Agenda

ND Teachers' Fund for Retirement
Board Meeting

Thursday, May 15, 2014
3:30 pm

Via teleconference
NDRIO Conference Room
1930 Burnt Boat Drive
Bismarck, ND

1. Call to Order and Approval of Agenda - Pres. Gessner (Board Action)
2. Approval of Minutes of March 27, 2014 Meeting – Pres. Gessner (Board Action)
3. GASB 67/68 Implementation – Fay Kopp (Board Action)
4. DOMA Update – Mary Kae Kelsch, Attorney General's Office (Board Action)
5. Legislative Update – Fay Kopp (Information)
6. Other Business
7. Adjournment

NEXT MEETING: JULY 24, 2014

Any person who requires an auxiliary aid or service should contact the Retirement and Investment Office at 701-328-9885 at least three (3) days before the scheduled meeting.

NORTH DAKOTA TEACHERS' FUND FOR RETIREMENT
MINUTES OF THE
MARCH 27, 2014, BOARD MEETING

BOARD MEMBERS PRESENT:	Mike Gessner, President Clarence Corneil, Vice Chair Kirsten Baesler, State Superintendent Kim Franz, Trustee Rob Lech, Trustee Mel Olson, Trustee Kelly Schmidt, State Treasurer
STAFF PRESENT:	David Hunter, ED/CIO Fay Kopp, Deputy ED/CRO Darlene Roppel, Retirement Assistant Darren Schulz, Deputy CIO Shelly Schumacher, Retirement Program Manager Tami Volkert, Employer Services Coordinator
OTHERS PRESENT:	Janilyn Murtha, Attorney General's Office Stuart Savelkoul, ND United

CALL TO ORDER:

Mr. Mike Gessner, President of the Teachers' Fund for Retirement (TFFR) Board of Trustees, called the board meeting to order at 1:00 p.m. on Thursday, March 27, 2014, at the State Capitol, Peace Garden Room, Bismarck, ND.

THE FOLLOWING MEMBERS WERE PRESENT REPRESENTING A QUORUM: SUPT. BAESLER, MR. CORNEIL, MRS. FRANZ, MR. GESSNER, MR. LECH, MR. OLSON, AND TREASURER SCHMIDT.

APPROVAL OF AGENDA:

The Board considered the meeting agenda.

TREASURER SCHMIDT MOVED AND SUPT. BAESLER SECONDED TO APPROVE THE AGENDA AS PRESENTED.

AYES: MR. CORNEIL, TREASURER SCHMIDT, SUPT. BAESLER, PRESIDENT GESSNER, MRS. FRANZ, MR. OLSON, AND MR. LECH.
NAYS: NONE
MOTION CARRIED.

MINUTES:

The board considered the minutes of the regular TFFR board meeting held January 23, 2014.

MR. LECH MOVED AND MR. OLSON SECONDED TO APROVE THE MINUTES OF THE REGULAR TFFR BOARD MEETING HELD JANUARY 23, 2014.

AYES: MR. LECH, SUPT. BAESLER, MR. OLSON, MRS. FRANZ, TREASURER SCHMIDT, MR. CORNEIL, AND PRESIDENT GESSNER.
NAYS: NONE
MOTION CARRIED.

BOARD EDUCATION – TFFR EMPLOYER REPORTING:

Mrs. Shelly Schumacher, Retirement Program Manager, and Mrs. Tami Volkert, Employer Services Coordinator, presented an overview of TFFR Employer Reporting. Topics included: employer responsibilities, employer model descriptions, and reporting requirements. Guidance is provided to employers through the TFFR website, publications, newsletters, workshops, and telephone and written communications. Board discussion and questions followed.

The presentation is on file at the Retirement and Investment Office (RIO).

2015 LEGISLATIVE PLANNING:

Mrs. Fay Kopp, Deputy Executive Director/Chief Retirement Officer, reviewed provisions of the bill drafted by Mrs. Jan Murtha, Attorney General’s office. The bill includes technical changes to the TFFR plan. These changes update TFFR statutes for Internal Revenue Service (IRS) compliance purposes by changing applicable dates from August 1, 2013, to August 1, 2015.

MR. CORNEIL MOVED AND MRS. FRANZ SECONDED TO APPROVE SUBMISSION OF TFFR BILL DRAFT FOR INTERIM STUDY BY THE LEGISLATIVE EMPLOYEE BENEFITS PROGRAMS COMMITTEE (LEBPC).

AYES: TREASURER SCHMIDT, MR. OLSON, SUPT. BAESLER, MR. LECH, MR. CORNEIL, MRS. FRANZ, AND PRESIDENT GESSNER.
NAYS: NONE
MOTION CARRIED.

Mrs. Kopp updated the Board on various interim studies and committee meetings.

The LEBPC last met in November 2013 when they received TFFR’s 2013 valuation report from Segal. The Committee is expected to meet after the April 1, 2014, deadline for submitting bill drafts. Once they take jurisdiction over the TFFR bill draft, the bill will be submitted to the actuary for analysis and technical review.

The Legislative Audit and Fiscal Review Committee (LAFRC) met on January 21, 2014. RIO’s external auditors, CliftonLarsonAllen, presented the audit report for the agency for the two fiscal years ended June 30, 2012, and June 30, 2013. Mrs. Kopp and Mr. Dave Hunter, ED/CIO, responded to questions and submitted information to the committee about the changes in TFFR's unfunded liability from 2007 to 2013.

The Legislative Government Finance Committee (LGFC) has been meeting regularly during the interim. One of the studies the Committee has been assigned is a study of the feasibility and desirability of the existing state retirement plans, including an analysis of both a defined benefit and defined contribution plan, with considerations and possible consequences for transitioning to a defined contribution plan. At their March 13, 2014, meeting, the Committee reviewed actuarial costs relating to the Public Employees Retirement System (PERS) defined benefit plan if state employees hired after January 1, 2016, would be required to participate in a defined contribution plan. The Committee discussed options for requesting a third-party actuary to conduct a review of the actuarially calculated costs.

GASB 67 AND 68 PLANNING:

Mrs. Kopp gave a brief update on the implementation of GASB 67 and 68. TFFR, PERS, and the State Auditor's Office (SAO) continue to have discussions relating to implementing the new pension reporting standards. Implementation guides for both standards have been issued, although questions remain primarily relating to coordination of effort between plan auditors and employer auditors. More audit guidance is needed and expected. It is anticipated that actuarial and audit costs will increase significantly, particularly in the first few years of implementation. Different avenues of training are being considered. TFFR, PERS, and State Auditor's Office have contacted a potential consultant to facilitate the training. A small group planning session is tentatively scheduled to be held in June 2014, and full employer training in November 2014, which will be recorded or webcast.

Mrs. Kopp has met with representatives of North Dakota United (NDU), North Dakota Council of Educational Leaders (NDCEL), and North Dakota School Board Association (NDSBA) regarding the new standards and potential implications on school district financial statements.

SIB UPDATE:

Mr. Hunter updated the board on recent TFFR investment performance, risk update, watch list, and current investment initiatives and projects. The estimated fiscal year to date (July 1, 2013-March 20, 2014) net return is 11.36%.

RIO STAFFING UPDATE:

Mr. Hunter presented a staffing update. Candidates for the IT Coordinator position have been interviewed. The Audit Supervisor position has not been filled and applications are being reviewed. Staff annual performance reviews will begin in April.

AUDIT COMMITTEE UPDATE:

President Gessner reported on the last Audit Committee meeting held February 28, 2014. Due to the audit department being short staffed, the goal this year is to review 24 school districts rather than 52. As of February 28, 2014, 14 audits have been completed, two audits are in progress and two not in compliance reviews have been completed.

