribute an additional 2% of salary towards their pensions.	$6,044,180
	TOTAL FY12 MCG Savings	**$29.6 million**

Executive's Proposal: Estimated Six-Year Savings (By Year)

(in $ millions)

Executive recommends all benefit changes take effect on July 1, 2011

Executive's Proposed Changes	FY12	FY13	FY14	FY15	FY16	FY17	6-Year
COUNTY GOVERNMENT							
Health Insurance - Employee Cost Share: Increase medical, dental, vision, and stand-alone prescription drug employee cost share to minimum of 30%	$8.23	$9.05	$9.96	$10.95	$12.04	$13.25	$63.48
Additional Salary-Based Charge for Medical and/or Prescription Drug Plan Enrollment: Additional charge of $910/year for employees with annual salaries of $50,000 and above; $1,560/year charge for employees with salaries $90,000 and above	$7.42	$8.16	$8.98	$9.87	$10.86	$11.95	$57.24
Prescription Drug Coverage: Mandatory generics	$1.20	$1.32	$1.45	$1.60	$1.76	$1.93	$9.26
Prescription Drug Coverage: Elimination of erectile dysfunction drug coverage	$0.40	$0.44	$0.48	$0.53	$0.59	$0.64	$3.08
Prescription Drug Coverage: Doubling mail-order copay	$0.20	$0.22	$0.24	$0.27	$0.29	$0.32	$1.54
Life Insurance: Reduced coverage/increase to 30% cost share	$1.20	$1.32	$1.45	$1.60	$1.76	$1.93	$9.26
Long-Term Disability Cost Share: Increase to 30% cost share	$0.05	$0.05	$0.06	$0.06	$0.07	$0.08	$0.37
Defined Benefit Retirement: Additional employee contribution (2% of salary)	$6.04	$6.21	$6.39	$6.60	$6.82	$7.07	$39.13
Defined Contribution Retirement: Reduced employer contribution (2% of salary)	$4.86	$4.99	$5.14	$5.31	$5.49	$5.68	$31.47
TOTALS	**$29.60**	**$31.76**	**$34.16**	**$36.79**	**$39.68**	**$42.86**	**$214.85**

Actions Required to Implement the Council's Package for Changes to Montgomery County Government Employee Benefits

Benefit Type	Relevant Documents	Implementation Process
Group Insurance Benefits for Active Employees	Group insurance plan documents provided to employees Collective bargaining Agreements	**Council**: Include changes in the FY12 Budget Resolution **Executive**: Amend the group insurance plan document(s) provided to employees
Retirement Benefits	Retirement plan documents provided to employees County Code, Chapter 33, Article III (§ 33-34 to 33-61J)	**Council**: Amend the County Code **Executive**: Amend the retirement plan document(s) provided to employees
Retiree Health	Group insurance plan documents provided to employees Council Resolution No. 10-2233 (10/16/86) Council Resolution No. 14-1168 (3/5/02)	**Council**: Adopt Council resolution **Executive**: Amend the group insurance plan document(s) provided to employees

MONTGOMERY COUNTY COUNCIL
ROCKVILLE, MARYLAND

OFFICE OF THE COUNCIL PRESIDENT

MEMORANDUM

May 16, 2011

TO: County Council

FROM: Valerie Ervin, Council President

SUBJECT: Pre-funding Retiree Health Benefits

Starting in 2003, the Council has focused on the importance of pre-funding retiree health benefits, or OPEB (Other Post Employment Benefits). Actuarial advisers for the four County tax supported agencies have estimated the total liability associated with providing these benefits for current and future retirees at $3.6 billion. As both health care costs and the number of retirees continue to rise sharply, the agencies will not be able to cover the annual expense on a pay-as-you-go basis, as they have done to date.

To meet the Annual Required Contribution (ARC) needed to meet future obligations, pre-funding through a trust vehicle is essential. The agencies have all established retiree health benefits trusts, but the severe fiscal pressures of the past several years have sharply restricted funding for the trusts. For FY08 the Council set a five-year schedule for the agencies to phase in their pre-funding and budgeted $31.9 million for the first year. For FY09, in view of growing fiscal pressures, the Council extended the phase-in schedule to eight years. For FY10 the only tax supported OPEB appropriation was $12 million for MCPS. For FY11, an extremely difficult year, there was no tax supported contribution for any agency.[1]

For FY12 the Executive proposed to resume tax supported funding at a total level of $49.8 million: $26.1 million for County Government, $20.0 million for MCPS, $1.0 million for Montgomery College, and $2.7 million for M-NCPPC. This funding would represent a start toward returning to a clear phase-in schedule for all agencies.

[1] If the County had followed the five-year phase-in schedule that was approved four years ago, the total FY11 tax supported contribution for all four agencies would have been $149 million. Non-tax supported contributions from proprietary funds and participating outside agencies, however, have consistently been made. On May 9 the Council supported $12.1 million in FY12 funding for this purpose.

Based on the Council's recent discussions of this issue, I suggest two steps:

First, to provide a more coherent and consistent approach to pre-funding retiree health benefits starting in FY12, I will introduce legislation to enable MCPS and Montgomery College to participate in a consolidated County retiree health benefits trust.[2] Many jurisdictions, including Baltimore, Frederick, and Howard County, have adopted a consolidated approach to achieve economies in administration and investment of funds, including lower fees and access to investment managers with minimum asset requirements. Such an approach will also make the Council's annual OPEB funding decisions clearer and more transparent. This will benefit both the agencies and their retirees.

Second, I suggest that we place the proposed FY12 OPEB contributions for MCPS ($20.0 million) and the College ($1.0 million) in separate County Government Non-Departmental Accounts, one on behalf of each agency, for transfer to the consolidated trust after the bill has been enacted.

I believe that these steps will help all agencies meet their commitments to their retirees in a fiscally responsible way.

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[2] The legislation would provide representation on the consolidated trust's governing board and would base each agency's share of trust assets on its contributions and on earnings on the contributions. The existing trusts of both agencies would continue to be a source of future funding of retiree health benefits. Since M-NCPCC is a bi-county agency, its participation would require collaboration with Prince George's County.

AGENDA ITEM #6
May 9, 2011

MEMORANDUM

May 5, 2011

TO: County Council

FROM: Stephen B. Farber, Council Staff Director SBF

SUBJECT: **Action** – Compensation and Benefits for All Agencies

This memo outlines recommendations on compensation and benefits made by the Government Operations and Fiscal Policy Committee on May 5. For ease of reference, the updated packet from the April 25 Committee briefing is attached to this memo. Since the Committee is still working on health and retirement benefit issues, the recommendations in these areas are not yet complete.

1. FY12 Pay Changes (see pages 1-5)

The Committee reviewed the FY12 budget and compensation context on pages 1-3. The Committee also reviewed the information on pay changes in the region on pages 3-4, including the original agency pay change requests outlined on page 5. (Pay changes at WSSC and M-NCPPC will be reviewed with the Prince George's County Council at the bi-county meeting on May 12.) **Committee recommendations:**

- In view of the County's severe fiscal constraints, do not support General Wage Adjustments (COLAs) or service increments (step or merit increases) for any agency in FY12.[1]

- For MCG, approve the proposed FY12 salary schedules listed on ©34-46. These schedules are (in order) for Non-Represented Employees (General Salary Schedule), Management Leadership Service, Medical Doctors, Seasonal Workers, MCGEO, Sheriff Management, Deputy Sheriffs, Fire/Rescue Management, IAFF, Police Management, FOP, Correctional Management, and Correctional Officers.

2. FY12 County Government Retirement Program (see page 6)

The Committee reviewed a range of issues concerning the MCG retirement program, including the actuarially determined County contribution to the defined benefit Employees' Retirement System (ERS) and the amount for the defined contribution Retirement Savings Plan (RSP) and the cash balance plan (GRIP). The Committee also reviewed the budgets of the Deferred Compensation Plan, the Retiree Health Benefits Trust, the ERS, and the RSP. **Committee recommendations:**

[1] For County Government (MCG), the arbitrated awards for the FOP, IAFF, and MCGEO do not include GWAs. The FOP award alone includes a 3.5% step increase that would cost $1.4 million. The total cost of a step increase for all tax supported agencies would be $36.5 million: $5.6 million for MCG, $28.0 million for MCPS, $2.0 million for MC, and $0.9 million for M-NCPPC.

- Approve the recommended FY12 County contribution of $104.1 million for the ERS, $10.8 million for the RSP, and $3.0 million for the GRIP, **subject to the Council's final action on the Executive's retirement proposals.**

- Approve the FY12 budgets of the four plans on ©23.

3. FY12 County Government Compensation-Related NDAs (see page 7)

The Committee reviewed six Non-Departmental Accounts, as outlined on page 7 and ©47-50. **Committee recommendations:**

- Approve the first three NDAs, which reflect annual County obligations: Judges' Retirement Contribution ($3,000), State Positions Supplement ($77,270), and State Retirement Contribution ($1,081,690).

- Approve the Group Insurance for Retirees NDA ($32,462,450), **subject to the Council's final action on the Executive's group insurance proposals.**

- Approve the Compensation and Employee Benefits Adjustment NDA ($1,030,850), **subject to the Council's final action on the Executive's group insurance and retirement proposals.**

- Approve the Retiree Health Benefits Trust NDA ($26.1 million) for the General Fund, **subject to the Council's final action on the agencies' pre-funding contributions (OPEB).** Approve the non-tax supported contributions from proprietary funds and outside participating agencies ($12.1 million) outlined on ©18.

4. FY12 Group Insurance (see pages 7-10)

The Committee reviewed the Executive's proposed group insurance changes and related issues outlined on pages 7-10. **Committee recommendations**:

- Support the normal start date of January 1, 2012 (rather than July 1, 2011) for the next group insurance plan year. Also support the principle of equitable treatment of all agencies' employees in the design of any changes to current plans.

When the Committee has completed its review of group insurance issues, it will decide whether to support (1) the Executive's proposed agency OPEB contributions (in addition to $26.1 million for MCG): $20.0 million for MCPS, $1.0 million for MC, and $2.7 million for M-NCPPC; and (2) the recommended funding for the MCG Employee Health Benefits Self Insurance Fund ($191,567,580) and for the other agencies' requests for both active employees and retirees outlined on page 10.

5. Other Compensation Issues (see pages 10-12)

The Committee discussed the personnel management reviews and similar reports prepared by the agencies. The Committee also reviewed funding requests for the agencies' FY12 employee awards and tuition assistance programs. **Committee recommendation:**

- Approve the requests outlined on page 12 of the April 25 packet as a ceiling.

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Resolution No.:	17-107
Introduced:	April 12, 2011
Adopted:	April 26, 2011

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Councilmember Leventhal, Councilmember Elrich, Council President Ervin, Councilmember Navarro, Councilmember Berliner, Councilmember Rice, and Councilmember Riemer

SUBJECT: Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs

Background

1. The Council has historically provided strong support for the employee group insurance programs of the five County and bi-County agencies: Montgomery County Government, Montgomery County Public Schools, Montgomery College, the Maryland-National Capital Park and Planning Commission, and the Washington Suburban Sanitary Commission. The Council has also encouraged multiple measures to reduce costs. The Council recognizes that for the two bi-County agencies, M-NCPPC and WSSC, coordination with Prince George's County is required.

2. On December 9, 2003 the Council adopted Resolution No. 15-454, Policy Guidance for Agency Group Insurance Programs. The resolution endorsed a series of cost-reduction proposals made by the Council's 2003 Task Force on Health Benefit Improvements and by the Council's actuarial consultant, Bolton Partners. The agencies have followed through in several areas. For example, to achieve economies of scale, the agencies have jointly bid components of their group insurance programs. For new contracts that took effect on January 1, 2011, all five agencies jointly bid their medical, dental, vision, and life insurance programs.

3. Efforts to further contain increases in group insurance costs must remain a high priority The combined FY11 group insurance budgets for all agencies (excluding WSSC) total $393.6 million, $314.6 million for active employees and $79.0 million for retired employees. (Funding for retired employees is the annual pay-as-you-go amount only and does not include the much larger cost of pre-funding these benefits.) These costs are projected to continue to rise significantly in future years. The County Executive's FY12 Recommended Operating Budget projects that costs could increase an average of 10 percent annually through FY17.

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4. The Cross-Agency Resource-Sharing (CARS) Committee, established in 2010, included employee benefits in its review of potential cost savings. Three components under review by a CARS subcommittee address consolidation and streamlining of agency group insurance programs:

   - Consolidate agency employee benefit plan offerings under fewer vendors;
   - Consolidate the offerings under one administrative unit; and
   - Consolidate the offerings under a uniform plan design.

5. The CARS subcommittee estimates that the potential annual savings from the first component is $2-4 million, depending on the degree of consolidation. The second and third components have the potential for additional savings, also depending on how they are constructed and implemented. One example of current agency consolidation is the Montgomery County Self-Insurance Program, which is administered by the Finance Department. The program provides comprehensive property and casualty insurance for the County and participating agencies and is funded through actuarially determined contributions they provide.

6. The Council strives to improve the health of all residents of Montgomery County and believes that health care plans should not just focus on how an employee's health care costs are paid for but how our health plans and programs can be used to improve the health and well-being of our employees. In addition, experts have told the Council that the cost of providing health care can also be reduced by increasing employee wellness, which will decrease the dollars needed for treatment and medications.

Action

The County Council for Montgomery County, Maryland approves the following resolution:

Access to affordable health care for all employees and all residents of Montgomery County is a primary goal of the Council.

A Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs is established by the Council to identify as much cost containment in employee health coverage as possible.

1. Members of the Task Force will include, but are not limited to, representatives from County Government's Office of Human Resources and Department of Health and Human Services, Montgomery County Public Schools, Montgomery College, M-NCPPC, WSSC, and bargaining unit representatives from the County and bi-County agencies. The Council will also seek members who are public health experts and representatives from County businesses with employee wellness programs. The Council will appoint a Chair and Vice Chair.

2. The Task Force will submit a report to the Council not later than November 1, 2011. The report should contain a plan including:

   a. A review of employee wellness programs currently in place in County and bi-County agencies.

   b. Information on models of employee wellness programs in both the public and private sector, including the success and outcomes of programs and whether there is evidence that health care costs have been reduced over time.

   c. Recommendations for establishment of or improvements to employee wellness programs in the County and bi-County agencies. These recommendations should be developed in a framework that minimizes administration and the number of vendors that might be required.

   d. A comparison of the major provisions/benefits of the health plans currently offered to employees and retirees and an analysis of why costs may vary.

   e. Recommendations on how to streamline and reduce the current cost of administration, including how to:
      - Consolidate agency employee benefit plan offerings under fewer vendors;
      - Consolidate the offerings under one administrative unit; and
      - Consolidate the offerings under a uniform plan design.

   f. Recommendations regarding other cost containment strategies and options.

In order to best use the time and expertise of Task Force members, the Task Force may be organized into committees to focus separately on the issues of: (1) employee wellness and disease prevention programs, and, (2) consolidation of plan design and administration.

If, in its November 1 report, the Task Force identifies issues requiring further study, the Council may extend the time for the Task Force to conclude its work.

The Council acknowledges that employee benefits are subject to bargaining for each bargaining unit.

This is a correct copy of Council action.

Linda M. Lauer

Linda M. Lauer, Clerk of the Council

GO Committee #1
May 5, 2011

MEMORANDUM

May 3, 2011

TO: Government Operations and Fiscal Policy Committee

FROM: Office of Legislative Oversight, Budget Project Team
Karen Orlansky, Aron Trombka, Craig Howard, Leslie Rubin & Sarah Downie

SUBJECT: **County Executive's FY12 Recommended Budget:**
Follow-up: Proposed Changes to County Government Employees' Retirement, Health, and Life Insurance Benefits

This memorandum provides follow-up information related to the GO Committee's discussion (4/25/11) of the County Executive's proposed changes to retirement, health insurance, and life insurance benefits for County Government employees. It also includes OMB's explanation of the Executive's FY12 Budget Adjustment (transmitted 4/26/11) related to proposed prescription drug plan changes.

Committee members are asked to bring GO Committee #3, 4/25/11. Copies are available from OLO's office or at http://www.montgomerycountymd.gov/content/council/pdf/agenda/cm/2011/110425/20110425_GO3.pdf

The information in this memo is organized as follows:

A. Action Item: Executive Recommended Budget Adjnstment

The Executive's package of FY12 recommended budget adjustments includes a cost decrease of $1,036,280 in the Self-Insurance Fund. This cost decrease results from three proposed prescription drug plan design changes – mandatory generics, increased copays for mail order drugs, and eliminating coverage for lifestyle drugs. (For descriptions of these proposed changes, see GO Committee #3, 4/25/11, page 22.)

OMB reports that this budget adjustment is a technical change to the FY12 recommended budget for the Health Insurance Self-Insurance Fund to align that budget with the savings from prescription design changes. This budget adjustment does not change the savings estimated by the County Executive from the prescription drug plan design changes in his FY12 Recommended Budget ($1.8 million out of the total $29.6 million in compensation-related savings).

The March 15th budget for the Self-Insurance Fund was based on an October multi-year valuation from the County's actuaries and therefore did not reflect the prescription plan design changes. Revised multi-year actuarial projections that reflect the plan design changes were not obtained until after March 15th.

The value of the budget adjustment ($1.036 million) is different from the Executive's original savings estimates for the prescription drug changes ($1.8 million). This is because the budget adjustment ($1.036 million) measures the savings from the prior year's approved total, i.e., the difference in the FY12 recommended total for prescription drugs vs. the FY11 approved total for prescription drugs. The Executive's March 15th savings estimate ($1.8 million) measures the difference in the FY12 recommended total for prescription drugs vs. the projected FY12 total if no changes were made.

Staff recommends approval of this budget adjustment.

B. Savings Estimates of Alternatives

This section provides fiscal impact information that OLO received since the April 25th worksession.

1. Retiree Health Benefits

The Executive's Recommended FY12 Budget did not propose any changes to retiree health benefits. For the two alternatives included in the packet (GO Committee #3, 4/25/11, pages 18-19), OLO had requested estimates from the County's actuary (Aon) for savings that would result from applying these alternatives to all employees hired on or after July 1, 2011.

County actuaries calculate an Annual Required Contribution or "ARC" that the County would have to set aside to fully fund the County's OPEB liability for current and future retirees. The current ARC of approximately $156 million includes a pay-as-you-go portion (approximately $32.5 million) plus a pre-funding portion (approximately $123.5 million). The Executive's Recommended Budget includes $32.5 million in pay-as-you-go funding and $26.1 million in OPEB pre-funding for FY12.

Aon reports that neither alternative would provide any savings in pay-as-you-go costs (i.e., the amount the County pays each year to provide retiree health benefits in that year). However, each alternative would reduce the County's overall future OPEB liability beginning in FY13, the first year after adoption of the change.

Alternative #1. Changing Eligibility Requirements for New Hires. Aon estimates that the OPEB savings (i.e., a reduction in the overall OPEB liability) under this alternative would be 1% in FY13, and the percent savings would gradually increase each year as new hires accrue more years of service. Based on the County Government's current OPEB annual required contribution of $123.5 million (excluding the pay-as-you-go portion), this alternative would reduce that amount by about $1.2 million in FY13 and progressively higher amounts in future years.

Alternative #2. Eliminate Retiree Health Benefits for New Hires. Aon estimates that the OPEB savings (i.e., a reduction in the overall OPEB liability) under this alternative would be 3.8% in FY13, and the percent savings would gradually increase each year as new hires accrue more years of service. Based on the County Government's current OPEB annual required contribution of $123.5 million (excluding the pay-as-you-go portion of the recommended contribution), this alternative would reduce that amount by about $4.7 million in FY13 and progressively higher amounts in future years.