2014-15 BOARD MEETING SCHEDULE:

Mrs. Kopp reviewed the proposed 2014-15 TFFR meeting schedule. The April 24, 2014, meeting may be a very brief meeting, which could be handled by teleconference or delayed until the next meeting. The Committee agreed the April meeting should be kept on the schedule until a decision is made. Meetings in 2014-15 are scheduled in July, September, and October 2014, January, February, March, and April 2015. An actuarial experience study will be done after the 2014 valuation report is completed, and should be delivered to TFFR in 2015. State statute requires an experience study every five years.

MR. CORNEIL MOVED AND MR. LECH SECONDED TO APPROVE THE 2014-15 BOARD MEETING SCHEDULE.

AYES: MRS. FRANZ, TREASURER SCHMIDT, MR. CORNEIL, SUPT. BAESLER, MR. LECH, MR. OLSON AND PRESIDENT GESSNER.
NAYS: NONE
MOTION CARRIED.

CONSENT AGENDA:

TREASURER SCHMIDT MOVED AND SUPT. BAESLER SECONDED TO APPROVE THE CONSENT AGENDA WHICH INCLUDES ONE DISABILITY APPLICATION # 2014-2D AND ONE QUALIFIED DOMESTIC RELATIONS ORDER (QDRO) # 2014-1Q.

AYES: MR. OLSON, MR. CORNEIL, MR. LECH, TREASURER SCHMIDT, MRS. FRANZ, SUPT. BAESLER, AND PRESIDENT GESSNER.
NAYS: NONE
MOTION CARRIED.

LEGAL UPDATES:

President Gessner explained that this item must be held in Executive Session due to attorney consultation and discussion of confidential member information under NDCC 44-04-19.1, 44-04-19.2, and 15-39.1-30. The topic to be discussed in the Executive Session is a member QDRO litigation. President Gessner reminded the board to limit discussion to the announced topic.

TREASURER SCHMIDT MOVED AND SUPT. BAESLER SECONDED TO GO INTO EXECUTIVE SESSION FOR ATTORNEY CONSULTATION.

AYES: SUPT. BAESLER, MR. LECH, MRS. FRANZ, MR. CORNEIL, MR. OLSON, TREASURER SCHMIDT, AND PRESIDENT GESSNER.
NAYS: NONE
MOTION CARRIED.

EXECUTIVE SESSION

Executive session attendees included: Mrs. Murtha, Supt. Baesler, Mr. Corneil, Mrs. Franz, President Gessner, Mr. Lech, Mr. Olson, Treasurer Schmidt, Mrs. Kopp, Mrs. Schumacher, Mr. Hunter, And Mrs. Roppel.

Executive session began at 3:15 p.m. and ended at 3:25 p.m.

OPEN SESSION

Mr. Lech left the meeting at 3:26 p.m.

Mrs. Murtha gave a brief explanation of the Halliburton amicus brief and how it relates to TFFR.

OTHER BUSINESS:

The reading material contains information about what is happening in other states, contribution rates, and DB and DC plans.

ADJOURNMENT:

With no further business to come before the Board, President Gessner adjourned the meeting at 3:43 p.m.

Respectfully Submitted:

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Mr. Mike Gessner, President
Teachers' Fund for Retirement Board

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Darlene Roppel
Reporting Secretary

MEMORANDUM

TO: **TFFR Board**

FROM: **Fay Kopp**

DATE: **May 8, 2014**

SUBJ: **GASB 67/68 Implementation Plan**

NEW PENSION STANDARDS

As discussed in previous educational sessions with TFFR's actuarial consultant, and staff updates at board meetings, the Governmental Accounting Standards Board (GASB) issued two new standards in June 2012 that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans.

GASB Statement No. 67, *Financial Reporting for Pension Plans,* revises existing guidance for the financial reports of most governmental pension plans (i.e. NDTFFR and NDPERS). Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions,* revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits (i.e. school districts, cities, counties, state). Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

PROPOSED IMPLEMENTATION PLAN FOR NDTFFR

Since the new GASB provisions will apply to both NDTFFR and NDPERS, we have been working closely together and with the State Auditor's Office (SAO) on plans to implement the new GASB standards. The goal of this joint effort is to reduce costs, reduce duplication of effort, and provide consistent reporting to participating employers. Discussions also include plan actuaries (two different Segal consultants for TFFR and PERS), and plan auditors (Clifton Larson Allen for TFFR and Brady Martz for PERS). Similar discussions are happening with other pension plans, actuaries, and auditors around the country.

The following plan has been developed which includes three basic tasks:

1) Educate stakeholders and participating employers.
2) Develop the necessary information for RIO/TFFR financial statements, and the information which will be sent to participating employers for inclusion in employer financial statements.
3) Integrate this effort into the ongoing operations of the plan going forward.

1) Educate stakeholders and participating employers

To date, we have relied on TFFR's actuarial consultant, Segal, to provide broad education to the TFFR Board and Legislative Employee Benefits Programs Committee. Staff has then utilized much of this information in their general presentations to other stakeholder groups and employers.

However, as we move into the more detailed aspects of the implementation effort, more specific training is needed. For this step, TFFR and PERS have been discussing with the State Auditor's Office jointly sponsoring GASB 67/68 educational sessions. As I have reported to you in previous meetings, we first plan to bring together a small focus group of participating TFFR and PERS employers (6 employers from TFFR and 6 from PERS) and invite the business manager, administrator, and auditor of each employer. We would provide education to this group, review the actuarial/financial information that we will be providing to them, and work with them to identify and address issues they may have with the implementation. We have tentatively scheduled June 26, 2014 for this meeting, and expect to have 50-75 people attend.

The next step is to facilitate a statewide educational session for all TFFR and PERS employers which would also be jointly sponsored by TFFR, PERS, and the State Auditor's Office. The purpose of this meeting would be similar to the first small group meeting, but we would also add the lessons learned in working with our pilot group, refine the implementation plan, and incorporate any other new guidance. We are targeting November 18, 2014 for this meeting and expect to have 200-400 people attend. We also plan to webcast or record this meeting for employers who are unable to attend.

To conduct the educational sessions, we have identified Eric Berman, a consultant from Eide Bailly, who has been working with other state and local governments around the country to implement GASB 67/68. Eide Bailly is also an auditor that the State Auditor's Office uses. Please see attached **Eide Bailly Proposal, April 24, 2014**, for a cost estimate and scope of services expected to be provided. We anticipate TFFR and PERS sharing these expenses. However, work relating specifically to one system or the other would be that system's responsibility.

Staff will continue to include GASB information in presentations to legislative committees and other interested parties (ND School Business Manager Association, ND School Board Association, ND Council of Educational Leaders, ND United, ND Retired Teachers Association, ND School Study Council, etc.).

2) Develop the necessary information for RIO/TFFR financial statements, and the information which will be sent to participating employers for inclusion in employer financial statements.

GASB now requires certain additional information that must be disclosed in the plan's financial statements, as well as certain information and disclosures that must now be sent to employers and disclosed on employer financial statements. This information should be calculated by the plan's actuary according to the recommendations of the AICPA (American Institute of Certified Public Accountants). See attached **AICPA Example Schedule 1 and Schedule 2** which shows some of the information that will need to be provided to employers. Extensive disclosure items will also need to be prepared and reported in notes to financial statements.

See **Segal Proposal, April 22, 2014,** for the estimated cost of developing this additional information and production timeline.

3) Integrate this effort into the ongoing operations of TFFR going forward

Once we get through the initial GASB 67/68 implementation in 2014 and 2015, we will need to add the various tasks to the annual valuation effort by the actuary, annual audit effort by external auditor, and annual efforts by RIO staff to send this information to each TFFR participating employer.

Summary

While GASB has provided guidance for these new accounting and financial reporting requirements, there are many practical implementation issues that are still being identified. Cost sharing plans (like TFFR), and their employers (primarily school districts) face particular challenges, such as the need for employer auditors to depend on information developed by the retirement system and their actuarial consultant. More discussion, clarification, and decisions need to be made.