2. Prescription Drug Plan Design

On April 25th, OLO had outlined two alternatives to the Executive's proposals for a mandatory generic requirement with no exceptions and to eliminate coverage for lifestyle ED drugs. (GO Committee #3, 4/25/11, page 26)

Alternative #1. Add Strict Waiver Provision to the Executive's Mandatory Generic Requirement: Caremark estimates that adding a letter of medical necessity waiver provision, as is done in MCPS' Caremark prescription plan, would reduce the estimated savings from this mandatory generic change by up to 5%. This alternative would reduce the Executive's estimated $1.2 million in FY12 savings to approximately $1.14 million, a $60,000 decrease.

Alternative #2. Limit Coverage for Lifestyle Drugs: Caremark estimates that limiting coverage of medications that treat erectile dysfunction to six doses per month, as is done in MCPS' Caremark prescription plan, would reduce the estimated savings from this change by one-third. This alternative would reduce the Executive's estimated $400,000 in FY12 savings to approximately $266,000, a $134,000 decrease.

3. Life Insurance

The Executive's proposed changes to basic life insurance benefits would reduce the benefit level for most County Government employees (from two times to one time annualized salary) and change the cost share split to achieve an estimated $1.2 million in FY12 savings. OLO had described one alternative to the Executive's proposal, which was to keep the life insurance benefit at twice an employee's salary. (GO Committee #3, 4/25/11, page 36)

Alternative: Keep Life Insurance Benefit at Two Times Annualized Salary. OHR staff report that the estimated savings from life insurance changes only reflects the change in coverage from two times to one time salary. The estimate does not include savings from the proposed cost share change as those savings would likely be canceled out by other factors. As a result, this alternative would eliminate the Executive's estimated $1.2 million in FY12 savings.

C. Additional Information Requested by Councilmembers

At the GO Committee's April 25th session, Committee members asked staff to provide additional information relating to employee benefits. This section responds to Committee members' information requests.

1. Retirement

a. Defined Benefit Plan Provisions

The GO Committee requested that OLO provide details on current and potential alternative plan provisions for County Government defined benefit plans. The table on the next page summarizes pension plan provisions for the groups in the Employees' Retirement System. The table on pages 5-7 compares current plan provisions to the changes proposed by the County Executive (2% increased employee contribution) and by OLO's alternatives (GO Committee #3, 4/25/11, pages 13-15).

Summary of the County Government Employees' Retirement System (ERS) Provisions for Employees Hired after June 30, 1978 (Mandatory Integrated Plan)

Employee Group	Employee Contribution (% of salary)	Vesting	Average Final Salary	Full Retirement	Early Retirement	Multiplier	COLAs
Mandatory Integrated (employees hired after June 30, 1978)							
Non-public safety hired pre-10/1/94	4% up to SSWB 6% over SSWB	5 years	Highest 36 consecutive months	30 years svc./55 y.o. 5 years svc./60 y.o.	50 y.o./15 years svc. 45 y.o./20 years svc.	Pre-SSRA: 2.0 At SSRA: 1.25	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees
Deputy Sheriff Corrections	4.75% up to SSWB 8.5% over SSWB	5 years	Highest 36 consecutive months	25 years svc./46 y.o. 15 years svc./55 y.o.	45 y.o./15 years svc. 41 y.o./20 years svc.	Pre-SSRA: 2.4 for yrs. 1-25 (2.0 for yrs. 26-31) At SSRA: 1.65	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees
Police	4.75% up to SSWB 8.5% over SSWB	5 years	Highest 36 consecutive months	25 years svc./any age 15 years svc./55 y.o.	45 y.o./15 years svc. 41 y.o./20 years svc.	Pre-SSRA: 2.4 At SSRA: 1.65	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees
Fire and Rescue	5.5% up to SSWB 9.25% over SSWB[1]	5 years	Highest 36 consecutive months	20 years svc./any age 15 years svc./55 y.o.	n/a	Pre-SSRA: 2.5 for yrs. 1-20 (2.0 for yrs. 21-31 yrs.) At SSRA: 1.71875 for yrs. 1-20 (1.375 for yrs. 21-31)	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees

[1] At 25 years, 4.75% up to SSWB; 8.5% over SSWB

Summary of FY12 Pension Alternatives for Montgomery County's ERS Mandatory Integrated Plan (for employees hired after June 30, 1978)

	Current	Alternative	Employees Affected: Current	Employees Affected: Hired after June 30, 2011
Non-public Safety Employees Hired pre-10/1/94				
Employee Contribution	4% up to Social Security Wage Base (SSWB) 6% over SSWB	6% up to SSWB 8% over SSWB	✓	✓
Vesting	5 years	10 years		✓
Average Final Salary	Highest 36 consecutive months	Highest 5 consecutive years		✓
Cost-of-Living Adjustment	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees	1. 100% of CPI up to a maximum annual increase of 2.5%; or 2. 100% of CPI: • Up to 2.5% if the County Government meets its annual investment return assumption (7.5%); or • Up to 1% if the investment return assumption not met.	✓	✓
Police; Deputy Sheriff; Corrections Employees				
Employee Contribution	4.75% up to SSWB 8.5% over SSWB	6.75% up to SSWB 10.5% over SSWB	✓	✓
Vesting	5 years	10 years		✓
Average Final Salary	Highest 36 consecutive months	Highest 5 consecutive years		✓
Cost-of-Living Adjustment	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees	1. 100% of CPI up to a maximum annual increase of 2.5%, or 2. 100% of CPI: • Up to 2.5% if the County Government meets its annual investment return assumption (7.5%); or • Up to 1% if the investment return assumption not met.	✓	✓
Multiplier	**Deputy Sheriff/Corrections** Pre-Social Security Retirement Age (SSRA): 2.4 for yrs. 1-25 (2.0 for yrs. 26-31) At SSRA: 1.65 **Police** Pre-SSRA: 2.4 up to 36 yrs. At SSRA: 1.65	Pre-SSRA: 2.2 At SSRA: 1.65		✓

Summary of FY12 Pension Alternatives for Montgomery County's ERS Mandatory Integrated Plan (for employees hired after June 30, 1978) (cont.)

	Current	Alternative	Employees Affected: Current	Employees Affected: Hired after June 30, 2011
Fire and Rescue Employees				
Employee Contribution	5.5% up to SSWB 9.25% over SSWB	7.5% up to SSWB 11.25% over SSWB	✓	✓
Vesting	5 years	10 years		✓
Average Final Salary	Highest 36 consecutive months	Highest 5 consecutive years		✓
Cost-of-Living Adjustment	100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%; no cap over age 65 or for disabled retirees	1. 100% of CPI up to a maximum annual increase of 2.5%, or 2. 100% of CPI: • Up to 2.5% if the County Government meets its annual investment return assumption (7.5%); or • Up to 1% if the investment return assumption not met.	✓	✓
Multiplier	Pre-SSRA: 2.5 for yrs. 1-20 (2.0 for yrs. 21-31) At SSRA: 1.71875 for yrs. 1-20 (1.375 for yrs. 21-31)	Pre-SSRA: 2.2 At SSRA: 1.65		✓
Minimum Service for Full Retirement	20 years	25 years		✓

Source: Montgomery County Code

b. Savings from Changes to MCPS' Locally-Funded Pension System

The GO Committee requested information on the savings that would result from implementing changes to MCPS' locally-run and locally-funded pension system that correspond to pension plan changes recently adopted by the General Assembly for the Teachers' Retirement System. The Council's actuarial advisor, Thomas Lowman of Bolton Partners, estimates that MCPS could expect savings of approximately $9 million in FY12 from such changes – specifically, from implementing a parallel increase in employee contributions and parallel changes to the COLA provision.

Note that all MCPS employees receive a locally-funded pension supplement in addition to their core pension and contribute an additional amount for the supplement (regardless of whether an employee receives his/her core pension from the State plan or MCPS' locally-funded plan). If the Board of Education also increased employee contributions for the local pension supplement (corresponding to the State-required increase in employee pension contributions), Mr. Lowman estimates an additional savings of approximately $2.7 million in FY12.

All MCPS employees currently contribute 5% of salary for their core pensions. Employees in the State pension plan make their contributions to the State pension system and employees in MCPS' locally-funded pension plan contribute directly to the local plan. Based on the State's recent pension plan changes, MCPS employees in the State plan will contribute 7% of salary for their core pension beginning July 1, 2011.

In addition, all MCPS employees currently contribute an additional 0.5% of salary to MCPS' locally-funded plan to fund the local pension supplement (for a current total employee contribution of 5.5% of salary). Mr. Lowman's estimated $2.7 million in savings related to the pension supplement assumes a parallel increased employee contribution for this component, increasing from 0.5% of salary to 0.7%.

The table below summarizes Mr. Lowman's estimates of FY12 savings if the Board of Education applied the changes to the State pension system to MCPS' locally-funded core pension (#1), and the additional savings if the Board of Education were to make corresponding increases in the required employee contributions to MCPS' locally-funded pension supplement (#2).

Estimated FY12 Savings from Changes to MCPS' Locally-Funded Pension Plan

	MCPS Pension Component	State Pension Changes Applied to Local MCPS Plans beginning in FY12	FY12 Estimated Savings
1	Core	Increase employee contribution from 5% of salary to 7%; change COLA provision	$9.0 million
2	Supplement	Increase employee contribution from 0.5% of salary to 0.7%	$2.7 million

Source: Thomas Lowman, Bolton Partners, Inc.

c. Effect of State Pension Changes on Montgomery College

The GO Committee asked for information on how the recently adopted changes to the State-run pension plans apply to Montgomery College. Currently, Montgomery College pays annually for 285 employees to participate in State-run pension plans. The State pension system sets the rates paid by participating governmental units, like the College, for their employees to participate in State retirement plans. According to Montgomery College staff, the State pension system has not recalculated the FY12 contribution rates for participating governmental units to reflect savings from the General Assembly's changes to State pension plans. Accordingly, Montgomery College does not anticipate any savings in FY12 based on the State pension changes.

d. Level of Retirement Benefit

Four documents are attached for reference in response to the Committee's discussion on the "adequacy of a retirement benefit." The first document, *A Role for Defined Contribution Plans in the Public Sector*, is an Issue Brief from the Center for State & Local Government Excellence (see © 1 - 13). This April 2011 Issue Brief describes the costs of and risks to both employers and employees associated with defined contribution, hybrid, and defined benefit retirement plans. The Issue Brief also considers the plans' adequacy in the public sector.

The Issue Brief acknowledges the relatively higher costs associated with defined benefit pension plans and asks "how much risk should taxpayers bear for public employee retirement plans?" Taking into consideration a balance between employer and employee risk and the adequacy of retirement benefits, the author encourages public employers to examine "stacked" hybrid plans as an alternative to a purely defined contribution retirement plan.

The second document is a copy of OLO's March 17, 2011 memorandum, *Additional Information about Current Retirement Benefits* (see © 14 - 26). This OLO memo analyzes the primary factors that impact the level of employee retirement benefits in the County Government and Montgomery County Public Schools and includes retirement benefit calculations for four example employees.

For the example of the four retired employees with similar salaries and years of service, OLO found that the present value of a pension plan is worth more than twice as much as the value of a defined contribution plan. OLO also found that among the County Government and MCPS pension plans compared in the examples, a plan's value at retirement varies based on whether: a plan is integrated with Social Security; the plan's pension multiplier for years of service; and an employee's years of service.

The last two documents highlight the decades-old concept of the "three-legged stool," the idea that retirement income is based on three legs: an employer pension, Social Security, and private savings (see © 27 - 29). Recent writings on this topic emphasize that the applicability of the concept has diminished over the decades for many workers as more and more employers move away from providing defined benefit pension plans – one of the three foundations of the stool.

For County Government (and for other employers that provide traditional pensions), however, the concept is still relevant for the half of the workforce that still participate in defined benefit plans. Under the traditional "three-legged stool" concept, pension income is meant to provide workers with one source of retirement income. The pension is not meant to be a retiree's sole (or even majority) source of retirement income. Social Security provides a second source and workers themselves are expected to provide the third source through personal savings.

2. Health and Prescription Drug Benefits

a. Cost Comparison – Health and Prescription Drug Alternatives

The GO Committee asked for a comparison of the projected cost increase to County Government employees for medical, prescription, dental, and vision coverage in 2012 under the Executive's proposed changes and under the alternatives outlined in OLO's packet from the GO Committee's meeting on April 25. (See GO Committee #3, 4/25/11, pages 20-29.)

In comparing the cost impact of each proposal, it is important to keep in mind that the cost of health benefits, both for the County and its employees, is projected to increase by 9-10% annually even with no changes to plan design. Before taking into consideration any changes to the cost share structure, County Government employees, who in 2011 pay between $1,237 and $7,290 towards the cost of their health benefits, will see premium cost increases in 2012 ranging from around $111 to $656.

The table below shows the range of increase in employee health benefit costs (using projected calendar year 2012 premium rates) if employees stay in their current choice of medical, prescription, dental, and vision coverage under the Executive's proposal and each of the three alternatives presented by OLO to the GO Committee on April 25.

COMPARISON OF EMPLOYEE COST INCREASES UNDER HEALTH BENEFIT PRICING OPTIONS *

Employee Salary Level	Range of Cost Increase to MCG Employees in 2012 From…			
	CE's Proposal (updated with projected 2012 rates[2])	Alternative #1 – 5 point (max.) cost shift	Alternative #2 – 10 point (max.) cost shift	Alternative #3 – Fixed employer contribution
Under $50,000	$400 to $2,359	$24 to $1,180	$90 to $2,359	$24 to $3,109
$50,000-$89,999	$1,310 to $3,269			
$90,000+	$1,960 to $3,919			

* The range of cost increases under each proposal would be in addition to the 9-10% inflationary increase in health care costs projected by County actuaries.

The current range for the actual percent of annual health insurance premiums paid by County Government employees' is 20% to 32%. The table below shows the actual cost share ranges (based on projected 2012 rates) under the Executive's proposal and the alternative options.

COMPARISON OF EMPLOYEE COST SHARE UNDER HEALTH BENEFIT PRICING OPTIONS (Based on Projected 2012 Rates)

CE's Proposal	Alternative #1 – 5 point (max.)	Alternative #2 – 10 point (max.)	Alternative #3 – Fixed employer contribution
30% to 56%	20% to 32%	25% to 37%	20% to 40%

[2] The range of cost increase under the Executive's proposal differ from those shown in the April 25th GO Committee packet because OLO updated the data using projected calendar year 2012 premium rates. This allows for a more accurate comparison with Alternative's #1-#3 that also use projected 2012 premium rates.

b. Taft-Hartley Plans

At the April 25 worksession, the GO Committee discussed "Taft-Hartley" health insurance plans. A Taft-Hartley Plan is a multi-employer health plan for the private sector. According to AFSCME, Taft-Hartley plans have five basic characteristics:

- One or more employers contribute to the plan;
- The plan is collectively bargained with each participating employer;
- Assets are placed in a trust fund;
- The plan and its assets are managed by a joint board of trustees made up of labor and management representatives;
- Mobile employees can change employers without losing health or pension coverage if the new job is with an employer who participates in the same Taft-Hartley fund.[3]

c. Generic Drug Waiver Provision

The GO Committee asked for information about how MCPS implements the waiver provision in its generic vs. brand name drug coverage policy.

The MCPS Caremark prescription drug plan requires that a doctor provide a letter of medical necessity for coverage of a brand drug when a generic equivalent is available. According to MCPS' *2011 Employee Benefit Plan Summary*, the letter must be written on the doctor's official letterhead and provide details on the medical reason for prescribing a brand name drug over its generic equivalent. Simply stating that in his/her medical opinion brand name drugs are better than generic drugs is not sufficient medical documentation. The prescription and the letter of medical necessity must be sent to Caremark's Department of Appeals, which will determine whether to approve coverage of the brand drug. Caremark requires yearly updates of medical necessity.

MCPS has had this provision for the past eight years. MCPS staff report that this provision has increased the use of generic drugs compared to the plan's previous practice (which was similar to the County's current practice of covering the brand name drug when a physician checked "dispense as written" on the prescription). MCPS staff also report that following initial employee concerns about the change, they have not received many complaints from employees about the current practice.

Over 40,000 employees and dependents are enrolled in MCPS' Caremark plan. In 2010, Caremark received 107 requests for exception to MCPS' mandatory generic provision. Of these, 98 were approved (92%).

3. County Government Average Salary Data

At the April 25 GO Committee meeting, Committee members asked for information on average salaries of County Government employees. The Office of Human Resources' Personnel Management Review (PMR) provides average annual salary data (excluding overtime, shift or holiday pay) for full-time employees overall by grade level. PMR data on 2010 average County Government salaries by grade level appears on © 30 - 31.

[3] AFSCME website, http://afscme.org/publications/9727.cfm, "All for One and One for All: Taft-Hartley Health Insurance Plans," 2000, accessed 5/2/2011.

CENTER FOR STATE &
LOCAL GOVERNMENT
EXCELLENCE

ISSUE BRIEF

A Role for Defined Contribution Plans in the Public Sector

April 2011

1

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, bnt 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.

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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 contribntion 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.

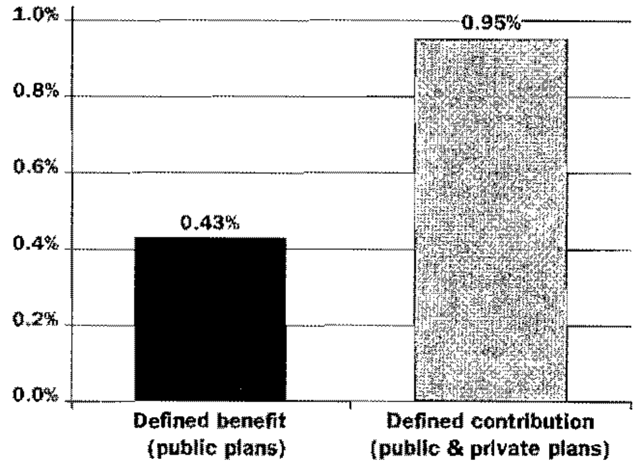
Costs

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

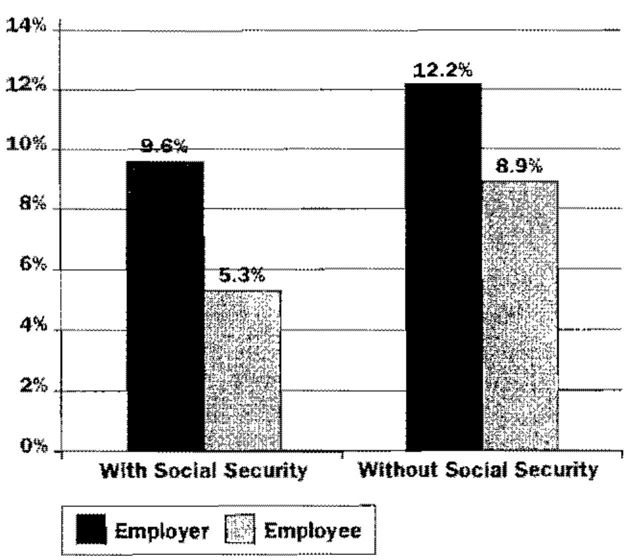
Risk, cost, and human resource considerations are the real issues relevant to deciding whether to shift from a defined benefit to a defined contribution plan. But other assertions also arise in the debate. Some supporters highlight the magnitude of the unfunded liabilities in public sector defined benefit 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. Transfer-ring 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*



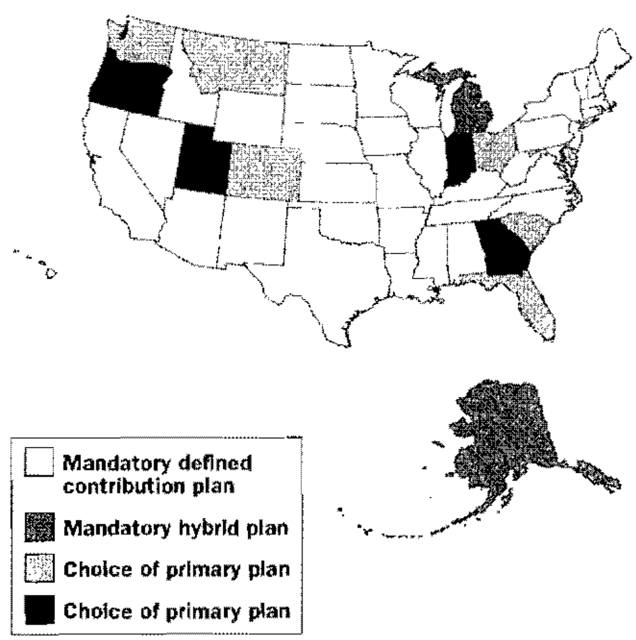
Source: Public Plans Database (2009).