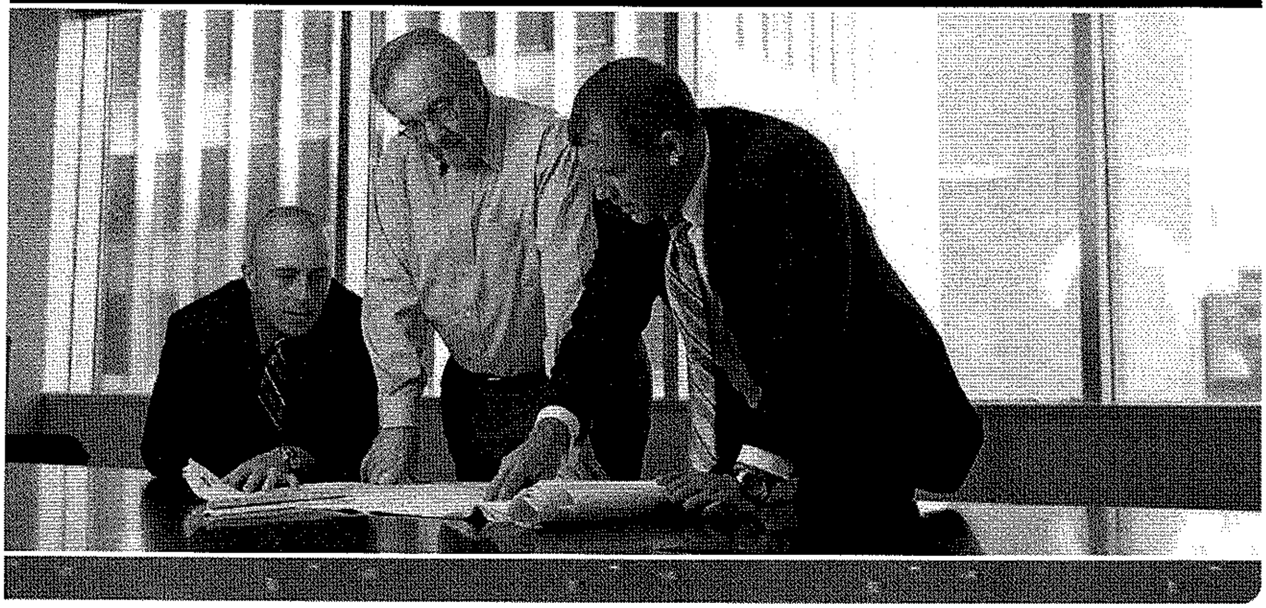
What we do know is that actuarial calculations, schedules, and disclosures for GASB 67 and 68 will increase TFFR actuarial costs significantly, particularly in the first few years of implementation. Additionally, audit fees will also increase due to the additional work required to implement new standards. (For example, the State Auditor's Office is planning to amend current audit contracts for TFFR and PERS to include auditing employer census data, including visiting selected employers.)

Board Action Requested:

Staff is requesting TFFR Board approval of the GASB 67 and 68 implementation plan and associated efforts outlined in this memo.

Enclosures

Experience the Eide Bailly Difference



April 24, 2014

Proposal for Services

State of North Dakota

- North Dakota Public Employees Retirement System
- North Dakota Teachers Fund for Retirement

Eide Bailly LLP

Eric Berman
T: 208.424.3524
M: 626.375.3600
eberman@eidebailly.com

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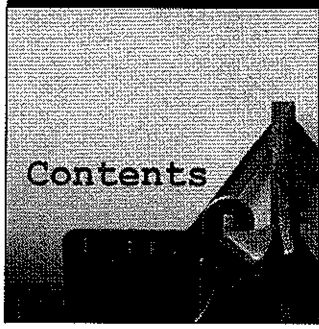

Contents

Executive Summary

Thank you for giving Eide Bailly LLP the opportunity to propose on Government Accounting Standards Board Statement Nos. 67, 68 and 71 Consultation Services. We believe Eide Bailly is the right firm for the State of North Dakota and more specifically, the North Dakota Public Employees Retirement System (NDPERS) and the North Dakota Teachers Fund for Retirement (TFFR), (collectively "the State") for the following reasons:

Unprecedented Government Industry Experience

We are confident the State will benefit from working with Eide Bailly. Our extensive government experience and knowledge positions us to be the right Firm for you.

"We Get Governments!" It is more than just an understanding of government auditing and reporting. Eide Bailly professionals are nationally recognized as thought leaders in the public sector. We understand the operational and political aspects of our government clients. We are excited about government work and commit the necessary resources to show our clients that performing government services is more than just filling a gap of time outside of a busy tax season. As we are leaders in the industry, rather than followers, our clients are fully informed and can be prepared for the implementation dates of new standards years in advance.

We are confident our extensive government experience and knowledge positions us to be the right Firm for you. Our firm annually performs more than 90,000 service hours for clients within the governmental industry. We have more than 500 government consulting, audit and assurance engagements. We are also unique in that our team has "both sides of the desk" experience in state and local governments.

Additionally, our firm serves as a leader in the Governmental Accounting Standards Advisory Council (GASAC), the AICPA's Governmental Audit Quality Center, State and Local Government Expert Panel and PCPS Technical Committee, local and national boards of the Associations of Government Accountants (AGA) including the Financial Management Standards Board, and the review committee for the GFOA's Certificate of Excellence for Achievement in Financial Reporting. As part of our commitment to the success of the engagement, our director of governmental services, Lealan Miller, CGFM, CPA, will serve as a technical resource as needed.

As part of almost every engagement, our Firm regularly interacts with those charged with governing boards and decision-makers. We are comfortable providing decision-makers with information *beyond the numbers.* Given our consultative point of view, we most often provide tools and techniques for decision-makers to consider for the future, helping organizations across the country achieve their goals and seize opportunities, instead of dwelling on historical information.

As a former deputy comptroller of a state and a former chief financial officer of a major public authority, I have written, analyzed or enacted hundreds of laws and considered the effects of many more. I was also in charge of issuing billions of dollars in tax exempt debt using complex structures and the accounting and financial reporting over the largest infrastructure project ever undertaken by a non-federal entity.

Executive Summary

Particularly germane to the proposed engagement with the State, I possess the following:

- Eleven years as a deputy comptroller over the Commonwealth of Massachusetts with budgets ranging from in excess of $21 billion in 1999 to nearly $27 billion in 2010. My functions included financial reporting, Governmental Accounting Standards Board (GASB) implementation and compliance, general accounting, capital accounting, federal relations, financial reporting, systems, procurement, component unit relationships, training and budgetary preparation, analysis and implementation.
- I've had direct participation in the GASB standard setting process since 1995 not only as a task force member, but as a member and Vice Chairman of the GASAC and chairman of the AGA Financial Management Standards Board. I've also had direct participation as a member or chair of a number of senior committees and expert panels at the National Association of State Auditors, Comptrollers and Treasurers, as well as the American Institute of Certified Public Accountants, the California Society of Certified Public Accountants, and the Massachusetts Society of Public Accountants.
- Since 1994, I've been a nationally known speaker, author, and thought leader on interpreting budgetary and accounting standards in a consultative manner on behalf of my organizations and state and local governments nationwide. As a member and Vice-Chairman of the GASAC and member of the California Society of Certified Public Accountants Governmental Accounting and Auditing Committee, I've represented the committee (as well as AGA) in front of the GASB. I've worked with state and local governmental clients across the country to improve their processes and procedures.
- I have been a Certified Public Accountant since 1994.
- I was one of the first Chartered Global Management Accountants (CGMA) approved by the AICPA. In addition, many leaders of our firm are Certified Government Financial Managers (CGFMs). My experience in government as well as in preparing standards and commenting on standards allowed me to obtain the CGMA.
- Since 1994, I have been conducting training, writing and developing materials on GASB topics, for-profit and not-for-profit accounting and auditing.
- Since 1998, I have worked on, trained others, commented on, and participated in task forces and implemented post-employment benefits and pension standards for state and local governments across the country. I was the chair of the NASACT task force to implement OPEB and am recognized as a nationally known expert on defined benefit and defined contribution plans.