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]

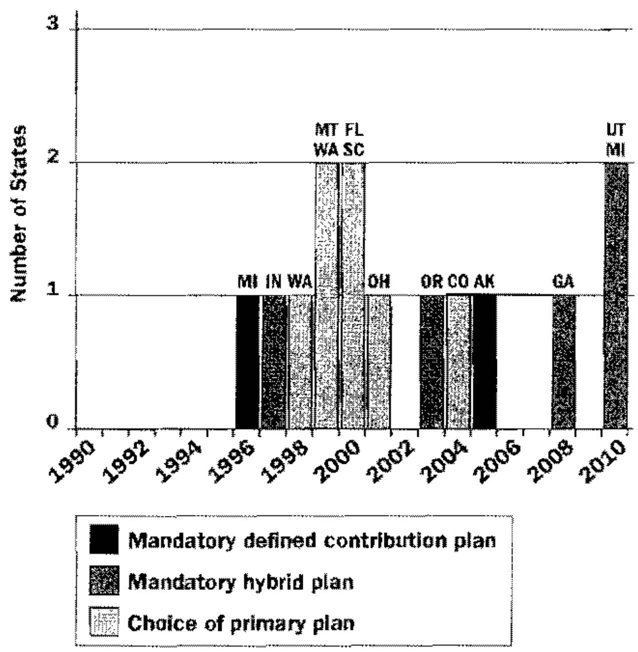
Figure 3. *Defined Contribution Plans, by State, 2011*



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.

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 only 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.

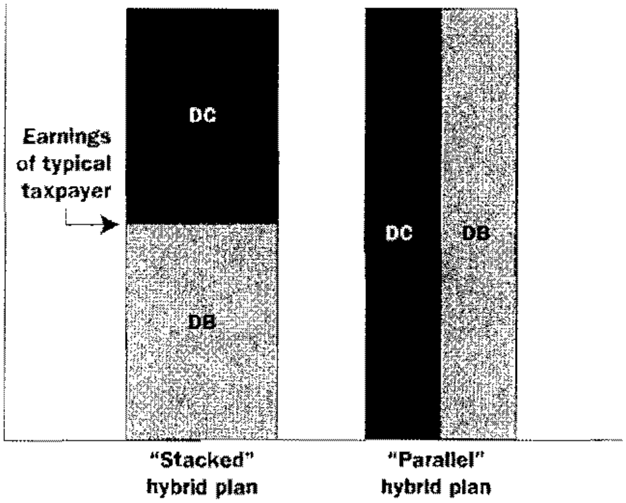
A Better Mousetrap?

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 nnder 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 contribntion 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 wonld 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); Stever (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.

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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).

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MEMORANDUM

March 17, 2011

TO: Councilmembers

FROM: Aron Trombka, Senior Legislative Analyst AT
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.

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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

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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 <u>hypothetical employees</u> 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.

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).

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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?

__Social Security Integration:__ 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?

__Pension Multipliers:__ 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?

__Years of Service:__ 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.

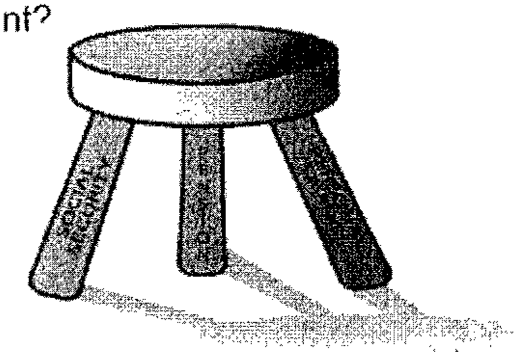
c. Steve Farber

[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.

Retirement Security

Why is Social Security's work on retirement issues important?



Retirement income used to fit the model of the three-legged stool—Social Security, a defined benefit pension from an employer, and a personal savings.

For better or worse, it is no longer that simple for a number of reasons:

- The increasing reliance on defined-contribution pension plans shifts financial risks from employers to employees.
- The increasing life spans and lower personal saving rates can lead to people outliving their personal retirement savings.
- Despite longer lives, most workers continue to take their Social Security benefits at age 62 even though that may permanently reduce the monthly benefit. A 2007 survey found that only 19 percent of workers can correctly identify the age at which they will be eligible for unreduced benefits from Social Security.

Building a financially secure retirement has become much more complicated, especially with falling contributions from employers and lower rates of personal saving. Everyone, from workers and employers to researchers and policymakers, is trying to figure out how to build retirement security in the 21st century.

Workers can educate themselves about how to plan for retirement and when to claim Social Security benefits. That is why Social Security has developed a special initiative to encourage saving by improving financial literacy and education.

For policymakers and researchers, Social Security is studying ways to develop retirement security that addresses 21st century challenges. Keeping Social Security sound for future generations is at the heart of work on trust fund solvency and in the research that we support through the Retirement Research Consortium.

U.S.News & WORLD REPORT
usnews.com

4 Retirement Pillars Have Serious Cracks

By Philip Moeller
Posted January 31, 2011 11:31 AM ET

Something not-so-funny has happened to millions of Americans, including me, on the way to retirement. The rules have changed. This is hardly news, but much of the debate over retirement security is still shaped by the traditional view of retirement supports. That long-held view was that retirement was a three-legged stool, supported by an employer pension, private investments, and Social Security.

[See 10 Senior-Smart Community Ideas.]

One of the major legs of the stool—employer pensions—began weakening in the 1980s as employers began moving away from traditional, defined benefit pension plans to defined contribution plans. How's that working out for us? Not so good. As employees, we were not very responsible in taking advantage of these new contribution-based plans. As investors, we often sell low and buy high. Important reforms enacted in 2006 put badly needed improvements in place—just in time for the market crash of 2007 and 2008. Most 401(k) plans have since recovered a lot of ground, but not enough to reverse life-altering declines in nest eggs that weren't big enough even before the Wall Street collapse.

Private investments were never a real strong leg of the stool for most Americans. We didn't save enough and, of course, those assets got hammered during the Great Recession along with 401k(s) and IRAs.

Social Security has continued paying all of its benefits, and has assumed an importance in retirement income well beyond its initial role. Even here, however, a slowly widening funding shortfall has raised questions about Social Security's long-term viability. It needs a fix.

So much for the three-legged stool. Out with the old, as they say. Meet the four pillars of retirement. Four is more, and thus better than three, right? And pillars are more substantial and stronger than the legs of a stool, aren't they? Late last year, I interviewed a retirement policy expert who talked naturally about the four pillars. When I asked what they were, he seemed surprised. This is a well-known concept, he said, and has been in use for a long time.

[See Senior Safety Nets at Risk in 2011.]

Don't be embarrassed if you cannot name the four pillars. They have not exactly become the Mt. Rushmore icons of retirement security.

While doing some superficial research, I came across an outfit called the Geneva Association in Switzerland, which bills itself as the international think tank of the insurance industry. The association began a research effort into what it called the Four Pillars Program (or Programme, for Eurocentric readers). Here was its rationale:

"The Geneva Association launched its 'Four Pillars' Research Program with a view to identifying possible solutions to the issue of the future financing of pensions and, more generally, to organizing social security systems. Demographic trends—especially increased life expectancy—could be seen as positive if we were able to devise ways of enabling 'aging in good-health populations' to make a valid economic and social contribution to the functioning of our service economies over the decades to come."

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Not bad, and especially insightful, given that the program began in 1987! The three legs of the traditional stool were retained, although the pension component was shifting into defined contribution plans. The fourth pillar, the association said, was "the need for a flexible extension of work-life, mainly on a part-time basis, in order to supplement income from the three existing pillars for future years." So, the fourth pillar was continued employment. What may have seemed an optional solution in 1987 is, of course, a necessity in 2011.

More recently, in 2005, Prudential Financial unveiled a new framework. It was called the Four Pillars of U.S. Retirement. Again, the legs of that traditional stool were still there. Now, they were supplemented with a fourth pillar the company called "Retirement Choices." It was different than the Geneva Association's pillar. In fact, it sounded a lot like Prudential's product brochure:

"There are aspects of retirement planning that fall outside of 'saving.' Many Americans may choose to continue working in retirement, while others may consider the equity they've built in their homes as a potential retirement income source. In addition, protecting retirement income through annuities and long-term care insurance, and providing wealth transfer through life insurance, are other choices individuals should consider."

[See Social Security, Medicare a Bargain for Many.]

Others have weighed in with their own views of the Four Pillars. In 2007, AARP came up with a version that lumped pensions and retirement savings into a single pillar, picked up supplemental income as a third pillar, and added affordable healthcare as its fourth pillar. Given that healthcare is the largest uncontrollable expense faced by retirees, there is logic for viewing affordable care as a pillar of retirement security. Here were AARP's objectives in 2007:

"Social Security: We must protect this essential program from destructive changes that would undermine the goal of Social Security solvency. The public must be educated about their need for additional income because too many Americans are relying upon Social Security as their chief source of retirement income.

"Affordable Health Care: Health care is one of the most pressing issues facing American seniors today. Without affordable health care, a person's entire retirement security could be hanging in the balance—left vulnerable to an unplanned illness or other health concern.

"Pensions/Retirement Savings Plans: Too many Americans have suffered recently as an increasing number of businesses have dramatically scaled back retirees' pension and benefits plans—putting retirement security at risk for countless Americans.

"Supplemental Earnings: Many seniors can't afford to retire when they wish. More employment opportunities must be created for American seniors who want to work, and age discrimination should be kept out of the workplace."

So, perhaps the Four Pillars haven't quite settled into their new roles. Maybe your fourth pillar is having a roof over your head. Or that hoped-for inheritance from Uncle Sid. Works for me.

Twitter: @PhilMoeller

Why We're Not Wired for Successful Retirements
Senior Villages Take Root as Movement Matures

Montgomery County Office of Human Resources
Personnel Management Review
2010 Average Annual Salary by Grade (Full-Time Employees)

Grade	Category	Number of Employees	Average Annual Salary
Overall Weighted Average		**7,873**	**$70,424**
A1	Police Management	133	$98,460
A2		32	$116,167
A3		21	$135,961
B1	Fire Management	100	$88,382
B2		139	$108,553
B3		24	$123,606
B4		13	$134,447
B6		3	$152,308
C1	Corrections and Rehabilitation Management	20	$92,726
C2		3	$103,377
C3		7	$40,538
C4		65	$50,176
C5		161	$60,361
C6		43	$80,379
D1	Deputy Sheriff Management	29	$96,755
D2		11	$97,409
D3		4	$117,642
D4		0	--
F1	Firefighter/Rescuer	1	$41,613
F2		254	$50,493
F3		372	$64,120
F4		206	$81,618
G2	Deputy Sheriff	3	$45,170
G3		20	$50,990
G4		70	$68,812
H3	Physician	0	--
H4		1	$191,682
J3	Psychiatrist	2	$173,732
J4		1	$172,494
M1	Management Leadership Service	20	$146,679
M2		103	$127,736
M3		226	$107,093

Montgomery County Office of Human Resources
Personnel Management Review
2010 Average Annual Salary by Grade (Full-Time Employees)
(Continued)

Grade	Category	Number of Employees	Average Annual Salary
P1	Police	33	$47,383
P2		37	$49,881
P3		133	$55,580
P4		708	$76,138
P5		64	$88,318
5	General Government	4	$37,534
7		6	$38,834
8		23	$38,997
9		28	$36,690
10		39	$36,586
11		18	$44,563
12		36	$45,770
13		263	$47,818
14		187	$44,180
15		782	$46,213
16		438	$54,684
17		179	$54,856
18		469	$61,041
19		121	$64,522
20		254	$65,404
21		331	$69,566
22		132	$72,243
23		509	$77,161
24		345	$82,105
25		352	$89,629
26		88	$93,738
27		46	$96,509
28		123	$105,075
29		2	$106,765
31		1	$127,511
32		32	$120,307
34		2	$119,754
40		1	$136,372

Source: Montgomery County Office of Human Resources, Personnel Management Review, April 2011

Agenda Item #3B
June 14, 2011
Action

MEMORADUM

TO: County Council

FROM: Michael Faden, Senior Legislative Attorney
Karen Orlansky, Director, Office of Legislative Oversight

SUBJECT: **Action:** Resolution to Approve County Policy on Group Insurance Benefits for Retired County Employees

The attached resolution, introduced on May 26, is scheduled for final Council action on June 14. The resolution implements changes to the eligibility requirements for retiree group insurance benefits for employees hired on or after July 1. The Council approved these changes in principle during its review of employee benefits issues on May 19.

The gist of these changes is that any employee hired (or re-hired) on or after July 1, 2011 will need ten years of County service (up from five years) to qualify for retiree health benefits, and 25 years (up from 16 years) to receive the maximum health premium subsidy. The premium cost share percentages will remain at a minimum of 50% County/50% retiree and a maximum of 70% County/30% retiree.

These structural changes to retiree health benefits will reduce the County's OPEB liability beginning in FY13.

Resolution No.: ________
Introduced: May 26, 2011
Adopted: ________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By County Council

Subject: County Policy on Group Insurance Benefits for Retired County Employees

Background

1. On October 16, 1986, the County Council adopted Resolution No. 10-2233. That resolution established the Council's policy for insurance benefits for retired County employees, which applied to any employee hired on or after January 1, 1987. The resolution included the following cost-sharing formula for retiree health insurance:
   - 50% County/50% retiree for each employee with 5 years of plan participation as an active employee;
   - for each additional year above 5, the County's share was increased two percentage points up to a maximum County share of 70%.

2. On November 23, 1999, the Council adopted Resolution No 14-348. That resolution issued policy guidance regarding group insurance benefits. The resolution stated that all County agencies should link eligibility and cost-sharing decisions regarding retiree group insurance benefits to years of service, rather than the number of years of plan participation.

3. The 2011 County Government Group Insurance Summary Description lists the following requirements for a retired employee to be eligible for group insurance benefits:
   - If an employee is a member of the optional or integrated plan under the Employees' Retirement System and retires under normal, early, disability or discontinued service retirement, the employee is eligible for group insurance benefits.
   - If an employee is a member of the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, the employee is eligible for group insurance when the employee separates from County service if the employee's age and credited service under a County Retirement Plan at the time of separation from service meet the following requirements:

If you belong to Group:	And you have credited service of at least:	And your age is at least:
RN, RM RC; or CN, CM, CC, CZ; or ZK	5 years	60
	15 years	50
	20 years	45
RP, CP – Police, Corrections, Sheriffs	15 years	45
	20 years	41
RP, CP – Fire	20 years	Any age

- If an employee qualifies for a disability benefit and does not meet the minimum age and credited service criteria in the preceding table, the employee is eligible for group insurance continuation as follows:
  - If the disability is non-service connected, the employee is eligible for group insurance benefits for the duration of the initial and continued disability if the employee had 5 years of credited service before becoming disabled.
  - If the disability is service-connected, the employee is eligible for group insurance benefits for the duration of the initial and continued disability.

4. The 2011 County Government Group Insurance Summary Description contains the following description of the cost share arrangement for retired employees:

- The cost share arrangement for each eligible employee hired after December 31, 1986 for medical, dental, discount vision, standard option prescription, term life, and dependent life insurance is:
  - 50% County/50% retiree for each employee with 5 years of eligibility under the group insurance plan as an active employee;
  - 70% County/30% retiree for each employee with 15 or more years of eligibility under the group insurance plan as an active employee;
  - For each year between 5 and 15 years that the employee is eligible under the group insurance plan as an active employee, the County's share increases 2%.

- At the time of retirement, each employee hired before January 1, 1987 may choose between the cost share arrangement for employees hired after December 1, 1986 or an 80% County contribution for medical, dental, discount vision, standard option prescription, term life, and dependent life insurance, effective for the period of time after retirement equal to the number of years the employee is eligible under the group insurance plan, beginning from the employee's retirement date. After this time period expires, the retiree must pay 100% of the group insurance costs.

- Each retiree (regardless of when the retiree was hired) must pay a higher cost share of the plan cost if the retiree enrolls in the high option prescription plan.

- Regardless of an employee's cost sharing arrangement, at age 65 a retiree's term life insurance becomes 100% County paid. Also, if an employee retires on a disability, the employee's term life insurance is 100% County paid until the employee reaches the normal retirement date. From that time until age 65, the cost sharing arrangement in effect for that employee's other benefits apply to the cost of term life insurance if the employee is eligible for term life insurance at the time of the disability. If the employee had not met the special eligibility requirements for term life insurance at the time of the disability, the term life coverage ends at the employee's normal retirement date.

- If an employee retires on a service-connected disability either under the Employees' Retirement System, the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, to calculate the employee's cost share, 5 years must be added to the employee's years of eligibility under the group insurance plan.

5. The 2011 County Government Group Insurance Summary Description contains the following provision:

   The County expects to continue the Plan, but it is the County's position that there is no implied contract between employees and the County to do so, and reserves the right at any time and for any reason to amend or terminate the Plan, subject to the County's collective bargaining agreements.

   The Plan may also be amended by the County at any time, either prospectively or retroactively, to conform with the Internal Revenue Code.

Action

The County Council for Montgomery County, Maryland approves the following resolution:

1. With regard to retiree group insurance benefits for any employee hired or rehired as a permanent employee on or after July 1, 2011, the Council's policy is:

   - Each employee hired or rehired as a permanent employee on or after July 1, 2011, including any employee awarded a non-service connected disability, and who is a member of a County retirement plan must have at least 10 years of County service to be eligible for group insurance continuation when the employee leaves County service. All other eligibility criteria remain the same as applied before that date.

   - The cost-sharing formula for each employee hired or rehired as a permanent employee on or after July 1, 2011, for medical, dental, discount vision, standard option prescription, basic life, and dependent life insurance ($2,000/$1,000/$100 tier), is:
     - 50% County/50% retiree for each retiree with 10 years of eligibility under the group insurance plan as an active employee;

- 70% County/30% retiree for each retiree with 25 or more years of eligibility under the group insurance plan as an active employee; and
- for each year between 10 and 25 years that the employee is eligible under the group insurance plan as an active employee, the County's share must increase 1.33 percentage points to the maximum County share of 70%.

• If an employee retires on a service-connected disability under the Employees' Retirement System, the Elected Officials' Plan, the Retirement Savings Plan, or the Guaranteed Retirement Income Plan, and the employee does not have 10 years of eligibility under the group insurance plan, for group insurance eligibility and cost-sharing purposes the employee must be treated as having 10 years of County service.

2. Any other retiree group insurance benefit provision that applies to all or some employees hired before July 1, 2011, or that applies to an employee regardless of when the employee was hired, is not affected by this resolution.

3. The Council recognizes the County Executive's authority at any time and for any lawful reason to amend or terminate the County's group insurance benefits and policies for retired employees. However, any material change in any part of this resolution or its application to any retired or active employee or group of employees, including any premium holiday or other waiver of premiums for County-provided health or life insurance, is subject to Council approval.

This is a correct copy of Council action.

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Linda Lauer, Clerk of the Council

GO Committee #3
April 25, 2011
Discussion

MEMORANDUM

April 21, 2011

TO: General Operations and Fiscal Policy Committee

FROM: Office of Legislative Oversight, Budget Project Team
Karen Orlansky, Aron Trombka, Craig Howard, Leslie Rubin & Sarah Downie

SUBJECT: **County Executive's FY12 Recommended Budget: Analysis of Proposed Changes to County Government Employees' Retirement, Health, and Life Insurance Benefits**

This memorandum provides the Office of Legislative Oversight's analysis of the proposed changes in the County Executive's FY12 Recommended Operating Budget to retirement, health insurance (including medical, prescription drug, dental, and vision coverage), and life insurance benefits for County Government employees. It includes review of the fiscal impact and policy issues raised by the County Executive's proposed changes, and offers some alternatives for Committee discussion and consideration. The memorandum is organized into six parts as follows:

This memo focuses on the County Executive's proposed FY12 changes to County Government employee benefits and potential alternatives for the Committee to consider. As background and reference, the memo also includes information on: MCGEO's last best final offer regarding retirement and health benefits, as included in the arbitration award; pension and retiree health benefit changes recently adopted by the State of Maryland; and employee benefit changes either under discussion (or already adopted) by the governing boards of the other tax supported County agencies: Montgomery County Public Schools, Montgomery College, and M-NCPPC.

Changes to the structure of the County Government's retirement plans would require changes to County law. Retirement and group insurance benefits for active employees are mandatory subjects of collective bargaining between the Executive and employee unions. For a discussion of legal issues surrounding collective bargaining and modifications to employee benefits, see Mr. Drummer/Mr. Faden's packet (GO Committee #4, 4/25/11).

As the Committee takes up the employee compensation issues raised by the proposals contained in the County Executive's Recommended FY12 Budget, the Committee is reminded that similar discussions are occurring in other state and local governments across the country. For examples of the changes being considered and implemented in other jurisdictions, see the Appendix to OLO's Part II Report on *Achieving a Structurally Balanced Budget in Montgomery County*, pages ©119-147.

A. OVERVIEW OF COUNTY EXECUTIVE'S PROPOSALS

The County Executive's Recommended FY12 Operating Budget includes proposals for making a number of structural changes to the benefits of County Government employees. In his budget transmittal memo to the Council, the Executive writes:

> *My recommended changes to the County's benefits structure is the beginning of a continued effort to better structure our benefits to provide savings for both the County and its employees. I believe that over time, working together, we can develop additional cost efficient ways to further reduce benefit costs, while still maintaining a highly competitive benefits package for our workers.*

The County Executive's Recommended FY12 Budget includes proposed changes to:

- Pension (defined benefit) plan <u>employee</u> contributions;
- Retirement account (defined contribution[1]) <u>employer</u> contributions;
- The employee cost share for group insurance premiums (medical, prescription drug, dental, vision, life insurance, and long-term disability insurance); and
- The design of the prescription drug benefit and the amount of mandatory life insurance coverage.

The County Executive's Recommended FY12 Budget <u>does not include</u> proposed changes to:

- Pension benefits for new hires or for years not yet served by current members;
- Retiree health benefit cost share or eligibility, either for current or future retirees; or
- Medical insurance plan design, e.g., copays, deductibles.

The Executive's FY12 budget assumed a July 1, 2011 effective date for all of his recommended changes to employee benefits. On April 15, 2011, the Council President notified the County Executive that the Council intends to set a date that is later than July 1st for implementing whatever changes to group insurance are approved by the Council. For more on the implementation date issue, see Mr. Farber's packet (GO Committee #1, 4/25/11).

The Executive's specific recommendations are limited to the benefits for County Government employees. **With regard to employee benefits in other tax-supported agencies, the Executive's FY12 budget transmittal memo states that**:

> *To promote equity among locally funded public employees and produce sustainable savings across the entire government, I recommend that the governing boards of the other County funded agencies support a similar approach to compensation in FY12.*

[1] In this memo, the term "defined contribution" plan includes both the Retirement Savings Plan (RSP) and the Guaranteed Retirement Income Plan (GRIP).

The table below summarizes the Executive's proposed changes to County Government employee benefits and shows his estimated FY12 savings that would result from implementation of the changes.

Summary of Executive's Proposed Changes to County Government Employees' Benefits

Benefit Type	County Executive's Proposal	CE Estimated FY12 Savings
Retirement	**Pension (Defined Benefit) Plans.** Employees would contribute an additional 2% of salary towards their pensions.	$6,044,180
	Retirement Account (Defined Contribution) Plan. The employer's contribution to employee retirement accounts would be reduced by 2%.	$4,860,290
Health (Medical/ Prescription/ Dental/Vision)	**Minimum 30% Cost Share.** Employees' cost share of medical, prescription drug, dental and vision insurance premiums would increase from a minimum of 20% to a minimum of 30%.	$8,229,530
	Additional Salary-Based Charge. Employees with an annual salary between $50,000 and $89,999 who enroll in a medical and/or prescription drug plan would pay an additional $910 per year. Employees with an annual salary of $90,000 and above would pay an additional $1,560 per year.	$7,418,000
Prescription Drug	**Generics.** Employees who buy a brand name drug when a generic equivalent is available would always pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent. Currently, this requirement is waived if a physician prescribes a brand drug and writes "dispense as written" on the prescription.	$1,200,000
	Lifestyle Drugs. The County would eliminate coverage for medications used to treat erectile dysfunction.	$400,000
	Mail-Order Copays. The copay for mail order prescriptions (up to a 90-day supply) would increase from one time to two times the copay for a 30-day supply purchased through a retail pharmacy.	$200,000
Life Insurance	**30% Cost Share and Benefit Level.** The life insurance benefit provided to all employees would be reduced from two times to one time annual salary. Employees' cost share would increase from 20% to 30% of premium.	$1,200,000
Long-Term Disability	**30% Cost Share.** Employees' cost share for long-term disability insurance would increase from 20% to 30% of premium.	$48,000

Six-Year Fiscal Impact. The Executive's proposal changes the structure of employee compensation and, if implemented, would produce recurring savings in future years. As shown in the table below, the Office of Management and Budget (OMB) estimated the savings for each of the next six years that would result from implementing the proposed benefit changes. OMB's estimates of FY12 savings reflect the assumption of a July 1, 2011 implementation date for all proposed changes.

OMB Estimate of Savings from Executive's Proposed Changes in Employee Benefits
($ in millions)

Executive's Proposed Change	FY12	FY13	FY14	FY15	FY16	FY17
Defined Benefit Retirement: Additional employee contribution (2% of salary)	$6.04	$6.21	$6.39	$6.60	$6.82	$7.07
Defined Contribution Retirement: Reduced employer contribution (2% of salary)	$4.86	$4.99	$5.14	$5.31	$5.49	$5.68
Health Insurance Cost Share: Increase to minimum of 30%	$8.23	$9.05	$9.96	$10.95	$12.04	$13.25
Health Insurance Cost Share: Additional salary-based charge	$7.42	$8.16	$8.98	$9.87	$10.86	$11.95
Prescription Drug Coverage: Mandatory generics	$1.20	$1.32	$1.45	$1.60	$1.76	$1.93
Prescription Drug Coverage: Elimination of ED drug coverage	$0.40	$0.44	$0.48	$0.53	$0.59	$0.64
Prescription Drug Coverage: Doubling mail-order copay	$0.20	$0.22	$0.24	$0.27	$0.29	$0.32
Life Insurance: Reduced coverage / increased cost share	$1.20	$1.32	$1.45	$1.60	$1.76	$1.93
Long-Term Disability Cost Share: Increase to minimum of 30%	$0.05	$0.05	$0.06	$0.06	$0.07	$0.08
Totals	$29.60	$31.76	$34.16	$36.79	$39.68	$42.86

OMB's estimates represent combined savings from both tax supported and non-tax supported funds. To calculate the future year fiscal impact, OMB assumed that:

- County Government employee salaries will increase in future years at the projected consumer price index growth rate. (Future year retirement savings are a function of assumed growth in salaries).
- Health, life, and long-term disability insurance costs will increase about 10% annually through FY17 (based on projections provided by the County's actuary).

Note that OMB applied the health care inflation rate to the additional salary-based health benefit charge. In other words, OMB assumed that the salary-based charge increases annually by the same rate (about 10%) of overall health benefits.

Combined Cost to Employees in FY12. The Executive's proposed benefit changes represent a structural change in the form of a cost shift of retirement and health benefit costs from the County to County employees. The combined effect of the proposed cost shifts would vary based on an employee's income, bargaining group, and health insurance plan selections.

The table below shows four examples of the annual cost to employees[2] – measured in dollars and percent of salary – of the Executive's proposed retirement and health benefit changes. Additional details on these changes are provided later in this memorandum (Parts B, D, and E). As shown in the table below, implementation of the proposed changes would cost employees an amount equal to between 2.8% and 7.6% of annual salary.

Examples of FY12 Additional Cost to Employees[2]
Executive's Proposed Retirement and Health Benefit Changes

	Employee Salary			
	$45,000	**$55,000**	**$85,000**	**$95,000**
Retirement				
$ Amount	$900	$1,100	$1,700	$1,900
% of Salary	2.0%	2.0%	2.0%	2.0%
Health Insurance				
$ Amount	$371 to $2,163	$1,281 to $3,073	$1,281 to $3,073	$1,931 to $3,723
% of Salary	0.8% to 4.8%	2.3% to 5.6%	1.5% to 3.6%	2.0% to 3.9%
Combined				
$ Amount	$1,271 to $3,063	$2,381 to $4,173	$2,981 to $4,773	$3,831 to $5,623
% of Salary	2.8% to 6.8%	4.3% to 7.6%	3.5% to 5.6%	4.0% to 5.9%

[2] Cost to employees calculated in pre-tax dollars. The reduction in take home pay would vary depending on the employee's income tax rate. For employees in a defined benefit retirement plan, retirement cost represents a reduction in earnings. For employees in a defined contribution retirement plan, retirement cost represents a reduction in retirement account contributions.

B. Retirement Benefits

In FY11, the County Government will pay $124 million (from tax-supported and non-tax supported funds) for County Government employee retirement benefits: $105 million for the defined benefit plans and $19 million for the defined contribution plans.[1] Currently, the defined benefit and the defined contribution plans have approximately the same number of enrollees.

This part of the memorandum analyzes the County Executive's proposed FY12 changes to County Government retirement plans and outlines some alternatives that the Committee may want to consider. It is organized as follows:

1. Summary of Executive's Proposed Changes

The County Executive proposed structural changes for employees in both the County Government's defined benefit plans and defined contribution plans. The Executive proposed that beginning July 1, 2011:

- Employees in the Employee Retirement System (ERS) defined benefit plans would contribute 2% more of their salary toward their retirement benefit; and
- The County Government would contribute 2% less to retirement accounts for employees in the Retirement Savings Plan (RSP) defined contribution plan or the Guaranteed Retirement Income (GRIP) hybrid plan.

The table below summarizes the Office of Management and Budget's estimate of tax supported and non-tax supported costs and savings from the Executive's proposals.

OMB Estimate of Costs and Savings from Executive's Proposed Retirement Plan Changes
FY12-FY17 Tax Supported and Non-Tax Supported Funds
($ in millions)

Plan	Estimated FY12 County Cost		Estimated Savings – CE Proposal					
	No Plan Changes	CE Proposal	FY12	FY13	FY14	FY15	FY16	FY17
ERS	$110.2	$104.1	$6.0	$6.2	$6.4	$6.6	$6.8	$7.1
RSP/GRIP	$18.7	$13.8	$4.9	$5.0	$5.1	$5.3	$5.5	$5.7
Total	**$128.8**	**$117.9**	**$10.9**	**$11.2**	**$11.5**	**$11.9**	**$12.3**	**$12.8**

Source: 3-29-11 OMB Fiscal Impact Statement – FY12 Labor Agreements; OMB data

[1] In this memo, the term "defined contribution" plan includes both the RSP defined contribution plan and the GRIP hybrid plan.

The Executive's proposed retirement changes would impact employees differently based on the retirement plan they belong to.

Impact on Employees in Defined Benefit Plans. Under the Executive's proposal, employees in the County Government's defined benefit plans would contribute an additional 2% of salary toward their pensions, employees would see a reduction of their take-home pay by less than 2%.[2] **The Executive's proposal would not change the benefit that employees in the defined benefit system receive when they retire.**

The table below summarizes employees' current contribution rates in the defined benefit plans and the rates under the Executive's proposal; all contributions are a percent of the employee's salary.

Executive's Proposed Increase in Annual Employee Defined Benefit Contributions

Employee Group	Employee Contribution (% of salary)		% Increase
	Current[3]	CE Proposed	
Non-Public Safety (hired before 10/1/94)	4%	6%	+50%
Police and Deputy Sheriff/Corrections	4.75%	6.75%	+42%
Fire & Rescue	5.5%	7.5%	+36%

Impact on Employees in Defined Contribution Plans. Under the Executive's proposal, the County Government would contribute 6% of salary to an employee's retirement accounts for most employees in the defined contribution plans, down from the County's current 8% contribution.[4]

The Executive's proposal would lower the benefit that employees in the defined contribution plans receive when they retire by reducing the County Government's retirement account contributions by 25% annually and by eliminating the opportunity to earn investment income from the contributions. The Executive has advised that employees could make up for the decreased employer contribution by contributing an additional 2% of their salary to a deferred compensation account.[5]

The table below summarizes the County Government's current contribution rates and the rates under the Executive's proposal, as a percent of employees' salary.

Executive's Proposed Reduction in Annual Employer Retirement Account Contributions

Employee Group	Employer Contribution (% of salary)		% Reduction
	Current	CE Proposed	
Non-Public Safety (hired on or after 10/1/94)	8%	6%	-25%
Non-Represented Public Safety (hired on or after 10/1/94)	10%	8%	-20%

[2] Employee contributions to retirement plans are paid in pre-tax dollars. A payment of 2% in pre-tax dollars would result in less than a 2% reduction to an employee's take-home pay.

[3] Employees in the ERS who earn more than the Social Security Wage Base (SSWB) ($106,800 in 2011) contribute a higher percent of salary toward their pensions for salary earned above the SSWB (non -public safety – 6%, Deputy Sheriff/Corrections and Police – 8.5%, Fire and Rescue – 9.25%). These contribution rates would also increase 2% under the Executive's proposal. The SSWB is the salary amount above which the federal government no longer withholds Social Security taxes.

[4] The County Government contributes 10% of salary for non-represented public safety employees in the defined contribution plans. Under the Executive's proposal, the County's contribution for these employees would fall to 8% of salary.

[5] Employees can take advantage of this option only if an additional 2% contribution to their deferred compensation account would not put their annual contribution over the maximum amount allowed under federal law ($16,500 in 2011).

2. Description of MCGEO Retirement Benefit Changes from Arbitration Award

UFCW Local 1994 MCGEO, (Municipal & County Government Employees Organization) is the certified collective bargaining representative for certain groups of County Government employees in the defined benefit and defined contribution retirement plans.[6] **During collective bargaining, MCGEO proposed one change to the County Government's defined benefit plans and a different change to the defined contribution plans. Both changes proposed by MCGEO would provide primarily one-time savings in FY12.**[7] Specifically, MCGEO proposed that:

- **Defined benefit**: The County Government would withhold its annual contribution to the defined benefit plans in FY12 for certain groups of employees, and those employees would not receive service credit for work in FY12. Employees would still make their required contributions; and
- **Defined contribution**: The County Government would contribute 6% of salary to employees' retirement account in FY12, rather than 8%.

An arbitrator chose MCGEO's last best final offer as the more reasonable offer (including its proposed retirement plan changes). The Executive, however, did not include MCGEO's retirement proposals in his recommended budget.

According to the County's retirement plan actuaries, MCGEO's proposed changes to the defined benefit plans would yield $28 million in savings. It is important to note that $11 million (or almost 40%) of the total savings would come from non-represented employees.

For a complete description of MCGEO's proposal and the associated savings, see GO Committee #4, 4/25/11, on the collective bargaining agreements, prepared by Council Attorneys Mike Faden and Bob Drummer.

3. Description of Retirement Changes in Other County-Funded Agencies

Montgomery County Public Schools. Approximately 75 percent of Montgomery County Public Schools' (MCPS) 21,000 employees belong to a State-run and currently State-funded pension system. The remaining MCPS employees belong to an MCPS-run and locally-funded pension system. Currently, employees in the State-run and locally-run systems receive the same pension benefits. This month, the Maryland General Assembly altered the structure of pension benefits for current and future employees in most State-run pension plans, including the Teachers' Retirement System.

For current MCPS employees, the State changes require a higher annual employee contribution and alter the formula used to calculate annual cost-of-living adjustments to retiree pensions for all service on or after July 1, 2011. For employees hired on or after July 1, 2011, the State also altered the retirement benefit received, the required years of service for full retirement, the minimum vesting period, and several other pension provisions. The table on page 10 summarizes the changes for current and future MCPS employees in the State system (and to other State pension systems).

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[6] MCGEO represents non-public safety employees hired before October 1, 1994 and represents employees in the Department of Corrections and Rehabilitation and in the Sheriff's Office in the defined benefit plans and all union employees in the defined contribution and hybrid plans.

[7] OMB estimates that MCGEO's defined benefit proposal would save $17.3 million in FY12 and potential recurring savings of $0.4 to $1.2 million annually thereafter. All of the direct savings from MCGEO's defined contribution proposal would occur in FY12.

In FY11, MCPS contributed $41.2 million to fund retirement benefits for employees in the locally-funded defined benefit plan, contributing 20.49% of employees' salary. **If the Board of Education made corresponding changes to MCPS' locally-funded defined benefit plan, based on FY11 data, MCPS employees would contribute approximately $4.0 million more toward retirement in FY12, resulting in reduced costs for MCPS.**

Montgomery College. All Montgomery College employees participate in State of Maryland-administered retirement plans. The State funds the retirement of faculty, administrators, and professional staff, who may choose between a defined benefit plan and a defined contribution plan. Montgomery College fully funds the cost for support, paraprofessional, and technical staff to participate in a State defined benefit plan.

The changes summarized in the table on page 10 also apply to Montgomery College employees in State pension plans.

Maryland-National Capital Park and Planning Commission. M-NCPPC currently is in the process of bargaining with its employee unions.

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	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

4. Summary of Retirement Benefit Policy Issues

The Executive's proposed retirement plan changes raise two primary policy questions.

Policy Question #1: Should the Council seek equivalent savings from employees in the defined contribution plans, which currently costs the County substantially less than defined benefit pension plans?

The Executive proposed that all County Government employees – regardless of their retirement plan – forego a similar amount in FY12 (2% of salary). However, the County incurs substantially higher costs for employees in the defined benefit retirement plans than for those in the defined contribution plans.

The table below summarizes the percent of salary that the County Government would contribute to fund each group's retirement in FY12 without the Executive's proposed changes.[8]

FY12 Retirement Plan Employer Contributions Excluding Executive's Proposed Savings

Retirement Plan	FY12 Employer Contribution (% of salary)
Defined Benefit	
Public Safety	36.88%
Non-Public Safety	25.17%
Defined Contribution[9]	8%
Hybrid – GRIP	7.27%

Source: 2010 Actuarial Valuation Report; Montgomery County Code

Taking into account the Executive's proposed retirement changes, the Office of Management and Budget estimates that the defined benefit plans would cost the County Government $104 million in FY12, or about 88% of the total cost for employee retirement benefits. OMB estimates that the defined contribution plans would cost the County Government $14 million (or 12% of the total) in FY12. At the same time, the Executive has proposed that 55% of the projected FY12 savings from retirement changes ($10.9 million) come from employees in the defined benefit plans and 45 percent from employees in the defined contribution plans.

Policy Question #2: Should a portion of the County's structural budget problem be addressed by changing the defined benefit package offered to employees?

The Executive did not propose any changes to the benefit provided by the defined benefit plans for current employees or for new hires. Even if the Council approves the Executive's proposal, County Government defined benefit pensions will continue to require large annual contributions. As of December 2010, while the County Government's pension liability for current employees and retirees is $3.6 billion, the ERS pension system is underfunded by $854 million.