Value for Fees

You can expect quality service at reasonable fees. Eide Bailly has established a reputation of providing quality work at a fair price. Our fees are based on the complexity of the issue and the experience level of the personnel necessary to address it. In the event you request additional services, Eide Bailly will obtain your agreement on fees before such work would commence. In other words, there will be no hidden fees.

Executive Summary

We Want to Work with You

The following pages highlight strengths that would benefit the State of North Dakota and demonstrate why Eide Bailly merits serious consideration. Know that you will be a highly valued client. Our people would be proud to work with the various entities of the State of North Dakota and build a trusting relationship with your team. Please contact me at 208.424.3524 if you would like to discuss any aspect of this proposal.

Sincerely,

Eric Berman, MSA, CPA, CGMA
Partner

Professional Resumes

Eric S. Berman, MSA, CGMA, CPA

Partner
208.424.3524 | eberman@eidebailly.com

Knowledge and Experience

- Trusted advisor to government agencies across the U.S., helping them to address GASB Standards, NCGA Statements and AICPA Statements of Auditing Standards.
- Uses his more than 24 years of experience in Governmental accounting, auditing and controllership to guide his federal, state and local governmental clients.
- Nationally recognized speaker, author and thought leader on financial reporting for state and local governments.
- Assists clients in achieving the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting.
- Author of the entire governmental library for CCH used by preparers, auditors and educators nationwide since 2011 including the *Governmental GAAP Guide*, the *Governmental GAAP Practice Manual*, the bi-monthly *Governmental GAAP Update Service* and the *Knowledge Based Audits – State and Local Government Audit Guide and Tools*.
- Served as Deputy Comptroller of the Commonwealth of Massachusetts for 11 years.
- Held the position of Chief Financial Officer of the Massachusetts Water Pollution Abatement Trust for 5 years.
- Awarded the Commonwealth of Massachusetts Manuel Carballo Award for Public Service in 2003.
- Awarded the President's award from the National Association of State Auditors, Comptrollers and Treasurers.
- Two-time President's award recipient from the Association of Government Accountants.

Professional Memberships

- Represents the Association of Government Accountants (AGA) as the Vice Chairman of the Government Accounting Standards Advisory Council (GASAC) to GASB
- AGA's Financial Management Standards Board, Chair
- California Society of Certified Public Accountants – Governmental Accounting and Audit Committee
- American Institute of Certified Public Accountants (AICPA) –Governmental Performance and Accountability Committee, former chair
- AICPA's State and Local Government Expert Panel, former member
- Massachusetts Society of Certified Public Accountants – Governmental Accounting and Auditing Committee, former chair

Designations & Licensures

- Certified Public Accountant
- Chartered Global Management Accountant

Education

- Master of Science, Accountancy – Bentley University
- Bachelor of Science, Broadcast Journalism – Boston University

Eric S. Berman, MSA, CPA, CGMA

Partner
208.424.3524 | eberman@eidebailly.com

Past Experience

- States
  - Commonwealth of Massachusetts (as deputy comptroller – 11 years)
  - State of Maine (Consulting/Training – 3 years)
  - State of Montana (Consulting/Training – 3 years)
  - State of Oregon (Consulting/Training – 2 years)
  - State of Tennessee (Consulting/Training – 8 years)
  - State of Texas (Consulting/Training – 1 year)
- Cities
  - City of Seaside (Audit – 1 year)
  - City of Pasadena (Audit and Consulting – 3 years)
- Counties
  - County of Riverside (Audit Technical Consulting – 3 years)
  - County of Tulare (Audit technical services – 3 years)
- Retirement Systems – (All Audit and Consulting – 3 years)
  - Los Angeles County Employees' Retirement Association
  - Ventura County Employees Retirement Association
  - San Mateo County Employees Retirement Association
  - Kern County Employees' Retirement Association
  - Marin County Employees' Retirement Association
  - Tulare County Employees' Retirement Association
  - Fresno City Employees' Retirement System
  - Los Angeles City Employees' Retirement System
  - Contra Costa County Employees' Retirement Association
  - Sonoma County Employees' Retirement Association
  - Fresno County Employees' Retirement Association
  - San Joaquin County Employees' Retirement Association
  - Fresno City Fire and Police Retirement System
- Corporations
  - Searchlight Minerals Corporation (PCAOB audit – 2 years)
  - Cappello Capital (PCAOB audit – 2 years)
  - CGI, Inc (Consulting – 1 year)
  - Ercolini and Company (Consulting – 3 years)
- Special Districts
  - Metro Link (Consulting – 1 year)
  - Rose Bowl Operating Company (Audit and Consulting – 3 years)
  - Pasadena Center Operating Company (Audit and Consulting – 3 years)
  - Pasadena Water and Power (Audit – 3 years)
  - Pasadena Community Development Commission (Audit – 2 years)
  - Montana State Fund (Consulting – 1 year)
- Non-Profits
  - Women at Work (Audit, Review – 2 years)
  - Pasadena Chamber of Commerce (Review – 2 years)
  - Pasadena Community Access Corporation (Audit – 3 years)
  - Granada Court Homeowner' Association (Review – 2 years)

Lealan Miller, CGFM, CGMA, CPA

Partner, Director of Government Services
208.383.4756 | lmiller@eidebailly.com

Knowledge and Experience

- More than 23 years public accounting experience specializing in serving the financial needs of state and local government clients.
- Partner in charge of financial audits and single audits of numerous state and local entities.
- Reviews and provides technical assistance to local governments in preparing Comprehensive Annual Financial Reports which receive the GFOA certificate.
- Serves as an instructor for various training sessions, including governmental accounting, financial accounting and auditing updates, fraud and auditing standards.
- Oversees coordination of firm-wide single audit training and annual audit updates.

Professional Memberships and Industry Involvement

- American Institute of Certified Public Accountants (AICPA)
- AICPA State and Local Government Expert Panel 2010-2013
- Eide Bailly Director of Government Services
- Idaho Society of Certified Public Accountants, past Treasurer
- Association of Government Accountants past local chapter president
- GFOA special report review committee
- Recognized contributor to the AICPA's 2013, 2012, 2011 "Government Auditing Standards and A-133 Audit Guide"
- Recognized contribution to the AICPA's 2011 "State and Local Governmental Developments Audit Risk Alert"
- Recognized contributor to the AICPA's 2012 and 2011 "State and Local Government Audit Guide"
- Starting in 2014, appointed as the representative of the Association of Government Accountants (AGA) as a member of the Government Accounting Standards Advisory Council (GASAC) to GASB

Designations & Licensures

- Certified Public Accountant
- Certified Government Financial Manager
- Chartered Global Management Accountant

Education

- Master of Science, Accounting - California State University, Sacramento
- Bachelor of Administration, Accounting - Idaho State University, Pocatello

Lealan Miller, CGFM, CGMA, CPA

Partner, Director of Government Services
208.383.4756 | lmiller@eidebailly.com

Past Experience

- Cities
  - City of Caldwell, ID (20 years)
  - City of Boise (15 years)
  - City of Nampa (5 years)
  - City of Flagstaff, AZ (5 years)
  - Town of Buckeye, AZ (5 years)
  - City of Grants Pass, OR (2 years)
  - City of Garden City (19 years)
- Counties
  - Ada County (5 years)
  - Jefferson County, CO (2 years)
  - Douglas County, CO (2 years)
- Retirement Systems
  - Public Employees Retirement System of Idaho (6 years)
  - South Dakota Retirement System (2 years)
  - Municipal Fire & Police Retirement System of Iowa (1 year)
- Colleges/Universities
  - Treasure Valley Community College, OR (3 years)
  - Rogue Community College, OR (2 years)
- Special Districts
  - Air Quality Board, Idaho (19 years)
  - Nampa Development Corporation (6 years)
  - Water Infrastructure & Finance Authority, AZ (1 years)
  - Valley Regional Transit, ID (12 years)
  - Josephine County 911 Agency, OR (2 years)
  - Redwood Sanitary Sewer Service District (2 years)
  - Grants Pass Redevelopment Agency (2 years)
- Non-Profits/Foundations
  - University of Idaho Foundation (9 years)
  - Boise State University Foundation (9 years)
  - Ballet Idaho (10 years)
  - Idaho State University Foundation (9 years)
  - Idaho Development and Housing (6 years)
  - Treasure Valley Community College Foundation (2 years)
  - Idaho Community Foundation (6 years)