As detailed above, to address the underfunding of its defined benefit plans, the State of Maryland made two changes to the defined benefit package for current employees in State-run pension plans and numerous changes to the defined benefit package that will be offered to new employees beginning July 1, 2011 (including most new employees hired by MCPS and Montgomery College beginning in FY12). The County Government could make similar changes to its defined benefit plans.

[8] For employees hired after July 1, 1978. The County Government contributes substantially more to the defined benefit plans for employees hired before July 1, 1978 – between 46% and 425% of salary.

[9] The County contributes 10% of salary to retirement accounts for non-rep. public safety employees in the RSP or GRIP.

5. **Committee Discussion of Retirement Benefit Alternatives**

a. **Defined Contribution Plan Alternatives**

The Executive's proposed retirement plan changes raise a question of fairness because the changes achieve disproportionate savings from the County Government's less expensive retirement plans. As mentioned above, under the Executive's proposed changes, the cost of contributions for members of the defined contribution plans account for about 12% of the County Government's annual retirement costs, while these employees contribute almost half of the Executive's estimated savings from retirement plan changes.

Defined contribution plans are less expensive than the defined benefit plans because they provide a less generous retirement benefit. As detailed in OLO's memorandum of March 17, the pension benefit for an employee who retires after 30 years of service is worth about 2 ½ more (in present value terms) than the defined contribution benefit provided an employee who worked the same number of years.[10]

To address the question of fairness raised by the Executive's proposed changes to the defined contribution retirement plans, below are three alternatives that the Committee may want to consider:

ALTERNATIVE **#1: Retain current contribution.** The Council rejects the Executive's proposal and retains the current 8% contribution to employees' defined contribution retirement accounts.

ALTERNATIVE **#2: Reduce contribution by 2% in FY12 only.** The Council approves a 2% reduction in the contribution to employees' defined contribution accounts for one year only, FY12.

ALTERNATIVE **#3: Reduce in proportion to employee cost.** The Council approves a decrease in the County Government's contribution to employees' defined contribution retirement accounts by 0.5%, which is an amount more proportional to the members' FY12 costs to the County.

The table below summarizes the projected savings between FY12 and FY17 from these alternatives.

Projected Savings from Defined Contribution/Alternatives, FY12-FY17
($ in millions)

Alternative	Description	FY12	FY13	FY14	FY15	FY16	FY17
#1	Retain current 8% contribution	$0	$0	$0	$0	$0	$0
#2	Reduce contribution by 2% in FY12 only	$4.9	$0	$0	$0	$0	$0
#3	Reduce contribution in proportion to cost	$1.2	$1.2	$1.3	$1.3	$1.4	$1.4
Executive's	Reduce contribution by 2% permanently	$4.9	$5.0	$5.1	$5.3	$5.5	$5.7

Note: Savings calculated by comparing cost of each alternative to what the cost would be each year if the current policy continued unchanged.
Source: OMB 3-29-11 Fiscal Impact Statement – FY12 Labor Agreements, OLO calculations

[10] http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-17-11AdditionalInformationaboutCurrentRetirementBenefits.pdf

b. Changes to the Structure of the Defined Benefit Plans

The Executive's proposed retirement benefit changes shift some of the cost of defined benefit plans to employees but do not lower costs by altering the structure of the benefit that employees receive when they retire. Many jurisdictions around the country, including the State of Maryland, have changed the structure of the defined benefit offered to new hires and, in some cases, to current employees for years not yet served. The State's changes will apply to employees in MCPS and Montgomery College.

Each of the four alternatives described in more detail below would change the structure of the County Government's defined benefit plans. The first three apply only to new hires. The fourth would change the benefit both for new hires and current employees for future years of service. The table at the end of the options compares the relative savings from alternatives 1, 2, and 4.

ALTERNATIVE #1: Change defined benefit components for new public safety hires.

This alternative would change three components of the defined benefit plans, the:

- Defined benefit vesting period,
- Calculation of employees' average final earnings, and
- Structure of retirees' annual cost-of-living adjustment.

These changes would be similar to the changes recently made to State-run pension plans and would apply to pensions for all represented public safety employees hired on or after July 1, 2011. The table below compares the current provisions and the changes in this alternative.

Provision	Current[11]	Alternative #1
Vesting – Years Required	5 years	10 years
Average Final Earnings – Calculation	Highest 3 consecutive years of salary	Highest 5 consecutive years of salary
Cost-of-Living – Calculation	• 100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%.	100% of CPI up to a maximum increase of 2.5%

[11] For employees hired on or after July 1, 1978.

ALTERNATIVE #2: Adjust pension formula for new public safety hires. This alternative would make the required years of service and the minimum pension the same for new public safety hires.

Under this alternative, to receive full retirement, all represented public safety employees hired on or after July 1, 2011 would be required to work 25 years and would receive a minimum pension of 55% of their average final salary.

Currently, deputy sheriff/corrections and police employees must work at least 25 years to earn full retirement and receive a minimum of 60% of their average final salary. Fire and Rescue employees must work 20 years to earn full retirement and receive a minimum of 50% of their average final salary.[12] The table summarizes the changes in this alternative.

	Current Provisions		**Alternative #2**
	Police, Deputy Sheriff, Corrections,	**Fire and Rescue**	**Represented Public Safety Employees Hired on or after July 1, 2011**
Minimum Years of Service	25 Years	20 Years	25 Years
Minimum Benefit at Full Retirement	60% of Salary (2.4 multiplier[13])	50% of Salary (2.5 multiplier)	55% of Salary (2.2 multiplier)

This alternative shows one example of modified pension provisions for new hires. The Council could consider other combinations of minimum years of service and salary multipliers for new hires.

ALTERNATIVE #3: Create a hybrid retirement plan. This alternative would establish a retirement plan for new public safety employees with defined benefit and defined contribution components.

Under this alternative, all new represented public safety employees hired on or after July 1, 2011 would be in a new hybrid defined benefit/defined contribution retirement plan. A hybrid plan could be structured in a number of ways, such as a "stacked" hybrid plan or a "parallel" hybrid plan.

"Stacked" hybrid plans provide a defined benefit for employees up to a certain salary level – say $50,000. Salary above the set level would be covered by a defined contribution plan. A "parallel" hybrid plan would provide employees a less generous defined benefit plan based on the full amount of their salary plus a supplemental defined contribution plan.[14]

Savings under this option would come from establishing a less generous pension than employees currently receive. The defined contribution portion could also be structured in a number of ways. A defined contribution option could be structured like the RSP (mandatory, set employer and employee contributions) or it could be made optional, with the employee choosing a contribution level within a range (e.g., 0-5% of salary) with the County Government matching a portion of that contribution.

The savings under this option would depend on the structure of the plan.

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[12] Employees receive a higher percent of salary as a retirement benefit for each year worked beyond the minimum number of years required for full retirement.

[13] The "multiplier" is one of three main components used to calculate an employee's annual pension when s/he retires (Annual Pension = Average Final Salary x Years of Service x Multiplier).

[14] For a good description of retirement plan structure, see *Issue Brief: A Role for Defined Contribution Plans in the Public Sector*, Center for State & Local Government Excellence (April 2011).
http://www.slge.org/index.asp?Type=B_BASIC&SEC=%7B6B5D32FD-C99D-41F7-9691-4F1B1D11452B%7D&DE=%7B6EE4FB32-1CE3-49C6-9CA9-6FC3E8B51D12%7D

ALTERNATIVE #4: **Lower cost-of-living adjustments.** This alternative would set a lower cap on annual cost-of-living adjustments for retiree pensions for current and future employees.

This alternative shows two ways to alter the structure of the cost-of-living adjustment that retirees receive. Alternative 4b mirrors the COLA provision recently adopted by the State of Maryland for most employees in State-run pension plans. This alternative would apply to all service on or after July 1, 2011, both for current County Government employees and for new hires.

Alternative	Provision	Current[15]	Alternative
4a	Cost-of-Living - Calculation	• 100% of the Consumer Price Index (CPI) up to 3%; plus 60% of CPI over 3% with a maximum annual increase of 7.5%. • Does not apply over age 65 or for disabled.	100% of CPI up to a maximum annual increase of 2.5%
4b			100% of CPI: • Up to a maximum of 2.5% if the County Government meets its annual investment return assumption (7.5%); or • Up to a maximum of 1% if the County Government does not meet its annual investment return assumption.

The table below summarizes estimates of savings calculated by the County Government's retirement plan actuaries. Given the time constraints under which the actuary was developing estimates, these numbers demonstrate the general magnitude of savings from these alternatives. The actuaries were not asked to estimate savings from Alternative #3 because savings would depend on the structure of the retirement benefit offered under the alternative.

Estimated Savings from Defined Benefit Alternatives
($ in millions)

Alternative	Employees Affected	Description	Estimated Savings	
			FY12	Ultimate
1	Future Hires	Change defined benefit components	$32,000	$5,500,000
2	Future Hires	Adjust pension formula	$21,000	$4,500,000
4a	Current Employees and Future Hires	Lower cost-of-living adjustments	$3,150,000	$3,700,000
4b			$6,080,000	$7,200,000

Source: Magnitude of savings estimate, Mercer

[15] This calculation applies to COLAs for employees hired on or after July 1, 1978.

C. RETIREE HEALTH BENEFITS

1. Summary of Executive's Proposed Changes

The Executive's Recommended FY12 Budget impacts retiree health benefits only insofar as the proposed changes to the prescription drug plan design will apply to both active and retired employees enrolled in the Caremark Prescription Drug plan. The design changes include:

- A mandatory generic provision;
- Eliminating coverage for medications used to treat erectile dysfunction; and
- A doubling of the copays for mail order prescriptions.

For more information on these proposed changes and some alternatives for the Committee's consideration, see page 18 of this memo.

The Executive's Recommended FY12 Budget did not propose any changes to the eligibility requirements for retiree health benefits or the premium cost share paid by retirees.

2. Recently Enacted Changes to Retiree Health Benefits by the State and Montgomery College

Recent changes made by the State of Maryland and Montgomery College to the structure of retiree health benefits are summarized below.

Note: On April 12, 2011, the Board of Education's Fiscal Management Committee's agenda included a discussion on retiree health benefits. OLO has requested that MCPS forward information on the specifics of any proposed changes as soon as it is available.

a. State of Maryland

The changes made by the State of Maryland are summarized in the table on the next page and further described below.

Eligibility. Employees hired after July 1, 2011 will have to work for 10 years (up from 5 years) to qualify for any retiree health benefits, and 25 years (up from 16 years) to receive the maximum health premium subsidy. The maximum subsidy will range from 80%-85% of medical plan premiums, depending on the type of plan; 75% of the prescription drug premium; and 50% of the dental plan premium. Employees who work between 10 and 25 years will receive proportionally smaller subsidies from the State.

Prescription Drug Plan Design and Premium Cost Share. Currently, the State's active employees and retirees are in the same prescription drug program. For FY12, the State will create a separate prescription drug program for current and future retirees. The retiree plan will have increased copays (mirroring the copay increase for active employees, see page 17) and the out-of-pocket maximums will increase to $1,500 for an individual and $2,000 for a family.

In addition, the State changed the cost share percent for retiree prescription drug premiums from 80/20 to 75/25, which reduces the State's cost share by five points.

Elimination of Prescription Drug Coverage for Medicare-Eligible Retirees in 2020. Beginning on July 1, 2020, Medicare-eligible retirees will no longer receive prescription coverage from the State. Instead, they will have to enroll in Medicare Part D coverage. Spouses and dependents under age 65 will continue to receive coverage through the State.

Summary of the State of Maryland's Changes to Retiree Health Benefits (Effective July 1, 2011)

Area	Current Provision	New Provision
Retiree Health Benefits		
Eligibility for new hires	• 5 years of service to qualify for minimum subsidy • 16 years of service for maximum subsidy	• 10 years of service to qualify for minimum subsidy • 25 years of service for maximum subsidy
Prescription Drug Benefit		
Copays	• Range of $5 to $50 for retail • Range of $5 to $20 for mail order	• Range of $10 to $80 for retail • Range of $10 to $80 for mail order
Annual out-of-pocket cap	$700 per family unit	• $1,500 for individual coverage • $2,000 for family coverage
Premium Cost Share	20% of premium	25% of premium

b. Montgomery College

The table below summarizes Montgomery College's recently adopted changes to retiree health benefits for employees hired on or after July 1, 2011. **In sum, similar to the State of Maryland, the College increased the number of years an employee has to work before being eligible for retiree health benefits and before they can receive the maximum subsidy.** The College also added a provision that retirees cannot add new dependents after they retire. This would apply only to new dependents who were not previously eligible when the retiree was employed by the College. (MCPS already has a similar restriction; Montgomery County does not).

Montgomery College Changes to Retiree Health Benefits for FY12

Area	Future retiree health benefit for...	
	Current Employees	**Employees Hired on or after 7/1/11**
Eligibility	• When eligible to retire under state system	• When eligible to retire under state system plus minimum age of 55 and minimum 15 years of service
Premium Cost Share	• If fewer than 10 years of service, 40% of premium paid by College • If 10+ years of service, 60% of premium paid by College	• If fewer than 20 years of service, 40% of premium paid by College • If 20+ years of service, 60% of premium paid by College
Coverage of Dependents	• Able to add new dependents after retirement	• No adding new dependents after retirement

3. Committee Discussion of Retiree Health Benefit Alternatives

Below are two alternatives to achieve savings in the area of retiree health benefits for County Government employees. If the Committee is interested, there are other ways to make changes to retiree health benefits that staff could further develop and bring back for Committee consideration. For additional options, see OLO's Part II Report on *Achieving a Structurally Balanced Budget in Montgomery County*, Chapter D, Health Benefits for Retired Employees and items 19-23 listed in the Appendix titled "Additional Options."

Both of the alternatives below would apply only to newly hired employees. Although making structural changes to the benefits of new hires does not generally yield large savings in the short run, it does leads to substantial savings in the long run. For both of the alternatives, OLO has requested that the County's actuary provide an estimated amount of FY12 and future year savings of implementation for all County Government employees hired on or after July 1, 2011. OLO will forward this information to the Committee as soon as it is received.

ALTERNATIVE #1: Changing Eligibility Requirements and Cost Share for New Hires

This alternative parallels the changes recently adopted by the State of Maryland to change eligibility requirements for retiree health benefits for employees hired on or after July 1, 2011.

While some employees currently qualify for retiree health benefits after a minimum of 5 years of service, this alternative would raise that minimum to 10 years. Also, a retiree's health benefit cost share is based on the number of years they were eligible for benefits as active employees. Under this alternative, the cost share would remain the same, but the years of service would change.

Retirees who qualify for retiree health benefits with the new minimum of 10 years (up from 5 years) of credited service would receive the minimum County subsidy of 50% of the premium cost (i.e., a 50/50 cost share). Employees would need 25 years or more of credited service (up from the 15 years) to qualify for the maximum County subsidy of 70% of the cost (i.e., 70/30 cost share). For each year between 10 and 25 years, the County's share would increase by 1.33 percentage points.

Retiree Health Benefit Alternative 1: Changes to Eligibility Requirements/Cost Share

Area	Current	Alternative
Eligibility	• ERS Participants: employees eligible for retirement, with minimum 5 years of service • RSP Participants: varies based on years of service and age, with minimum of 5 years of service	• ERS Participants: employees eligible for retirement and minimum 10 years of service • RSP Participants: varies based on years of service and age, with minimum of 10 years of service
Cost Share	• 5 years of service: 50/50 cost share • 15+ years of service: 70/30 cost share • For each year between 5 and 15 years of service, the County's share increases 2%	• 10 years of service: 50/50 cost share • 25+ years of service 70/30 cost share • For each year between 10 and 25 years of service, the County's share increases 1.33%

ALTERNATIVE #2: Eliminate Retiree Health Benefits for New Hires

This alternative would eliminate retiree health benefits for new employees hired after July 1, 2011 or some other specified date in the future. It would maintain existing eligibility and benefit levels for current employees and retirees.

While not included in the County Executive's FY12 Recommended Budget, the Last Best Final Offer (LBFO) that the County submitted for its arbitration hearings with both MCGEO and IAFF proposed eliminating retiree health insurance for employees hired after July 1, 2011.

Since this alternative would only apply to employees hired after a specified future date, the County Government would continue to pay health care costs for current retirees and for the cohort of already hired employees once they retire. Over the course of many years, the County Government's cost for group insurance for retirees would be vastly reduced and eliminated. To date, the County Government has funded a relatively small portion of its long-term liability related to group insurance for retirees. If retiree health benefits were eliminated for new hires, the OPEB liability for current employees and retirees would still have to be paid. However, the County would not accrue any <u>new</u> OPEB liability related to newly hired employees.

D. HEALTH BENEFITS FOR ACTIVE EMPLOYEES

In FY11, the County Government will pay about $90 million (from tax supported and non-tax supported funds) for health insurance premiums for active employees. This includes coverage for medical, prescription drug, dental, and vision insurance. **The cost of health benefits, both for the County and its employees, is projected to increase by 9-10% annually over the next six years.**

This part of the memorandum is organized into six sections as follows:

On April 12, 2011, the Council introduced a resolution to establish a Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs. Additional discussion about the role of this Task Force is in the final section on alternatives, beginning on page 27.

1. Summary of Executive's Proposed Changes

The table below summarizes the Executive's proposed changes to health insurance for active employees and the estimated FY12 savings associated with each change. All of the Executive's estimated savings for health benefit changes assume a July 1, 2011 implementation date. More detail on each change follows the table.

Benefit Type	County Executive's Proposal	CE Estimated FY12 Savings
Health (Medical, Prescription, Dental, and Vision)	Minimum 30% Cost Share	$8,229,530
	Additional Salary-Based Charge	$7,418,000
Prescription Drug	Mandatory Generics	$1,200,000
	Eliminate ED Lifestyle Drugs	$400,000
	Increase Mail-Order Copays	$200,000

a. Executive's Proposed Changes to Active Employee Premium Cost Share

Currently, County Government employees pay at least 20% of health benefit premiums.[1] The Executive proposed a new two-part health care pricing approach.

(1) All employees would pay at least 30% of medical, prescription drug (standard), dental, and vision insurance premiums; AND

(2) Most employees who enroll in a medical and/or prescription plan would pay an additional salary-based charge.

Executive Recommended Changes to MCG Employee Health Benefit Cost Share

Salary Level	Percent of Workforce*	Current Minimum Employee Health Premium Contribution [1]	CE's Proposed Minimum Annual Employee Health Premium Contribution
Under $50,000	22%	20% of premium	30% of premium
$50,000 - $89,999	58%		30% of premium + $910
$90,000+	20%		30% of premium + $1,560

*Source: Montgomery County Office of Management and Budget, April 2011.

Actual Cost Share. If the Executive's proposals are implemented, employees will pay an actual cost share ranging from **30% to 58%** of the total combined premium for medical, prescription drug, dental, and vision coverage. Because the salary-based charge proposed by the Executive does not vary based on plan choice (e.g., HMO vs. POS) or level of coverage (e.g., single vs. family), employees subject to the added charge will pay a higher percent of the total premium if enrolled in a less expensive plan (e.g., single coverage, HMO plans).

Employee Cost Share for Combined Health Insurance Premium: Current vs. Executive's Proposal

Salary Level	% of Annual Premium* Paid by Employee [2]	
	Current Range	Range Under CE's Proposal
Under $50,000	20% to 32%	30% to 37%
$50,000-$89,999		34% to 49%
$90,000+		37% to 58%

*Includes costs for medical, prescription, dental, and vision coverage using calendar year 2011 premium rates.

Cost Share Increases Translated into Dollars. The Executive's proposal would require County Government employees to pay more to retain their current health care coverage. Employees in a higher cost plan (e.g., Carefirst High Option POS) could mitigate their additional cost of health insurance by switching to a lower cost plan (e.g., Kaiser HMO).

[1] Non-represented employees hired since 10/1/94 ("Select" plan members) pay 24% of premiums. Also, an employee who chooses the "high option" prescription plan pays an additional 7-8% of total health insurance premium costs.

[2] The highest employee cost share under current pricing and as proposed by the Executive reflects the cost of high option prescription coverage.