Work Plan/Methodology

Services to be Provided

Based upon our discussion, we will work closely with State staff and management to provide advice and expert level training and consultative services related to the Governmental Accounting Standards Board's (GASB) and other authoritative sources of guidance through the release of statements, interpretations, technical bulletins, concept statements, and other regulations and supplemental publications. In particular, we will assist you in the training component of implementing GASB Statement No. 67, *Financial Reporting for Pension Plans,* GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and the related GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* – (an amendment of GASB Statement No. 68). In addition, if there are projects and due process documents due from the GASB over the course of our potential engagement that are applicable to the engagement or not applicable to the engagement, that the State desires consultation on, we will also assist the State in understanding the pronouncement, or provide a training course to State personnel and stakeholders, as an option to this engagement.

In particular, we will:

- Provide advice and expert level training and consulting services at your direction related to the GASB and other authoritative sources of guidance through their release of statements, interpretations, technical bulletins, concept statements, and other regulations and supplemental publications related to the Standards related post-employment benefits.
- Provide an independent point of view to the State.
- Keep the State advised on developments in the State of North Dakota and federal legislation and / or regulations regarding grants, pensions, as well as accounting or reporting issues related to other standard-setting organizations. (As a client, you will receive our Government Insights electronic newsletter, e-blasts and access to training on breaking news on these issues, some of which is entirely free).
- Keep the State advised on proposed GASB pronouncements and review the State memoranda for policy and procedural changes related to the pronouncements that are related to post-employment benefits, or additional topics.
- Provide assistance to the State in preparing the various disclosures in the notes to the financial statements, if requested.
- Provide a thorough review to ensure the presentations are free of technical, and / or other errors. As part of this resource, Lealan Miller will provide 'the second set of eyes' as a technical resource.
- Provide the services based on the State's schedule and not our Firm's.

To accomplish these goals, we will specifically provide the following:

1. Training and Consultative Services – GASB 67, 68 and 71

Most governments nationwide are in the process of implementation of the GASB standards related to the new defined benefit pension standards and the State of North Dakota is no different. Work will include a presentation of issues and challenges related to the standards and analysis, cataloguing and closure of implementation issues related to each standard. The tentative dates of an initial training have already been established as June 26, 2014 with a follow up meeting tentatively slated for November 18, 2014, both to be held in Bismarck, North Dakota.

Work Plan/Methodology

We will work with you to provide the right content and scope for the audience in attendance at both sessions in advance. Continuous, clear and concise communications with the various retirement stakeholders are the basic keys to a successful implementation. Our firm is in the midst of performing similar activities with a number of state and local governments nationwide. It is our notion that the GASB post-employment benefit standards are more of a logistics, operations and communications implementation than an accounting implementation.

In addition, as part of the training, we will touch upon these pending due-process items that may become standards during this period as they may effect post-employment benefit operations.

Statement	Title	Implementation Fiscal Year Ended June 30th
TBD	*Fair Value Measurement and Application*	2016 as slated to become a final standard by March of 2015.
TBD	*Fiduciary Responsibilities*	2016 as slated to become a final standard by June of 2015. This could change defined contribution plan and Section 457 plan reporting.
TBD	*Accounting and Financial Reporting for Pensions and Financial Reporting for Pension Plans That Are Not Administered through Trusts That Meet Specified Criteria and Amendments to Certain Provisions of GASB Statements 67 and 68*	2016 as slated to become a final standard by June of 2015. Certain elements related to GASB-67 and 68 may have an immediate impact.
TBD	*Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans – (superseding GASB-43 and GASB-57)*	2016 as slated to become a final standard by June of 2015.
TBD	*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (Superseding GASB-45)*	2016 as slated to become a final standard by June of 2015, but may not have an effect on State's financial reports as irrevocable trusts are used.

We can also touch upon other aspects including leasing operations and the reexamination of the financial reporting model at your discretion.

OPTIONAL *- Provide Guidance and Advice on Preparation for and Implementation of GASB Statement No. 68 – Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27, as well as GASB Statement No. 71 - Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68.*

Work Plan/Methodology

As an option, we can provide the State and the Plans a "second set of eyes" with regard to the implementation of GASB-67 and 68 through the review and recommendation for changes in disclosure presented within the annual financial reports of the State and the Plans. The review of the disclosure would be in accordance with GASB standards, and recently released AICPA auditing interpretations. Many states are also preparing standardized disclosure for employers / sponsors with regard to GASB-68. We have the ability to review the proposed disclosure and provide feedback as well.

OPTIONAL Additional Accounting Consulting Services and / or other Consulting Services

We are aware that the implementation of GASB Statement Nos. 67 and 68 is somewhat of a moving target and may continue to be so for years to come due to the potential for beginning balance restatements for at least 2015 through 2017, if not farther. **It is our firm policy not to charge more than the quoted hourly rates in our proposal for these additional services and we agree that the cost for these specialized additional accounting consulting and / or consulting services will not exceed 30% of the total evaluated contract cost, unless approved prior to services commencing.**

In addition, Eide Bailly LLP is a "full service" firm. We are more than just auditors. Our services include beyond the traditional tax preparation, audits, reviews, compilations and agreed upon procedures the following:

- *Service Organization Control Reports* – Note that the State Auditor may be required to perform these functions as part of the auditing of the information for GASB Statement No. 68.
- *Insurance Services*- Currently, we are engaged to review the structure and organization of a fund that provides Workers' Compensation activities for a state. We may be able to perform these in a similar fashion for the County.
- *Investment Services* – The GASB is in the midst of issuing guidance on fair value measurement and application. We have a team of specialists in investment valuation that can work with the Treasurer to properly implement the forthcoming standards.
- *Forensic Accounting Services* – We have an extensive team that can perform forensic accounting and rebuilding of records in support of judicial actions.
- *Internal Controls Examinations* – We can provide a risk assessment for fraud, waste and abuse to the State to help strengthen the State's internal controls. We base these assessments on the new COSO.
- *Health Care Reform (Affordable Care Act) Consulting* - Eide Bailly has developed a proprietary tool to help the County make informed decisions regarding health insurance coverage. We also have expertise in understanding and complying with the new reporting and tax requirements.
- *Risk Advisory Services – IT Controls Review* – We regularly provide our clients with IT controls reviews. We assess the administrative, technical and operational controls that exist as well as an assessment of IT applications. This evaluation identifies suggested improvements that management can implement to ensure systems availability and process integrity.
- *Risk Advisory Services – IT Risk Assessment* – We can help identify potential weaknesses in IT systems and provide recommendations for improving controls and mitigating risk.

- *Risk Advisory Services – Security Compliance and Testing* – Compliance with HIPAA, GLBA, PCI, DSS and other regulations, along with the provisions of State law are vital. We can help identify and test risks and help design and strengthen controls, policies and procedures.
- *Business Analytics Tools* – Dashboards are becoming commonplace for even small and medium-sized governments. We can help the State implement executive dashboards on top of any existing system.

Cost Proposal

	June 26, 2014		November 18, 2014	
Services to be Provided:	**Per Hour**	**Cap***	**Per Hour**	**Cap***
Government Accounting Standards Board Statement Nos. 67, 68, and 71, Training and Consultation	$ 350	$ 6,000	$ 350	$ 6,000

* The fees above DO NOT include out-of-pocket expenses estimated at $1,000 for each session.

Fee Philosophy

We understand you may require additional services from time to time. Our fees are based on the complexity of the issue and the experience level of the staff members necessary to address it. In the event you request additional services, Eide Bailly will obtain your agreement on fees before such work would commence. In other words, there will be no "surprises" or hidden fees. In terms of the "Cap," we can work with you to give you notice when we are within an agreed upon percentage of "Cap" to either restructure the engagement or seek additional funds.

Optional Items – Review of GAAP Implementation other than Pensions, CAFR Review and other General Consulting Services

All of these services will be based upon the fee per hour as quoted.

Billing Policy Regarding Telephone Inquiries

We have found that clients appreciate access to all of their service team members. We embrace this need and will ensure all our team members are available to service your questions and issues. This level of service is included in the scope of the engagement. If a particular issue surfaces that falls outside the scope of this engagement, we will bring it to your attention and obtain approval before proceeding on a path of resolution.

Conclusion

We firmly believe that the information presented in this proposal will allow you to make a decision in our favor. We have unparalleled expertise, depth of services and the ability to deliver the elements of the Scope of Services exceeding your expectations. We look forward to your feedback.

APPENDIX – Anticipated Timeline

Anticipated Dates	Anticipated Events
Contracting to June 24, 2014	Agenda setting for the June 26th meeting with stakeholders in Bismarck, ND, including invitations, content agreement and presentations
June 25, 2014	Existing Eide Bailly GASB Training in Bismarck, ND
June 26, 2014	Proposed "kick off" / training meeting with Plans, stakeholders etc. with content agreed upon prior to June 24, 2014.
Before October 31, 2014	Meeting / conference call focusing on auditing issues and planning for anticipated November 18, 2014 meeting, unresolved, undocumented issues
November 18, 2014	Anticipated meeting with Stakeholders
Ad Hoc	OPEB and other changes consulting
Ad Hoc	Accounting and financial reporting / GASB consultative issue resolution

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of the Firm, not just individual or office success.

Stretching ourselves to be innovative and
creative, while managing the related risks.

Recognizing the importance of maintaining
a balance between work and home life.

Promoting positive working relationships.

And, most of all, enjoying our jobs ...
and having fun!

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Segal Consulting

5990 Greenwood Plaza Boulevard Suite 118 Greenwood Village, CO 80111-4708
T 303.714.9900 www.segalco.com

April 22, 2014

Ms. Fay Kopp, Deputy Director – Retirement Officer
North Dakota Teachers' Fund for Retirement
1930 Burnt Boat Drive
Bismarck, ND 58507-7100

Mr. Sparb Collins, Executive Director
North Dakota Public Employees Retirement System
400 East Broadway, Suite 505
Bismarck, ND 58502

Re: North Dakota Public Employees Retirement System (PERS) and North Dakota Teachers' Fund for Retirement (TFFR) Implementation Proposal for GASB Statement Nos. 67 and 68

Dear Fay and Sparb:

As you know, the Governmental Accounting Standards Board (GASB) has issued a new Statement No. 67 that replaces the financial disclosure requirements that public employers such as PERS and TFFR (collectively referred to herein as "the Systems") have been following under Statement No. 25. In addition, there is a companion Statement No. 68 that replaces the Systems' participating employer disclosure requirements under Statement No. 27. The effective dates for the new requirements will be the Plan Years ending June 30, 2014 for Statement No. 67 and Fiscal Years ending June 30, 2015 for Statement No. 68.

As the valuation results for funding purposes will no longer be sufficient for financial disclosure purposes, we anticipate that there will be a significant amount of additional work in preparing the new disclosures. This will especially be the case during the first year of implementation as Segal becomes familiar with the practical requirements of satisfying the Statements. There will be considerable effort in coordinating the preparation of these disclosures among the Systems' staffs and auditors, employers, employers' auditors, and Segal. In addition, the Statements require a reconciliation of Net Pension Liability (NPL) in the first year of implementation. This will result in the calculation of two years of results before the 2014 disclosures can be prepared.

Below is a tentative list of implementation steps that we foresee being needed throughout this process. Please note that these items may change as more about the process becomes known.

ITEM	TIMEFRAME	RESPONSIBILITY
Discussions With Auditors	March 2014	PERS/TFFR/Segal/State Auditor/Brady Martz/Clifton Larson
2013 GASB 67 Results for 2013-2014 Reconciliation	July 1, 2014	Segal
2014 Valuation Data/Assets Delivery	July-August 2014	PERS/TFFR
2014 Valuation Results Delivery	October 15, 2014	Segal
2014 Valuation Results Presentation	October 23, 2014	Segal
2014 GASB 67 Interest Rate Calculations	October 31, 2014	Segal
2014 GASB 67 Results Preparation	October 31, 2014	Segal
2014 GASB 67 Disclosure Items Preparation	October 31, 2014	Segal/State Auditor/Brady Martz/Clifton Larson
2014 GASB 68 Percentage and Liability Allocations	November 10, 2014	Segal
2014 GASB 68 Allocations Communicated to Employers	November 2014	PERS/TFFR
Employer Education	Ongoing	PERS/TFFR/State Auditor

As a first step, we recommend an initial discussion between Segal, PERS and TFFR staff, the auditors for PERS and RIO (Brady Martz and Clifton Larson), and the State Auditor to discuss the above steps and make any changes to the scope of this assignment, as necessary.

In 2015 and thereafter, we expect that the GASB 67 and GASB 68 information will be prepared along with the annual actuarial valuations in October.

While GASB Statement No. 68 will not take effect until employer fiscal years beginning after June 15, 2014 (one year later than the effective date of GASB Statement No. 67), the AICPA State and Local Government Expert Panel's February 2014 White Paper recommends that "cost-sharing plans calculate each employer's allocation percentage and collective pension amounts". Pursuant to this recommendation, PERS and TFFR will communicate to employers the allocations of the Net Pension Liability, Pension Expense, Deferred Outflows of Resources Related to Pensions, and Deferred Inflows of Resources Related to Pensions, based upon the Systems' June 30, 2014 financial statements. These amounts will be communicated in November 2014, allowing employers to have access to these numbers well in advance of their auditors' deadlines.

Since the scope of the project is not completely defined at this time, we would propose that our cost to assist PERS and TFFR to comply with the new Statements for the Plan Year 2014-2015 be based on our hourly time charges associated with completing these projects. Our estimate of fees for your plans for the items above are provided below.

ITEM	ESTIMATED COST – PERS	ESTIMATED COST – TFFR
2014 GASB 67 Calculations and Preparation of Disclosure Items (includes 2013 GASB 67 Calculations for 2013-2014 Reconciliation)	$37,000 – $74,000 (130-260 hours)	$18,500 – $37,000 (65-130 hours)
2014 GASB 68 Employer Percentage Allocations	$3,000 – $6,000 (10-20 hours)	$1,500 – $3,000 (5-10 hours)
2014 GASB 68 Employer Liability Allocations	$6,000 – $12,000 (20-40 hours)	$3,000 – $6,000 (10-20 hours)

The first and second items above will include the GASB 67 calculations and disclosures and a calculation of GASB Statement No. 68 percentage allocations for the purposes of calculating Net Pension Liability and Pension Expense. The third item covers the additional work to calculate the Net Pension Liability and items needed for Pension Expense for individual employers. Please note that the amounts are larger for PERS because that System has more cost groups that will each require an independent rate calculation. We also anticipate that the costs for these services will be less in future years as the templates for delivering the work will be constructed in the first year.

For your information, the attached document (taken from a December 2012 Segal Public Sector Letter) contains a table that shows the extensive list of items that will ultimately need to be disclosed for GASB Statement Nos. 67 and 68.

We look forward to discussing this with you further.

Sincerely,

Kim Nicholl, FSA, MAAA, EA
Senior Vice President and Actuary

Sincerely,

Brad Ramirez, FSA, MAAA, EA
Consulting Actuary

/cz

Enclosure
cc: Cathie Eitelberg
Tammy Dixon
Matt Strom

5295148v4/01640.001

Disclosure Items in GASB's New Accounting Standards for Public Sector Pension Plans and Sponsoring Employers

This table summarizes the disclosure items in Statement 67, *Financial Reporting for Pension Plans* and Statement 68, *Accounting and Financial Reporting for Pensions by State and Local Governmental Employers*, that must be reported in notes to financial statements.