The following table shows the dollar amount of employee health benefit costs under current practice and as proposed by the Executive. The table shows the range of increase in employee health costs if employees stay in their current choice of health and prescription drug plans.

Annual Employee Health Insurance Premium Costs: Current vs. Executive's Proposal

Salary Level	Annual Employee Health Insurance Premium Costs*		
	Current Range	**Range Under CE's Proposal**	**Increase**
Under $50,000	$1,237 to $7,290	$1,855 to $8,587	$371 to $2,163
$50,000-$89,999		$2,765 to $9,497	$1,281 to $3,073
$90,000+		$3,415 to $10,147	$1,931 to $3,723

*Includes costs for medical, prescription, dental, and vision coverage using calendar year 2011 premium rates.

b. Executive's Proposed Changes to Prescription Drug Plan Design

The Executive proposes three changes to the design of the County's prescription drug plan. These changes would affect both active and retired employees enrolled in the County's Caremark prescription plans (both the Standard and High Option plans) but would not apply to those enrolled in the Kaiser prescription plan.

Mandatory Generic Drugs. Currently, employees who buy a brand name drug when a generic equivalent is available pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent. However, this requirement is waived if a physician prescribes a brand drug and writes "dispense as written" on the prescription. For FY12, the Executive proposes eliminating this exception process. Therefore, regardless of what the prescribing physician recommends, the County would not cover the cost of a brand drug when a generic is available and employees would have to pay the difference.

Lifestyle Drugs. The County's Caremark Prescription Plans would no longer cover medications that treat erectile dysfunction. Currently, the County's Kaiser Prescription Drug Plan does not cover these medications, but the Caremark Plan does.

Mail-Order Copays. The copays for mail order prescriptions (up to a 90-day supply) in the County's Caremark Prescription Plans would increase from one time to two times the copays for a 30-day supply purchased through a retail pharmacy as detailed in the table below.

Caremark Rx Drug Plan	Current Copay	Copay Under CE's Proposal
Standard Option	$10 Generic $20 Preferred Brand $35 Non-Preferred Brand	$20 Generic $40 Preferred Brand $70 Non-Preferred Brand
High Option 4/8	$4 Generic $8 Brand	$8 Generic $16 Brand
High Option 5/10	$5 Generic $10 Brand	$10 Generic $20 Brand

2. Description of MCGEO Proposed Health Benefit Changes for Arbitration Award

The last best final offer from MCGEO, Local 1994 included two provisions related to health insurance benefit changes. An arbitrator chose MCGEO's last best final offer as the more reasonable offer (including its proposed health benefit changes). The Executive, however, did not include MCGEO's health benefit proposals in his recommended budget.

Transfer of Employee Medical Coverage. The MCGEO proposal would require that all bargaining unit members currently enrolled in the Carefirst High POS or Carefirst Standard POS medical plans be moved to the United Healthcare HMO medical plan.

The Office of Management and Budget's Fiscal Impact Statement (FIS) for the FY12 Labor Agreements between Montgomery County and MCGEO estimated that this change would achieve up to **$2,096,348 million in FY12 savings.**[3] The FIS projected that the savings from this proposal would increase to $3,376,724 million in FY16.

Health Care Cost Management. The MCGEO proposal would require the County and the union to work with United Healthcare to develop a health care cost management strategy. The cost management strategy would be designed to impact the medical cost drivers to lower medical trend and plan costs by:

- Reducing health risk factors prevalent in the Montgomery County employee population;
- Improving treatment compliance of employees with chronic conditions;
- Improving medication adherence of employees with chronic conditions;
- Decreasing the prevalence of obesity in the population;
- Increasing the number of people exercising and eating nutritious meals;
- Exploring more cost efficient prescription, dental, and vision programs.

Neither the MCGEO proposal nor the Office of Management and Budget's Fiscal Impact Statement included a specific dollar savings associated with health care cost management for FY12 or future years.

3. Recent Changes to Prescription Drug Plan Benefits for State Employees

The State of Maryland recently made two changes to the prescription drug plan design (copays and out-of-pocket maximums) for State employees, beginning in FY12.

Increased copays. The State increased the prescription drug copays for both active and retired employees beginning in FY12 as detailed in the table below.

Type of Drug	Current Copay Range (varies by amount purchased)		New Copay Range for Retail and Mail Order (varies by amount purchased)
	Retail	Mail Order	
Generic	$5-$10	$5-$10	$10-$20
Preferred Brand	$15-$30	$15-$20	$25-$50
Non-Preferred Brand	$25-$50	$20	$40-$80

[3] Assumes that all MCGEO members enrolled in Carefirst at the end of 2010 will move to UHC. The estimated savings is the difference between the cost of the two plans in calendar year 2011 (County portion) multiplied by the enrollment at each coverage level (individual, individual plus one, and family).

4. Update on FY12 Health Benefit Changes in other County Agencies

Under current practice, County Government, MCPS, and Montgomery College separately structure and administer the group insurance benefits offered to each agency's respective employees and retirees.

Montgomery College staff report that the College is considering the introduction of a high-deductible medical plan that would be offered to employees beginning in FY12. The College currently has a 75/25 cost share split for health benefit premiums.

M-NCPPC currently has an 85/15 cost share split for health benefit premiums. The Commission (which provides the same package of benefits to all employees of this bi-County agency) is currently reviewing its structure of group insurance benefits.

5. Summary of Health Benefit Policy Questions

The Executive's proposed changes to active employee health benefits raise two primary policy questions.

Policy Question #1: Should employees in all County agencies be offered a comparable package of health benefits? If not, then what factors should determine how the benefits differ?

Currently, each agency structures employee health benefits differently in terms of the plan design, plan administration, and employee eligibility. Additionally, the current premium cost share arrangements for health benefits vary among County agencies. Using medical plans as an example, MCPS employees pay either 5% or 10% of the annual premium; M-NCPPC employees pay 15%; County Government employees pay either 20% or 24%; and Montgomery College employees pay 25%. Further information on premium cost comparison among agencies, including both total premiums and cost to the agency, is included in the February 1, 2011 memorandum attached at ©5.

The Executive's proposed changes would increase the portion of the premium paid by County Government employees to a minimum of 30% and add a salary-based charge for most employees.

On April 12, 2011, the Council introduced a resolution that would create a Task Force to examine consolidation of agency group insurance programs and employee wellness. If the resolution is approved as introduced, one of the options for the Task Force to consider is to consolidate the agencies' health benefit offerings under a uniform plan design.

Policy Question #2: Should changes implemented in FY12 be part of a multi-year plan designed to achieve some explicitly-stated policy decisions regarding the health benefits offered to employees?

To answer this broad policy question, there are at least four key "sub-questions" that should be addressed: the share of total group insurance costs paid for by the County; the factors that determine the pricing structure of group insurance; the cost paid by retirees compared to active employees; and whether to implement structural changes for future hires.

What is the share of total group insurance costs that the County should pay for its active employees?

Currently, the County pays approximately 80% of total group insurance costs for its active employees while employees pay the remaining 20%. The cumulative impact of the County Executive's proposed changes, including the additional salary-based change, would change the overall cost share between the County and employees from 80/20 to 60/40. For comparison, the overall split in group insurance costs for MCPS is approximately 92/8, meaning MCPS pays 92% of the overall costs while employees pay the remaining 8%.

What factors should determine the pricing structure of group insurance, i.e., type of plan, level of coverage, employee's salary?

Currently the County pays 80% of the premium cost for Choice Plan enrollees (represented employees and non-represented employees hired prior to 10/1/94) and 76% of the premium cost for Select Plan enrollees (non-represented employees hired after 10/1/94). There are several other factors that the County could consider when determining the premium cost share arrangement with employees:

- Type of coverage (medical, prescription, dental, and vision)
- Type of plan (HMO, POS, PPO)
- Level of coverage (single, single + 1, and family)
- Employment status (Part-time vs. full-time)

There are many examples of other places that consider one or more of these factors to determine cost share. For example, the State of Maryland and MCPS vary cost share based on coverage and plan type. The State of Maryland pays a medical plan cost share ranging from 80%-85% depending on whether an employee is enrolled in a PPO, POS, or EPO medical plan, and pays a 50% cost share for dental coverage. MCPS pays a medical plan cost share ranging from 90%-95% depending on whether an employee is in a POS or HMO plan and a prescription plan cost share of 90%.

Fairfax County and Fairfax County Public Schools vary cost share based on level of coverage. For full-time employees, Fairfax County pays 85% for individual medical coverage, 75% for two-party and family medical coverage, and 50% for dental coverage. Fairfax County Public Schools has the same cost share arrangements for medical coverage and pays 70% of the premium for dental coverage.

Currently the County does not price any health plan based on an employee's salary; the Executive's proposal to charge an additional salary-based premium would be a notable policy shift for the County. According to a 2010 survey of public and private sector employer-sponsored health benefits by the Kaiser Family Foundation and the Health Research & Educational Trust, 13% of covered workers are in firms that vary worker premium contributions by wage level. OLO was able to identify only one public sector example of this practice, the State of West Virginia, which has had a salary-based premium structure for its employee health benefits since 1991.

Should retirees pay more, less, or the same for health benefits as active employees?

Retirees who are not yet eligible for Medicare pay the same health benefit premiums as active employees because retirees are included in the same "pool" for calculating premiums. As a result, active employees in County Government pay a higher premium than they would if they were in a separate pool. However, retirees currently pay a higher share of their premium than actives; retirees have a cost share ranging from 50/50 to 70/30 (depending on years of service) while most active employees have an 80/20.[4] The Executive has not proposed any change to retirees' cost share. If the Executive's FY12 proposed changes to cost share are adopted, some active employees could have a less favorable cost share than some retired employees.

[4] Employees hired before 1/1/87 have the option to receive an 80/20 cost share for the number of years they were eligible for insurance as an active employee or a lifetime cost share of 70/30.

Should a portion of the County's structural budget problem be addressed by changing the health benefits offered to new hires?

The Executive's proposal does not offer any changes in either active employee or retiree health benefits that would affect new hires. As described above, the State of Maryland and Montgomery College are implementing changes to future retiree health benefits for new employees.

6. Committee Discussion of Health Benefit Alternatives

Below are alternatives to the County Executive's proposals in the area of active health benefits for County Government employees. If the Committee is interested, there are other ways to make changes to active health benefits that staff could further develop and bring back for Committee consideration. (For additional options, see OLO's Part II Report on *Achieving a Structurally Balanced Budget in Montgomery County*, Chapter C, Health Benefits for Active Employees and items 12-18 listed in the Appendix titled Additional Options.)

a. Discussion of Alternatives to the Executive's Proposals for Prescription Drug Plan Changes

This section presents alternatives that would modify two of the Executive's proposed prescription drug plan design changes.

ALTERNATIVE #1. Add Strict Waiver Provision to Executive's Mandatory Generic Requirement

As described earlier, the Executive has proposed that employees who buy a brand name drug when a generic equivalent is available would pay the generic drug copay plus the difference between the cost of the brand name drug and its generic equivalent with no exceptions.

As an alternative option, the County could adopt this requirement but include a waiver provision that is stricter than the current process (where the physician only has to check "dispense as written" on the prescription) but that still allows for some coverage of brand medications with a generic equivalent under special circumstances. **One possible model is MCPS' Caremark Plan, which requires that a doctor provide a letter of medical necessity for coverage of a brand drug when a generic is available.**

Adding a waiver provision would likely lower the savings estimates associated with the Executive's proposed change.

ALTERNATIVE #2. Limit Coverage for Lifestyle Drugs

The County could choose to limit coverage of ED drugs, rather than eliminating coverage altogether, as the Executive has proposed. The coverage limits could mirror how these drugs are handled in other County agencies. For example:

- MCPS' Caremark Prescription Plan limits ED drugs to 6 doses per month.
- M-NCPPC charges a 50% copay for ED drugs and limits coverage to 6 pills per month.
- Montgomery College limits ED drugs to 6 doses per 25 day period (retail) or 18 doses per 75 day period (mail order).

Limiting instead of eliminating coverage for lifestyle drugs would likely lower the savings estimates associated with the Executive's proposed change.

b. Discussion of Alternatives to the Executive's Proposals for Pricing Group Insurance Benefits

This section presents a number of alternatives to the Executive's proposals for FY12 changes to pricing group insurance benefits. Additional alternatives can be developed upon Committee request.

The Committee may want to evaluate any alternatives to the Executive's proposals within the context of the Council Resolution (introduced 4/12/11) to establish a Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs. A copy of the resolution is attached at ©1. As introduced, in addition to researching and making recommendations on employee wellness programs, the Task Force is being asked to:

- Compare the major provisions/benefits of the health plans currently offered to employees and retirees across the County agencies, and analyze why costs may vary; and

- Make recommendations on how to streamline and reduce the current cost of health benefit administration, including how to: consolidate benefit plan offerings under fewer vendors; consolidate the offerings under one administrative unit; and consolidate the offerings under a uniform plan design.

The Resolution calls upon the Task Force to report back to the Council by December 15, 2011. If the Resolution is approved by the Council, **the scope and timing of the Task Force's work suggest that the Committee may want to look at changes implemented in FY12 as an interim step towards a more comprehensive restructuring of overall plan design and administration of group insurance benefits across the agencies.**

THREE GROUP INSURANCE PRICING ALTERNATIVES FOR FY12

To begin the Committee's discussion of potential alternatives to the County Executive's proposed changes to health benefit pricing, OLO has developed three alternatives that are outlined on the next page. For each, OLO provides estimates of FY12, FY13, and FY12-FY17 cumulative savings; and scenarios that show the impact on individual employees.

The policy issues related to pricing health benefits were discussed earlier in this memo. (see page 24). **All three alternatives developed by OLO adhere to the following guidelines**:

- Assume an implementation date of January 1, 2012;
- Provide a pricing incentive for the lower cost HMO medical plans;
- Do <u>not</u> include differential pricing based on an employee's salary;
- Eliminate the cost share distinction between Choice vs. Select employee groups; and
- Maintain the current structure of differential premiums but uniform cost share by level of coverage, i.e., single, single+1, family.

In addition to the three alternatives listed below, the Council may want to request more information on the feasibility of adding a high deductible health plan to the plans offered to County Government employees. A high deductible health plan usually includes the following features: catastrophic coverage with a higher deductible that a typical plan; an employer-funded account that employees can use to pay out-of-pocket medical costs on a pre-tax basis; and full coverage for in-network preventive care.

- ALTERNATIVE #1: **Maximum 5 point cost shift**

This alternative maintains the HMO cost share at 80/20 and changes the cost share to 75/25 (a 5 point shift) for all other plans. The Kaiser HMO (including the bundled Kaiser prescription plan) and United Healthcare HMO medical plans would have an 80/20 cost share for all employees. The cost share for the Carefirst POS medical plans, Caremark Standard Option prescription drug plan, and all dental and vision plans would change to 75/25 for all employees. The current practice of allowing employees to "buy-up" and purchase the Caremark High Option prescription plan would be maintained.

- ALTERNATIVE #2: **Maximum 10 point cost shift**

This alternative changes the HMO cost share to 75/25 (a 5 point shift) and changes the cost share to 70/30 (a 10 point shift) for all other plans. The Kaiser HMO (including the bundled Kaiser prescription plan) and United Healthcare HMO medical plans would have a 75/25 cost share for all employees. The cost share for the Carefirst POS medical plans, Caremark Standard Option prescription drug plan, and all dental and vision plans would change to 70/30 for all employees. The current practice of allowing employees to "buy-up" and purchase the Caremark High Option prescription plan would be maintained.

- ALTERNATIVE #3: **Fixed Employer Contribution**

Under this alternative, the County's contribution for medical and prescription coverage would be fixed at 80% of the lowest cost plan. The cost share for dental and vision benefits would change to 75/25 (a five point shift). The County would pay a fixed contribution for each employee's health and prescription coverage that is fixed at 80% of the lowest cost plan (currently Kaiser). Employees would have the option to "buy-up" and purchase any coverage that exceeds the fixed employer contribution by paying the additional amount. In effect, this alternative would establish an 80/20 cost share for the lowest cost medical and prescription plans and progressively higher cost shares for other plans. The cost share for dental and vision benefits would change to 75/25 for all employees.

Projected savings under health benefit alternatives. For each alternative, the table on the next page shows the projected cost savings to County Government in FY12 (half-year savings), FY13 (full-year savings), and the cumulative six-year projected savings from FY12-FY17. The savings for FY12 are half-year savings based on a January 1, 2012 implementation date. All projections under each alternative include tax supported and non-tax supported savings.

Projected Savings to County Government under Alternative Options for Changes to the Structure of Health Benefits

Alternative	New Structure as of January 1, 2012	Projected Savings*		
		FY12 (half-year)	FY13 (full-year)	Cumulative FY12-FY17
5 Point (max.) Cost Shift Reduce current agency cost share by a maximum of 5 points	• 80/20 HMO • 75/25 All Other	$2.1 million	$4.3 million	$27.5 million
10 Point (max.) Cost Shift Reduce current agency cost share by a maximum of 10 points	• 75/25 HMO • 70/30 All Other	$5.2 million	$10.9 million	$69.4 million
Fixed Employer Contribution Fixed contribution for medical and prescription coverage set at 80% of lowest cost plan, reduce agency cost share for dental and vision by a maximum of 5 points	• 80% of Kaiser plan cost for Medical and Rx • 75/25 Dental and Vision	$6.0 million	$12.6 million	$81.1 million

*The calculation for projected savings under each alternative assume current plan designs, no enrollment changes, and annual increases in health care costs averaging approximately 9% per year (actual increases vary by benefit type and plan).

Impact on employees. In general, under all three alternatives, the preferential pricing for HMOs means that employees who select HMO coverage (Kaiser or United Healthcare) would experience the smallest cost increases while employees who select a Point-of-Service plan (Carefirst Standard or High Option POS) would experience the largest cost increases.

The tables beginning on page 30 illustrate how each alternative would impact an individual employee's cost of family coverage (the most commonly selected level of coverage) in the following three different medical plans, assuming an employee chooses to stay with his/her current plan choice:

- Kaiser HMO – the lowest cost plan that includes a bundled prescription drug benefit;
- United Healthcare HMO – County Government's highest enrolled HMO plan; and
- Carefirst High Option POS plan – the County Government's highest enrolled POS plan.

Except for the Kaiser example, where the prescription drug plan is bundled with the medical plan, the examples use the Caremark Standard Option prescription plan.[5] All examples use the same dental (United Concordia PPO) and vision (National Vision Administrators) coverage for each employee. The projected employee costs, both under the "no cost share change" and alternative scenarios, are based on projected premium rates as of January 1, 2012.

[5] If a County Government employee chooses to "buy-up" and purchase Caremark High Option prescription coverage, the employee's "actual" cost share shown in the examples (under both the "no change" and the alternative) would be approximately 6-8% higher. The total increase in projected costs to the employee in 2012 would not change.