PLAN DESCRIPTION	
Required by Statement 67 (for Plans) *and* Statement 68 (for Employers)	› Name of the pension plan › Identification of the public employee retirement system or other entity that administers the pension plan › Identification of the pension plan as a single-employer, agent or cost-sharing pension plan › Classes of employees covered (*e.g.*, general employees and public safety employees) › The number of employees covered, broken down into the following groups: retirees and/or their beneficiaries currently receiving benefits, inactive employees entitled to but not yet receiving benefits and active employees › Brief description of the benefit terms, including the types of benefits; the key elements of the pension formulas; terms or policies, if any, with respect to automatic postemployment benefit changes (including automatic COLAs) and *ad hoc* postemployment benefit changes (including *ad hoc* COLAs) › The authority under which benefit terms are established or may be amended › Closure to new entrants, if applicable › Brief description of contribution requirements, including the basis for determining contributions if the pension plan or the entity that administers the pension plan has the authority to establish or amend contribution requirements
Required by Statement 67 (for Plans) Only	› Disclosure of the number of participating employers (if the pension plan is a multiple-employer pension plan) › Whether the pension plan issues a stand-alone financial report (or it is included in the report of a public employee retirement system or another government) that is available to the public and, if so, how to obtain the report (for example, a link to the report on the public employee retirement system's website). › Disclosure of the number of nonemployer contributing entities, if any › Information about the plan's board and its composition (*e.g.*, the number of trustees)
Required by Statement 68 (for Employers) Only	Whether the pension plan issues a stand-alone financial report (or it is included in the report of a public employee retirement system or another government) that is available to the public and, if so, how to obtain the report (for example, a link to the report on the public employee retirement system's website)

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PLAN INVESTMENTS

Required by Statement 67 (for Plans) Only

- Investment policies, including procedures and authority for establishing and amending investment policy decisions, policies pertaining to asset allocation and a description of significant investment policy changes during the period
- A brief description of how the fair value of investments is determined, including the methods and significant assumptions used to estimate the fair value of investments if that fair value is based on other than quoted market prices
- Identification of investments (other than those issued or explicitly guaranteed by the U.S. government) in any one organization that represents 5 percent or more of net position
- The annual money-weighted rate of return on plan investments calculated as the internal rate of return on plan investments (net of investment expense) and an explanation that a money-weighted rate of return expresses investment performance (net of investment expense) adjusted for the impact of the changing amounts actually invested. Inputs to the internal rate of return calculation that represent amounts of additions to and deductions from plan investments should be determined using accrual-based measures no less frequently than monthly. The use of daily inputs is encouraged.
- The terms of any long-term contracts for contributions to the pension plan between the employer(s) or nonemployer contributing entity(ies) and the pension plan and the balances outstanding on any such long-term contracts at the end of the plan's reporting period
- Allocated insurance contracts excluded from plan assets: (1) the amount reported in benefit payments in the current period that is attributable to the purchase of allocated insurance contracts; (2) a brief description of the pensions for which allocated insurance contracts were purchased in the current period; and (3) the fact that the obligation for the payment of benefits covered by allocated insurance contracts has been transferred to one or more insurance companies
- In circumstances in which there is a policy of setting aside reserves for such purposes as benefit increases or reduced employer contributions, a portion of the plan's fiduciary net position that otherwise would be available for existing pensions or for plan administration: (1) a description of the policy related to such reserves; (2) the authority under which the policy was established and may be amended; (3) the purposes for and conditions under which the reserves are required or permitted to be used and (4) the balances of the reserves

If a pension plan includes terms that permit a plan participant to be credited for benefit payments into an individual participant account within the pension plan while continuing to provide services to the employer and to be paid a salary: (1) a description of the Deferred retirement option program (DROP) terms and (2) the balance of the amounts held by the pension plan pursuant to the DROP

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SIGNIFICANT ASSUMPTIONS USED TO MEASURE THE TOTAL PENSION LIABILITY

Required by Statement 67 (for Plans) *and* Statement 68 (for Employers)

- Salary changes
- Inflation
- *Ad hoc* postemployment benefit changes (including *ad hoc* COLAs), and inputs to the discount rate
- The source of the assumptions about mortality (*e.g.*, the published tables on which the assumption is based or the experience of the covered group). If different rates are assumed for different periods, information should be disclosed about what rates were applied to the different periods of the measurement.

INFORMATION ABOUT THE DISCOUNT RATE

Required by Statement 67 (for Plans) *and* Statement 68 (for Employers)

- The discount rate applied in the measurement of the total pension liability for benefits provided through the pension plan and the change in the discount rate since the prior measurement date, if any
- Assumptions made about projected cash flows into and out of the pension plan, such as contributions from the employer, nonemployer contributing entity(ies), and employees
- The long-term expected rate of return on pension plan investments and a description of how it was determined, including significant methods and assumptions used for that purpose
- If the discount rate incorporates a municipal bond rate, the municipal bond rate used and the source of that rate
- The periods of projected benefit payments to which the long-term expected rate of return and, if used, the municipal bond rate were applied to determine the discount rate
- The assumed asset allocation of the pension plan's portfolio, the long-term expected real rate of return for each major asset class, and whether the expected rates of return are presented as arithmetic or geometric means, if not otherwise disclosed
- Measures of the net pension liability calculated using (1) a discount rate that is one percentage point higher than and (2) a discount rate that is one percentage point lower than the discount required in the Standard

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NET PENSION LIABILITY COMPONENTS

Required by Statement 67 (for Plans) Only

- The total pension liability for benefits provided through the pension plan
- The plan's fiduciary net position
- The net pension liability
- The plan's fiduciary net position as a percentage of the total pension liability
- Information should be measured as of the plan's most recent fiscal year-end.

EMPLOYER'S TOTAL PENSION LIABILITY FOR ALL PLANS

Required by Statement 68 (for Employers) Only

- Net pension assets
- Deferred outflows of resources and deferred inflows of resources related to pensions
- Pension expense/expenditures for the period, if the total amounts are not otherwise presented in the financial statements
- The plan's fiduciary net position unless a financial report that includes disclosure about the elements of the pension plan's basic financial statements is available on the Internet (either as a stand-alone financial report or included as a fiduciary fund in the financial report of another government) and information is provided about how to obtain the report, reference may instead be made to the other report for these disclosures. In this circumstance, it also should be disclosed that the pension plan's fiduciary net position has been determined on the same basis used by the pension plan, and a brief description of the pension plan's basis of accounting, including the policies with respect to benefits paid (including refunds of employee contributions) and the valuation of investments should be included. If significant changes have occurred that indicate that the disclosures included in the pension plan's financial report generally do not reflect the facts and circumstances at the measurement date, information about the substance and magnitude of the changes should be disclosed.