Pricing Alternative #1: Maximum 5 Point Cost Shift

Illustrative Examples of Impact on Employees (premium rates projected as of 1/1/12)

Kaiser HMO Example – Family Coverage

- Maintains Kaiser HMO medical and prescription plan cost share at 80/20
- Shifts cost share for dental and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	5 Point (max.) Cost Shift	Increase
Medical: Kaiser HMO **Prescription:** Kaiser HMO	$3,662	$3,662	$0
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$3,960**	**$4,035**	**$74**
Employee "Actual" Cost Share	**20%**	**20%**	**0%**

United Healthcare HMO Example – Family Coverage

- Maintains HMO medical plan cost share at 80/20
- Shifts cost share for prescription, dental, and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	5 Point (max.) Cost Shift	Increase
Medical: United Healthcare HMO	$3,140	$3,140	$0
Prescription: Caremark Standard	$913	$1,141	$228
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$4,351**	**$4,653**	**$303**
Employee "Actual" Cost Share	**20%**	**21%**	**1%**

Carefirst POS Example – Family Coverage

- Shifts cost share for POS medical, prescription, dental, and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	5 Point (max.) Cost Shift	Increase
Medical: Carefirst High POS	$3,508	$4,385	$877
Prescription: Caremark Standard	$913	$1,141	$228
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$4,719**	**$5,899**	**$1,180**
Employee "Actual" Cost Share	**20%**	**25%**	**5%**

Pricing Alternative #2: Maximum 10 Point Cost Shift
Illustrative Examples of Impact on Employees (premium rates projected as of 1/1/12)

Kaiser HMO Example – Family Coverage

- Shifts Kaiser HMO medical and prescription plan cost share from 80/20 to 75/25
- Shifts cost share for dental and vision plans from 80/20 to 70/30

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	10 Point (max.) Cost Shift	Increase
Medical: Kaiser HMO **Prescription:** Kaiser HMO	$3,662	$4,578	$916
Dental: United Concordia PPO	$276	$414	$138
Vision: National Vision Administrators	$22	$33	$11
Health Benefit Total	**$3,960**	**$5,025**	**$1,065**
Employee "Actual" Cost Share	**20%**	**25%**	**5%**

United Healthcare HMO Example – Family Coverage

- Shifts HMO medical plan cost share from 80/20 to 75/25
- Shifts cost share for prescription, dental, and vision plans from 80/20 to 70/30

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	10 Point (max.) Cost Shift	Increase
Medical: United Healthcare HMO	$3,140	$3,925	$785
Prescription: Caremark Standard	$913	$1,369	$456
Dental: United Concordia PPO	$276	$414	$138
Vision: National Vision Administrators	$22	$33	$11
Health Benefit Total	**$4,351**	**$5,741**	**$1,390**
Employee "Actual" Cost Share	**20%**	**26%**	**6%**

Carefirst POS Example – Family Coverage

- Shifts cost share for POS medical, prescription, dental, and vision plans from 80/20 to 70/30

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	10 Point (max.) Cost Shift	Increase
Medical: Carefirst High POS	$3,508	$5,262	$1,754
Prescription: Caremark Standard	$913	$1,369	$456
Dental: United Concordia PPO	$276	$414	$138
Vision: National Vision Administrators	$22	$33	$11
Health Benefit Total	**$4,719**	**$7,078**	**$2,359**
Employee "Actual" Cost Share	**20%**	**30%**	**10%**

Pricing Alternative #3: Fixed Employer Contribution (80% of Kaiser)
Illustrative Examples of Impact on Employees (premium rates projected as of 1/1/12)

Kaiser HMO Example – Family Coverage

- Fixed contribution for medical and prescription plan set at 80% of lowest cost plan (Kaiser)
- Shifts cost share for dental and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	Fixed Employer Contribution	Increase
Medical: Kaiser HMO **Prescription:** Kaiser HMO	$3,662	$3,662	$0
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$3,960**	**$4,035**	**$74**
Employee "Actual" Cost Share	**20%**	**20%**	**0%**

United Healthcare HMO Example – Family Coverage

- Fixed contribution for medical and prescription plan set at 80% of lowest cost plan (Kaiser)
- Shifts cost share for dental and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	Fixed Employer Contribution	Increase
Medical: United Healthcare HMO	$3,140	$3,981	$841
Prescription: Caremark Standard	$913	$1,634	$722
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$4,351**	**$5,988**	**$1,637**
Employee "Actual" Cost Share	**20%**	**28%**	**8%**

Carefirst POS Example – Family Coverage

- Fixed contribution for medical and prescription plan set at 80% of lowest cost plan (Kaiser)
- Shifts cost share for dental and vision plans from 80/20 to 75/25

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	Fixed Employer Contribution	Increase
Medical: Carefirst High POS	$3,508	$5,821	$2,313
Prescription: Caremark Standard	$913	$1,634	$722
Dental: United Concordia PPO	$276	$345	$69
Vision: National Vision Administrators	$22	$27	$5
Health Benefit Total	**$4,719**	**$7,828**	**$3,109**
Employee "Actual" Cost Share	**20%**	**33%**	**13%**

MONTGOMERY COUNTY PUBLIC SCHOOLS
POTENTIAL SAVINGS AND IMPACT ON EMPLOYEES FROM TWO ALTERNATIVE CHANGES IN COST SHARE

The County Executive's group insurance proposals (as well as the alternatives beginning on page 28) show changes for County Government employees only. The County Council appropriates funds to MCPS in broad categories established under State law. One of the categories includes funding for employee group insurance benefits. **The issue of equity among agency employees is addressed in Mr. Farber's packet (GO Committee #1, 4/25/11).**

MCPS already uses incentive pricing for HMO medical plans. **The current employer/employee premium cost share is 95/5 for HMOs and 90/10 for all other plans.**

The table below shows the estimated FY12 (half-year savings), FY13 (full-year savings), and cumulative FY12-FY17 cumulative agency savings that would accrue from two alternatives. The first alternative is a 5 point shift in cost share and the second is a 10 point shift in cost share for MCPS employees. The estimates of savings assume a continuation of MCPS' current practice of incentive pricing for HMO medical plans.

Projected Savings to MCPS from Changes to the Structure of Health Benefits

Alternative	New Structure	Projected Savings*		
		FY12 (half-year)	**FY13 (full-year)**	**Cumulative FY12-FY17**
<u>**5 Point Cost Shift**</u> Reduce current agency cost share by 5 points for all benefit plans	• 90/10 HMO • 85/15 All Other	$7.0 million	$14.5 million	$91.0 million
<u>**10 Point Cost Shift**</u> Reduce current agency cost share by 10 points for all benefit plans	• 85/15 HMO • 80/20 All Other	$13.9 million	$28.9 million	$182.0 million

*The calculation for projected savings under each alternative assume current plan designs, no enrollment changes, and annual increases in health care costs averaging approximately 8% per year (actual increases vary by benefit type).

Impact on MCPS employees. The tables beginning on page 34 illustrate how each of the alternatives summarized above (a 5 point cost share shift and a 10 point cost share shift) would impact an MCPS employee's cost of group insurance (family coverage) in two different medical plans:

- United Healthcare HMO – MCPS' highest enrolled HMO plan; and
- United Healthcare Open POS plan – MCPS' highest enrolled POS plan.

All examples use the same prescription (Caremark), dental (Aetna PPO), and vision (National Vision Administrators) coverage for each employee example. The projected employee costs, both under the "no cost share change" and alternative scenarios, are based on projected premium rates as of January 1, 2012.

MCPS Example #1: 5 Point Cost Shift

Illustrative Examples of Impact on Employees (premium rates projected as of 1/1/12)

United Healthcare HMO Example – Family Coverage

- Shifts cost share for the HMO medical plan from 95/5 to 90/10
- Shifts cost share for the prescription, dental, and vision plans from 90/10 to 85/15

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	5 Point Cost Shift	Increase
Medical: United Healthcare HMO	$768	$1,537	$768
Prescription: Caremark	$451	$676	$225
Dental: Aetna PPO	$120	$180	$60
Vision: National Vision Administrators	$3	$4	$1
Health Benefit Total	**$1,342**	**$2,397**	**$1,055**
Employee "Actual" Cost Share	**6%**	**11%**	**5%**

United Healthcare Open POS Example – Family Coverage

- Shifts cost share for the medical, prescription, dental, and vision plans from 90/10 to 85/15

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	5 Point Cost Shift	Increase
Medical: United Healthcare Open POS	$1,552	$2,328	$776
Prescription: Caremark	$451	$676	$225
Dental: Aetna PPO	$120	$180	$60
Vision: National Vision Administrators	$3	$4	$1
Health Benefit Total	**$2,126**	**$3,189**	**$1,063**
Employee "Actual" Cost Share	**10%**	**15%**	**5%**

MCPS Example #2: 10 Point Cost Shift
Illustrative Examples of Impact on Employees (premium rates projected as of 1/1/12)

United Healthcare HMO Example – Family Coverage

- Shifts cost share for the HMO medical plan from 95/5 to 85/15
- Shifts cost share for the prescription, dental, and vision plans from 90/10 to 80/20

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	10 Point Cost Shift	Increase
Medical: United Healthcare HMO	$768	$2,308	$1,537
Prescription: Caremark	$451	$902	$451
Dental: Aetna PPO	$120	$240	$120
Vision: National Vision Administrators	$3	$6	$3
Health Benefit Total	**$1,342**	**$3,452**	**$2,110**
Employee "Actual" Cost Share	**6%**	**16%**	**10%**

United Healthcare Open POS Example – Family Coverage

- Shifts cost share for the medical, prescription, dental, and vision plans from 90/10 to 80/20

Health Benefit Type and Plan	Projected Cost to Employee in 2012		
	No Change in Cost Share	10 Point Cost Shift	Increase
Medical: United Healthcare Open POS	$1,552	$3,105	$1,552
Prescription: Caremark	$451	$902	$451
Dental: Aetna PPO	$120	$240	$120
Vision: National Vision Administrators	$3	$6	$3
Health Benefit Total	**$2,126**	**$4,252**	**$2,126**
Employee "Actual" Cost Share	**10%**	**20%**	**10%**

E. Life Insurance, Long-Term Disability, Accidental Death and Dismemberment Insurance

1. Summary of Executive's Proposed Life Insurance Benefit Changes

The County Executive proposed changes to life insurance benefits that would reduce the benefit level for most County Government employees and would change the cost share for all employees, as detailed in the table below.

County Government Employee Group	Current Basic Life Insurance Benefit	CE's Proposed Basic Life Insurance Benefit
Non-Represented Employees hired prior to 10/1/94 and Represented Employees	• Benefit level = 2x annualized salary • Employee pays 20% of premium	• Benefit level = 1x annualized salary • Employee pays 30% of premium
Non-Represented Employees hired on or after 10/1/94	• Benefit level = 1x annualized salary • Employee pays 24% of premium	

The Executive estimates that the proposed changes to life insurance benefits would achieve $1.2 million in FY12 savings, assuming implementation on July 1, 2011. Employees would still have the ability to buy up to higher levels of coverage by paying the full cost of optional life insurance. The Committee may want to consider the following alternative to the Executive's proposed changes to life insurance.

ALTERNATIVE: Keep Benefit at Two Times Annualized Salary

Rather than reducing the benefit to one times annualized salary, this alternative would maintain the benefit at two times annualized salary for most employees and increase the benefit to two times annual salary for non-represented employees hired on or after 10/1/94. The cost share arrangement for this benefit would track any changes made to the health benefit cost share arrangements.

Note: OLO has requested data from the Executive that would allow for calculating the savings associated with this alternative.

2. Summary of Executive's Proposed Long-Term Disability Insurance Changes

The County Executive proposed changing the cost share for long-term disability insurance so that all County employees would pay 30% of premiums. Currently, represented employees and non-represented employee hired prior to 10/1/94 pay 20% of premiums, and non-represented employees hired on or after 10/1/94 pay 24% of premiums. **The Executive estimates that this proposed change would achieve $48,000 in FY12 savings, assuming implementation on July 1, 2011.**

3. Summary of Executive's Proposed Accidental Death and Dismemberment (AD&D) Insurance Changes

Under the County Executive's proposed FY12 budget, the AD&D benefit for represented employees and non-represented employees hired prior to 10/1/94 (i.e., current Choice plan participants) would not change. The AD&D benefits for non-represented employees hired on or after 10/1/94 (i.e., current Select plan participants) would be increased to the same level as the current Choice plan participants, so all employees would receive the same AD&D benefit. This change is consistent with the Executive's package of group insurance proposals that would eliminate the distinction between Choice and Select employee groups. **OMB staff note that this change will have a negligible fiscal impact.**

F. FUTURE INCREASES TO SALARY

1. Overview of Spending on Salaries

In FY11, County agencies collectively will spend about $2.1 billion on tax supported employee salaries. **The amount spent on salaries (excluding benefits) represents about 62% of all tax supported spending for the four agencies combined.**

While the FY11 budget did not fund any pay increases for employees, agency salary costs have grown substantially over the past decade. Salary increases have a recurring fiscal impact because they shift the base of spending upwards and increase the cost of benefits that are a function of an employee's salary, i.e., retirement, social security/FICA, life insurance, and LTD insurance.

The table below shows salary expenditures by agency for FY02 and FY11. During this 10-year period, the rate of inflation was 29% and tax supported agency spending on employee salaries (in aggregate) increased by 50%. This percent change in agency salary expenditures reflects multiple factors such as salary increases, change in workforce size, turnover, promotions, position reclassifications, special pay, and overtime.

Tax Supported Salary Expenditures by Agency

Agency	FY02	FY11	FY02-FY11 Increase	
			$	%
Montgomery County Government	$364 million	$518 million	$154 million	42%
MCPS	$878 million	$1.3 billion	$422 million	53%
Montgomery College	$79 million	$141 million	$62 million	79%
M-NCPPC	$40 million	$53 million	$13 million	33%
Total	**$1.4 billion**	**$2.1 billion**	**$651 million**	**50%**

The table on the following page shows annual salary increases received by the three County Government bargaining units and non-represented employees between FY02 and FY11.

In most years during this time period, employees received two types of salary increases: steps (also referred to as service increments) and general wage adjustments.

- A **step increase (or service increment)** is an increase to base salary granted to employees who are below the maximum for their pay grade and who meet minimum job performance requirements. An employee typically receives a step increase on the anniversary of his/her original hire date.

- A **general wage adjustment (GWA)** is an increase in pay granted to all employees on a specific date, usually the beginning of a new fiscal year. Historically, the practice of County agencies has been to grant general wage adjustments as increases to base salary. The general wage adjustment is often referred to as a cost-of-living adjustment (COLA).

Employee salary levels and adjustments fall under the authority of the governing body for each agency. In addition, GWAs and step increases are included in agency personnel regulations and/or in collectively bargained agreements between agencies and their respective employee unions.

FY02-FY11 Annual County Government Step Increases and General Wage Adjustments By Bargaining Unit

		FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11
MCGEO	Step	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	0.0%
	GWA	3.25%	3.5%	3.75%	2.0%	2.75%	4.0%	4.0%	4.5%	0.0%	0.0%
	Total	**6.75%**	**7.0%**	**7.25%**	**5.5%**	**6.25%**	**7.5%**	**7.5%**	**8.0%**	**3.5%**	**0.0%**
IAFF	Step	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	0.0%
	GWA	3.0%	5.0%	3.5%	3.5%	4.0%	5.0%	5.0%	4.0%	0.0%	0.0%
	Total	**6.5%**	**8.5%**	**7.0%**	**7.0%**	**7.5%**	**8.5%**	**8.5%**	**7.5%**	**3.5%**	**0.0%**
FOP	Step	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	0.0%
	GWA	*	4.0%	2.0%	2.0%	2.75%	4.0%	**	4.0%	0.0%	0.0%
	Total	*****	**7.5%**	**5.5%**	**5.5%**	**6.25%**	**7.5%**	******	**7.5%**	**3.5%**	**0.0%**
Non-Represented	Step	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	0.0%
	GWA	3.25%	3.5%	2.0%	2.0%	2.75%	4.0%	4.0%	4.5%	0.0%	0.0%
	Total	**6.75%**	**7.0%**	**5.5%**	**5.5%**	**6.25%**	**7.5%**	**7.5%**	**8.0%**	**3.5%**	**0.0%**

Source: Memorandum from Council Staff Director to Management and Fiscal Policy Committee, April 20, 2010.

* The FY02 general wage adjustment for FOP members was a flat dollar amount of $3,400.

** The FY08 agreement with the FOP included a salary schedule adjustment and a general wage adjustment that resulted in a $3,151 increase to the starting pay for police officers.

2. Alternatives to Moderate the Rate of Future Salary Growth

As part of an overall strategy for addressing the structural budget deficit, the Council may want to consider establishing a policy for moderating the rate of future salary growth. Because salary increases are recurring costs that have a compounding effect on future year budgets, a structural change that addresses the rate of salary growth going forward could make a significant contribution to the sustainability of annual compensation decisions.

While the Executive's Recommended FY12 budget freezes County Government employee salaries (meaning no General Wage Adjustment and no steps/increments), it is generally accepted that increases to employee salaries will be recommended and funded at some point in the future. Towards that end, the Council may wish to consider establishing policies that would moderate the salary increases that result from either General Wage Adjustments and/or steps/increments.

Three alternative policies to consider are listed below.

1. Set a maximum percent increase: The Council could establish a policy that sets a maximum annual rate of employee salary increases that is sustainable over time. Such a policy could place a ceiling on pay increases (for GWAs and/or steps) that employees would be able to receive in any one year.

2. Award salary adjustments on a biennial basis: When revenues allow for the return of employee pay increases, the Council could establish a policy that encourages agencies to award GWAs and/or step increases every other year rather than annually.

3. Award lump sum payments in lieu of increases into base: This alternative would be to set a policy to encourage County agencies to consider lump sum "bonus" payments to employees in lieu of GWA or step increases. Lump sum payments provide employees additional compensation during the year of the award but do not add to base salary costs in future years.

If the Committee is interested in pursuing any of the above (or other) alternatives, staff recommends the Committee seek advice from the Council's Senior Legislative Attorneys about the different ways the Council could establish these types of parameters on salary growth.

List of Attachments

Resolution Introduced 4/12/11

Resolution No.: ______________
Introduced: ______________
Adopted: ______________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Councilmember Leventhal, Councilmember Elrich, Council President Ervin, and Councilmember Navarro

SUBJECT: Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs

Background

1. The Council has historically provided strong support for the employee group insurance programs of the five County and bi-County agencies: Montgomery County Government, Montgomery County Public Schools, Montgomery College, the Maryland-National Capital Park and Planning Commission, and the Washington Suburban Sanitary Commission. The Council has also encouraged multiple measures to reduce costs. The Council recognizes that for the two bi-County agencies, M-NCPPC and WSSC, coordination with Prince George's County is required.

2. On December 9, 2003 the Council adopted Resolution No. 15-454, Policy Guidance for Agency Group Insurance Programs. The resolution endorsed a series of cost-reduction proposals made by the Council's 2003 Task Force on Health Benefit Improvements and by the Council's actuarial consultant, Bolton Partners. The agencies have followed through in several areas. For example, to achieve economies of scale, the agencies have jointly bid components of their group insurance programs. For new contracts that took effect on January 1, 2011, all five agencies jointly bid their medical, dental, vision, and life insurance programs.

3. Efforts to further contain increases in group insurance costs must remain a high priority The combined FY11 group insurance budgets for all agencies (excluding WSSC) total \$393.6 million, \$314.6 million for active employees and \$79.0 million for retired employees. (Funding for retired employees is the annual pay-as-you-go amount only and does not include the much larger cost of pre-funding these benefits.) These costs are projected to continue to rise significantly in future years. The County Executive's FY12 Recommended Operating Budget projects that costs could increase an average of 10 percent annually through FY17.

4. The Cross-Agency Resource-Sharing (CARS) Committee, established in 2010, included employee benefits in its review of potential cost savings. Three components under review by a CARS subcommittee address consolidation and streamlining of agency group insurance programs:

   - Consolidate agency employee benefit plan offerings under fewer vendors;
   - Consolidate the offerings under one administrative unit; and
   - Consolidate the offerings under a uniform plan design.

5. The CARS subcommittee estimates that the potential annual savings from the first component is $2-4 million, depending on the degree of consolidation. The second and third components have the potential for additional savings, also depending on how they are constructed and implemented. One example of current agency consolidation is the Montgomery County Self-Insurance Program, which is administered by the Finance Department. The program provides comprehensive property and casualty insurance for the County and participating agencies and is funded through actuarially determined contributions they provide.

6. The Council strives to improve the health of all residents of Montgomery County and believes that health care plans should not just focus on how an employee's health care costs are paid for but how our health plans and programs can be used to improve the health and well-being of our employees. In addition, experts have told the Council that the cost of providing health care can also be reduced by increasing employee wellness, which will decrease the dollars needed for treatment and medications.

Action

The County Council for Montgomery County, Maryland approves the following resolution:

Access to affordable health care for all employees and all residents of Montgomery County is a primary goal of the Council.

The Council will begin to work immediately to identify as much cost containment in employee health coverage as possible.

A Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs is established by the Council.

1. Members of the Task Force will include, but are not limited to, representatives from County Government's Office of Human Resources and Department of Health and Human Services, Montgomery County Public Schools, Montgomery College, M-NCPPC, WSSC, and bargaining unit representatives from the County and bi-County agencies. The Council will also seek members who are public health experts and representatives from County businesses with employee wellness programs. The Council will appoint a Chair and Vice Chair.

2. The Task Force will submit its report to the Council not later than December 15, 2011. The report should include:

   a. A review of employee wellness programs currently in place in County and bi-County agencies.

   b. Information on models of employee wellness programs in both the public and private sector, including the success and outcomes of programs and whether there is evidence that health care costs have been reduced over time.

   c. Recommendations for establishment of or improvements to employee wellness programs in the County and bi-County agencies. These recommendations should be developed in a framework that minimizes administration and the number of vendors that might be required.

d. A comparison of the major provisions/benefits of the health plans currently offered to employees and retirees and an analysis of why costs may vary.

e. Recommendations on how to streamline and reduce the current cost of administration, including how to:
   - Consolidate agency employee benefit plan offerings under fewer vendors;
   - Consolidate the offerings under one administrative unit; and
   - Consolidate the offerings under a uniform plan design.

In order to best use the time and expertise of Task Force members, the Task Force may be organized into committees to focus separately on the issues of: (1) employee wellness and disease prevention programs, and, (2) consolidation of plan design and administration.

The Council acknowledges that employee benefits are subject to bargaining for each bargaining unit.

This is a correct copy of Council action.

____
Linda M. Lauer, Clerk of the Council

County Government Health Plan Enrollment Data
Active Employees (Select + Choice Groups) as of January 4, 2011

Medical Plan Enrollment

	#	%
Choice Group	7,014	89%
Select Group	868	11%
Total Active Employees	7,882	100%

Distribution of Enrollees By Plan

	Total
Medical	
Carefirst High POS	63%
Carefirst Std POS	4%
Kaiser HMO	13%
UHC HMO	20%
All Medical	100%
Prescription	
Caremark High 4/8	40%
Caremark High 5/10	19%
Caremark Standard	41%
All Prescription	100%
Dental	
UCCI PPO	97%
UCCI DMO	3%
All Dental	100%
Vision	
NVA	100%

Distribution of Enrollees by Level of Coverage – Single, Single +1, or Family

	Single	Single + 1	Family	Total
Medical				
Carefirst High POS	31%	23%	46%	100%
Carefirst Std POS	39%	27%	34%	100%
Kaiser HMO	38%	23%	39%	100%
UHC HMO	28%	24%	48%	100%
All Medical	32%	24%	45%	100%
Prescription				
Caremark High 4/8	35%	26%	39%	100%
Caremark High 5/10	31%	24%	46%	100%
Caremark Standard	27%	21%	52%	100%
All Prescription	31%	24%	46%	100%
Dental				
UCCI PPO	30%	24%	45%	100%
UCCI DMO	39%	21%	40%	100%
All Dental	31%	24%	45%	100%
Vision				
NVA	30%	25%	45%	100%

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Source: Office of Human Resources

Note: Due to rounding, numbers in the tables may not add to exactly 100%.

MEMORANDUM

February 1, 2011

TO: Councilmembers

FROM: Karen Orlansky, Director
Office of Legislative Oversight

SUBJECT: **Follow-up to OLO Report on Achieving a Structurally Balanced Budget: Answers to Questions about the Cost of Health Benefits for Active Employees**

This memo responds to Councilmembers' requests for additional information on the current costs of agency health benefits, including a comparison of health premium costs in County Government and Montgomery County Public Schools. It addresses the following questions:

- What is each agency's average annual premium cost per health plan enrollee[1]?
- What are each agency's annual total health premiums by plan and level of coverage?
- What are the major factors that affect an agency's health benefit costs?
- What is the impact of the County Government's practice of including retirees in the employee "pool" for calculating health plan premiums?

Summary of Findings on Premium Comparisons Among Agencies

An updated analysis of agency premiums and enrollment using FY11 data shows that:

- County Government and MCPS both have higher average health plan premiums and higher per enrollee costs compared to M-NCPPC and Montgomery College.
- In 2011, MCPS pays $557 (or 5%) more per health plan enrollee compared to County Government. Specifically, given current employer/employee cost share arrangements, MCPS pays an average annual health plan premium of $11,701 per enrollee while the County Government pays $11,144.
- In 2011, the annual total health premium per enrollee in County Government (agency plus employee share) is $2,203 (or 17%) higher compared to MCPS. Specifically, the total average health premium per enrollee in County Government is $14,866 compared to $12,663 in MCPS.
- A factor that complicates a comparison of premium rates between MCPS and County Government is that the County Government includes retirees in its calculation of premiums, while MCPS does not. Data from the County's actuaries show that if retirees were excluded from the County Government's active employee pool, the difference between the County Government's and MCPS' total average annual health premium for active employees would be lowered to $595 (or 5%). In other words, the inclusion of retirees "explains" about 73% of the County Government's higher total premium.

[1] Throughout this memo, "enrollee" refers to each active employee enrolled in an agency's health plan, not including dependents who are also covered by the plan.

Note on Health Benefit Cost Data. OLO's Part II appendix includes a document (beginning on page 99), prepared by CountyStat in March 2010, that lists average monthly employer-paid premiums for health benefits across nine local government organizations, including County Government and MCPS. These data showed that the employer portion of the average monthly premium for plans offered by County Government was higher than the average premium for plans offered by MCPS.

In response to questions generated by these data, OLO researched their source and learned that the information (which had been initially compiled for the County Government's Office of Human Resources by a consultant) relied upon 2010 rate data from the County Government and 2009 rate data from MCPS. Due to the steady annual increases in health care costs experienced in recent years, a comparison that uses cost data from two different years is problematic.

OLO apologizes for any confusion that including the CountyStat report in the appendix may have caused. Please note that OLO did not use these data for any of our issue paper calculations of projected costs or savings. Further, because we were able to access 2011 data for both County Government and MCPS, this follow-up memorandum serves as a more up-to-date and reliable comparison of the average health premium costs for each agency. As summarized above, the more current data indicate that the County Government's total average premium is higher than MCPS', but that the dollar amount paid per enrollee by the County Government is actually lower than that paid per enrollee by MCPS.

A. Multiple Variables Influence an Agency's Annual Health Premiums

When looking at health plan premiums, there are three components to examine: the total premium; the share of the premium paid by the agency; and the share of the premium paid by the employee. As reviewed in OLO's Part II report (page C-1), there are differences among how each agency currently structures their employee health benefits. Variables that influence the total health care costs paid by the agency and employee include:

- **Plan Design and Administration.** Each agency offers multiple health plans and contracts out plan administration to multiple insurance carriers who have a network of doctors an employee can use for care. Each plan structures features such as co-pays, deductibles, and out-of-pocket maximums differently. As a result of plan design, two health plans with similar names in different agencies are not the same plans.

- **Employee Eligibility and "Pool" of Enrollees.** Each agency establishes eligibility criteria for access to health benefits based on factors such as the number of hours worked, e.g., full-time vs. part-time. Based on the eligibility criteria and workforce demographics, each agency has a different "pool" of employees who choose to enroll in health benefit plans. Additionally, Montgomery County Government and M-NCPPC include retirees and active employees in the same "pool" for calculating the premiums, while MCPS and the College do not.

- **Levels of Coverage.** Each agency generally allows employees to choose among three different levels of insurance coverage: self (covers only the employee); self+1 (covers the employee and one eligible dependent); and family (covers the employee and all eligible dependents). Montgomery College does not offer the self+1 coverage option.

- **Premium Cost Share Arrangements.** On an annual basis, agencies determine the health care costs for their particular "pool" of employees in each plan and calculate per person charges, or premiums, that cover these costs. The annual premiums calculated for each agency vary by plan and level of coverage. The employer/employee cost share arrangements also vary by agency, and in some cases, by employee group or health plan within the agency.

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B. Average Annual Premium per Health Plan Enrollee

For each of the four tax supported agencies, Table 1 (on the next page) shows the average annual premiums for medical and prescription plans per enrollee. This table uses 2011 premium rates and January 2011 enrollment figures.[2] In sum, the data indicate the following:

- County Government and MCPS both have higher average health plan premiums and higher per enrollee costs compared to M-NCPPC and Montgomery College.

- In 2011, MCPS pays $557 (or 5%) more per health plan enrollee compared to County Government. Specifically, given current employer/employee cost share arrangements, MCPS pays an average health plan premium of $11,701 per enrollee while the County Government pays an average health plan premium of $11,144 per enrollee.

- In 2011, the annual total health premium per enrollee in County Government (agency plus employee share) is $2,203 (or 17%) higher compared to MCPS. Specifically, the total average health plan premium per enrollee in County Government is $14,866 compared to $12,663 per enrollee in MCPS.

Inclusion of retirees in active employee "pool" for health premiums. A factor that complicates any comparison of premium rates between MCPS and County Government is that the County Government includes retirees in its calculation of premiums, while MCPS does not. As a result, active employees in County Government pay a higher premium than they would if they were in a separate pool.

In order to provide a more "apples-to-apples" comparison of Montgomery County Government and MCPS average premiums, the County's actuaries were asked to estimate what the premiums for each County Government plan would be if they were calculated for active employees only, without including the County's retirees. The data show the following:

- If retirees were excluded from the County Government's active employee pool, the average annual total premium for active employees would be reduced from $14,866 to $13,258, a reduction of $1,608.

- An average total premium of $13,258 is still higher than MCPS' average total premium of $12,663, but the difference would be $595 (5%) instead of $2,203 (17%).

In other words, these data from the actuaries suggest that the County Government's practice of including retirees in with the active employees' pool for calculating premiums "explains" about 73% of the difference in average annual premiums between MCPS and County Government. More analysis by the agencies' health experts would be required to discern what other factors (for example, details of plan design or use experience), explain the rest of the cost difference.

[2] To calculate the average premium for medical and prescription plans, OLO calculated a total premium cost for all enrollees based on actual enrollment in different health plans and levels of coverage (i.e., self, self+1, family), and then divided by the total number of enrollees.

Table 1. 2011 Average Annual Premium per Enrollee

	Premium Cost	Agency Share	Employee Share
County Government – Choice and Select			
Medical Plan*	$10,871	$8,641	$2,230
Prescription Drug Plan	$3,995	$2,503	$1,492
Medical and Prescription Combined	**$14,866**	**$11,144**	**$3,722**
MCPS**			
Medical Plan	$9,748	$9,077	$671
Prescription Drug Plan	$2,915	$2,624	$291
Medical and Prescription Combined	**$12,663**	**$11,701**	**$962**
Montgomery College			
Medical and Prescription Combined	**$10,730**	**$7,999**	**$2,731**
M-NCPPC			
Medical Plan	$7,295	$6,201	$1,094
Prescription Drug Plan	$2,284	$1,941	$343
Medical and Prescription Combined	**$9,579**	**$8,142**	**$1,437**

*Although the Kaiser medical and prescription drug plan is combined for County Government, OLO's calculation uses a separate premium so it is comparable to the averages in other agencies.

**MCPS average does not include Closed POS Plan.

Source: OLO calculations using Calendar Year 2011 premium rates and January 2011 enrollment data provided by each agency.

C. 2011 Annual Premium Costs by Plan and Level of Coverage

Table 2, beginning on the next page, lists each agency's calendar year 2011 medical and prescription plans, current cost share arrangements, and enrollment and total premium data for each level of coverage, showing both the cost paid by the agency and the employee. These are the data used to calculate an estimate of the average annual premium shown in Table 1 (above).

The data show that the cost of medical and prescription plans vary both across and within the agencies by plan type and level of coverage.

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Table 2. 2011 Annual Premiums by Plan and Level of Coverage (per enrollee)

Agency and Plan	Current Cost Share	2011 Enrollment		Premium	Agency Cost	Employee Cost
County Government (Choice)*						
Carefirst High POS Medical	80% Agency 20% Employee	Individual	1,349	**$5,500**	$4,400	$1,100
		Self + 1	1,036	**$9,513**	$7,611	$1,903
		Family	2,008	**$16,019**	$12,815	$3,204
Carefirst Standard POS Medical	80% Agency 20% Employee	Individual	117	**$5,114**	$4,092	$1,023
		Self + 1	78	**$8,847**	$7,078	$1,770
		Family	89	**$14,897**	$11,918	$2,980
Kaiser HMO Medical & Prescription	80% Agency 20% Employee	Individual	361	**$5,728**	$4,583	$1,146
		Self + 1	209	**$10,769**	$8,615	$2,154
		Family	372	**$16,955**	$13,564	$3,391
UHC Select HMO Medical	80% Agency 20% Employee	Individual	387	**$4,691**	$3,753	$938
		Self + 1	324	**$9,019**	$7,215	$1,804
		Family	684	**$14,338**	$11,470	$2,868
Caremark Standard Prescription	80% Agency 20% Employee	Individual	633	**$1,461**	$1,168	$292
		Self + 1	506	**$2,702**	$2,162	$541
		Family	1,252	**$4,187**	$3,350	$837
Caremark High 4/8 Prescription	53% Agency** 47% Employee	Individual	934	**$2,193**	$1,168	$1,024
		Self + 1	698	**$4,056**	$2,162	$1,895
		Family	1,063	**$6,286**	$3,350	$2,936
Caremark High 5/10 Prescription	54% Agency** 46% Employee	Individual	277	**$2,164**	$1,168	$996
		Self + 1	224	**$4,004**	$2,162	$1,842
		Family	452	**$6,205**	$3,350	$2,855
MCPS						
Carefirst POS Medical	90% Agency 10% Employee	Individual	547	**$5,021**	$4,519	$502
		Self + 1	369	**$10,044**	$9,039	$1,004
		Family	664	**$13,666**	$12,299	$1,367
UHC Open POS Medical	90% Agency 10% Employee	Individual	1,511	**$5,281**	$4,753	$528
		Self + 1	1,194	**$10,564**	$9,507	$1,056
		Family	2,315	**$14,373**	$12,936	$1,437
Carefirst HMO Medical	95% Agency 5% Employee	Individual	1,017	**$3,520**	$3,344	$176
		Self + 1	662	**$6,614**	$6,284	$331
		Family	1,320	**$10,837**	$10,295	$542
Kaiser HMO Medical	95% Agency 5% Employee	Individual	1,051	**$4,722**	$4,486	$236
		Self + 1	896	**$9,417**	$8,946	$471
		Family	1,418	**$13,645**	$12,963	$682
UHC HMO Medical	95% Agency 5% Employee	Individual	1,605	**$4,623**	$4,392	$231
		Self + 1	1,696	**$8,684**	$8,250	$434
		Family	2,679	**$14,227**	$13,516	$711
Caremark Prescription	90% Agency 10% Employee	Individual	4,933	**$1,685**	$1,516	$168
		Self + 1	4,203	**$3,367**	$3,030	$337
		Family	7,144	**$4,155**	$3,739	$415
Kaiser Prescription	90% Agency 10% Employee	Individual	1,043	**$736**	$662	$74
		Self + 1	894	**$1,469**	$1,322	$147
		Family	1,413	**$2,127**	$1,914	$213

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Table 2, continued. 2011 Annual Premiums by Plan and Level of Coverage (per enrollee)

Agency and Plan	Current Cost Share	2011 Enrollment		Premium Cost	Agency Share	Employee Share
Montgomery College						
CIGNA PPO – Medical & Prescription	75% Agency 25% Employee	Individual	163	**$5,862**	$4,397	$1,466
		Family	137	**$15,831**	$11,873	$3,958
CIGNA POS – Medical & Prescription	75% Agency 25% Employee	Individual	263	**$6,157**	$4,618	$1,539
		Family	413	**$16,568**	$12,426	$4,142
Kaiser HMO – Medical & Prescription	75% Agency 25% Employee	Individual	214	**$4,367**	$3,275	$1,092
		Family	233	**$11,790**	$8,843	$2,948
M-NCPPC						
UHC POS Medical	85% Agency 15% Employee	Individual	112	**$3,516**	$2,989	$527
		Self + 1	81	**$7,032**	$5,977	$1,055
		Family	141	**$10,548**	$8,966	$1,582
CIGNA EPO Medical	85% Agency 15% Employee	Individual	30	**$3,804**	$3,233	$571
		Self + 1	23	**$7,608**	$6,467	$1,141
		Family	43	**$11,412**	$9,700	$1,712
UHC EPO Medical	85% Agency 15% Employee	Individual	90	**$3,444**	$2,927	$517
		Self + 1	57	**$6,888**	$5,855	$1,033
		Family	91	**$10,332**	$8,782	$1,550
Caremark Prescription	85% Agency 15% Employee	Individual	228	**$1,104**	$938	$166
		Self + 1	158	**$2,208**	$1,877	$331
		Family	273	**$3,312**	$2,815	$497

*The table shows enrollment and premium rates for the County Government Choice Group members, which represent approximately 90% of active employees enrolled in the County Government's health plan. For Select Group members, the available plans and total premium cost remain the same, but the agency share is 4% lower and the employee share is 4% higher due to a 76/24 cost share arrangement.

**For the Caremark High Option plans, the County pays the same amount as for the standard plan and the employee pays the rest of the premium.

c: Steve Farber

List of OLO Reports and Follow-Up Memorandums on
Achieving a Structurally Balanced Budget in Montgomery County

OLO web site: www.montgomerycountymd.gov/olo

11/23/10	OLO Report 2011-2, Achieving a Structurally Balanced Budget, Part I: Expenditure and Revenue Trends; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2011-2.pdf
12/7/10	OLO Report 2011-2, Achieving a Structurally Balanced Budget, Part II: Options for Long-Term Fiscal Balance; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2011-2Part-II.pdf
12/17/10	Follow-up to OLO Report on Achieving a Structurally Balanced Budget: Potential Savings for Part II Options, Sorted by Year; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/12-17-10PotentialSavingsforPartIIOptionssortedbyYear.pdf
1/19/11	Questions related to the County Government's retirement plans; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/1-19-11QuestionsrelatedtotheCountyGovernmentsRetirementPlans.pdf
2/1/11	Answers to Questions about the Cost of Health Benefits for Active Employees; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2-1-11AnswerstoQuestionsaboutthecostofHealthBenefitsforActiveEmployees.pdf
2/9/11	Comparison of the Governor's Proposed Pension Changes and Options Identified by OLO; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2-9-11ComparisonofGovernorsProposedPensionChanges.pdf
2/11/11	Recap of Recent Studies on Private vs. Public Sector Pay and Benefits; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2-11-11RecapofRecentStudiesonPrivatevsPublicSect.pdf
3/2/11	Estimated Savings from Alternative Health Insurance Cost Share Scenarios and Summary of Prescription Drug Copay Structures; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-2-11EstimatedSavingsfromAlternativeHealthInsuranceCostShareScenariosSummaryofPrescriptionDrugCopayStructures.pdf
3/14/11	County Government and MCPS Data on Employee Recruitment, Hiring, and Turnover; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-14-11MCGandMCPSRecruitmentandRetentionv.5.pdf
3/17/11	Additional Information about current Retirement Benefits; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-17-11AdditionalInformationaboutCurrentRetirementBenefits.pdf
3/22/11	Consolidation of Agency Group Insurance Programs; http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-22-11ConsolidationofAgencyGroupInsurancePrograms.pdf
4/8/11	Memo from K. Orlansky to Steve Farber, Council Staff Director, Overview of Proposed Changes to County Government Employees' Retirement, Health, and Life Insurance Benefits (Memo included in S. Farber's 4/12/11 Council Packet, Agenda Item #8); http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/4-8-11-OverviewofProposedChangestoCountyGovernmentEmployeesRetirementHealthandLifeInsuranceBenefits.pdf