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ADDITIONAL INFORMATION TO DISCLOSE	
Required by Statement 67 (for Plans) *and* Statement 68 (for Employers)	➤ The date of the actuarial valuation on which the total pension liability is based ➤ Indication that the amount reported is the result of the use of update procedures to roll forward amounts to the plan's fiscal year-end, if applicable
Required by Statement 68 (for Employers) Only	➤ The measurement date of its net pension liability ➤ If the employer has a special funding situation, its proportion of the net pension liability for benefits provided through the pension plan, the basis on which its proportion was determined, and the change, if any, in its proportion since the prior measurement date ➤ A brief description of changes of assumptions or other inputs that affected measurement of the net pension liability since the prior measurement date ➤ A brief description of changes of benefit terms that affected measurement of the net pension liability since the prior measurement date ➤ The amount of benefit payments in the measurement period attributable to the purchase of allocated insurance contracts, a brief description of the benefits for which allocated insurance contracts were purchased in the measurement period, and the fact that the obligation for the payment of benefits covered by allocated insurance contract has been transferred from the employer to one or more insurance companies ➤ A description of the nature of changes, if any, between the measurement date of the net pension liability and the employer's reporting date that are expected to have a significant effect on the net pension liability and the amount of the expected resultant change in the net pension liability, if known ➤ The amount of pension expense in the reporting period ➤ The balances of deferred outflows of resources and deferred inflows of resources related to pensions as of the fiscal year-end, classified as follows, if applicable: (1) net difference between projected and actual earnings on pension plan investments; (2) differences between expected and actual experience; (3) changes of assumptions; (4) changes in proportion and the effect of certain employer contributions on the employer's net pension liability; and (5) employer contributions made subsequent to the measurement date of its recognized net pension liability ➤ A schedule presenting for each of the subsequent five years, and in the aggregate thereafter, (1) the net amount of deferred outflows of resources and of deferred inflows of resources that will be recognized in pension expense and (2) the amount that will be recognized as a reduction of the net pension liability ➤ The amount of revenue recognized for the support provided by nonemployer contributing entities, if any

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REQUIRED SUPPLEMENTARY INFORMATION

Required by Statement 67 (for Plans) *and* Statement 68 (for Employers) Only

- 10-year schedule of changes in the net pension liability (asset), presenting for each year the beginning and ending balances of the total pension liability, the plan's fiduciary net position, and the net pension liability, and the effects on those items during the year of the following: (1) service cost; (2) interest on the total pension liability; (3) changes of benefit terms; (4) differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total pension liability; (5) changes of assumptions about future economic or demographic factors; (6) contributions from the employer(s); (7) contributions from the nonemployer contributing entity(ies); (8) contributions from plan members; (9) net investment income; (10) benefits paid, including refunds of plan member contributions; (11) plan administrative expenses; and (12) other changes, separately identified if individually significant
- A 10-year schedule presenting the following for each year: (1) the total pension liability; (2) the plan's fiduciary net position; (3) the net pension liability (asset); (4) the plan's fiduciary net position as a percentage of the total pension liability; (5) the covered-employee payroll; and (6) the net pension liability (asset) as a percentage of covered-employee payroll

Required by Statement 67 (for Plans) Only

- Required supplementary information presented by a defined benefit pension plan should include all information required by Statement 67 paragraphs 32-34,* as applicable, when the financial statements are presented (1) in a stand-alone pension plan financial report or (2) solely in the financial report of another government (as a pension trust fund). Statement 68 includes the requirements for required supplementary information to be presented in the financial reports of employers whose employees are provided with pensions and of certain governmental nonemployer contributing entities that are required to contribute to a pension plan on behalf of another government. If (1) a defined benefit pension plan is included in the financial report of a government that applies the requirements of Statement 68 for benefits provided through the pension plan and (2) similar information is required by this Statement and Statement 68, the government should present the information in a manner that avoids unnecessary duplication
- Information for each year should be measured as of the plan's most recent fiscal year-end. Information about cost-sharing pension plans should be presented for the pension plan as a whole. The information may be presented in a single schedule

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* Required information includes 10-year schedules for (1) the history of the changes in the NPL showing beginning and ending values as well as a reconciliation of the change; (2) the TPL, net fiduciary position NPL, the net fiduciary position as a percentage of the TPL, the covered employee payroll and the NPL as a percentage of this payroll; (3) the actuarially determined contribution (ADC), the actual contributions recognized each year, the difference between the two, the covered employee payroll, and the difference as a percentage of this payroll; and (4) the annual money-weighted rate of return on pension plan investments.

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REQUIRED SUPPLEMENTARY INFORMATION (*CONTINUED*)

Required by Statement 68 (for Employers) Only

- If the employer has a special funding situation, it should report the amount of the net pension liability for benefits provided through the pension plan recognized by the nonemployer contributing entity(ies) and the amount of the net pension liability for benefits provided through the pension plan recognized by the employer.
- For each pension plan, a 10-year schedule presenting the following for each year if the employer has a special funding situation: (1) the total pension liability for benefits provided through the pension plan; (2) the pension plan's fiduciary net position; (3) the net pension liability for benefits provided through the pension plan; (4) the nonemployer contributing entity's(ies') net pension liability that is associated with the employer; (5) the employer's net pension liability; (6) the pension plan's fiduciary net position as a percentage of the total pension liability; (6) the covered-employee payroll; and (8) the employer's net pension liability as a percentage of the covered-employee payroll
- The information should be determined as of the measurement date of the employer's net pension liability and may be presented in a single schedule. The information should be determined as of the employer's most recent fiscal year-end. If a primary government and one or more of its component units provide pensions through the same single-employer or agent pension plan, required supplementary information in the reporting entity's financial statements should present information for the reporting entity as a whole.

NOTES TO THE REQUIRED SCHEDULES

Required by Statement 67 (for Plans) *and* Statement 68 (for Employers)

- Significant methods and assumptions used in calculating the actuarially determined contributions, if any, should be presented as notes to the schedule required by the statements. In addition, for each of the schedules required by the statements, the employer should present information about factors that significantly affect trends in the amounts reported (for example, changes of benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions). (The amounts presented for prior years should not be restated for the effects of changes – for example, changes of benefit terms or changes of assumptions – that occurred subsequent to the measurement date of that information.)

This is an online supplement to The Segal Company's December 2012 *Public Sector Letter*, "Gearing Up to Comply with GASB's New Accounting Standards for Public Sector Pension Plans and Sponsoring Employers," which is available on the following page of Segal's website: http://www.segalco.com/publications/publicsectorletters/dec2012.pdf

Example Schedule of Employer Allocations

want % on the report

EXAMPLE COST SHARING PENSION PLAN
Schedule of Employer Allocations
6/30/20X5

Employer	20X5 Actual Employer Contributions	Employer Allocation Percentage
Employer 1	$ 2,143,842	36.376 %
Employer 2	268,425	4.554
Employer 3	322,142	5.466
Employer 4	483,255	8.199
Employer 5	633,125	10.742
Employer 6	144,288	2.448
Employer 7	95,365	1.618
Employer 8	94,238	1.599
Employer 9	795,365	13.495
Employer 10	267,468	4.538
Employer 11	403,527	6.847
Employer 12	165,886	2.815
Employer 13	68,454	1.161
Employer 14	6,240	0.106
Employer 15	2,144	0.036
Total	$ 5,893,764	100.000 %

SCHEDULE 1

Example Schedule of Pension Amounts by Employer

EXAMPLE COST SHARING PENSION PLAN
Schedule of Pension Amounts by Employer
As of and for the year ended 6/30/20X5

		Deferred Outflows of Resources					Deferred Inflows of Resources				Pension Expens	
Entity	Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Outflows of Resources	Differences Between Expected and Actual Experience	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Inflows of Resources	Proportionate Share of Plan Pension Expense	Net Amortization Deferred Amoun from Changes i Proportion and Differences Between Employer Contributions and Proportiona Share of Contributions
Employer 1	$ 45,224,620	438,859	1,569,847	1,404,206	695,426	4,108,338	355,917	–	726,425	1,082,342	1,907,283	12,375
Employer 2	5,661,780	54,942	196,533	175,796	84,231	511,502	44,558	–	74,326	118,884	238,777	(1,793)
Employer 3	6,795,628	65,945	235,892	211,001	117,354	630,192	53,481	–	98,465	151,946	286,596	(8,088)
Employer 4	10,193,442	98,917	353,838	316,502	161,215	930,472	80,222	–	165,453	245,675	429,894	3,021
Employer 5	13,355,038	129,597	463,584	414,668	199,845	1,207,694	105,103	–	197,645	302,748	563,229	(9,900)
Employer 6	3,043,487	29,534	105,646	94,499	53,453	283,132	23,952	–	48,453	72,405	128,355	599
Employer 7	2,011,585	19,520	69,827	62,459	33,458	185,264	15,831	–	35,345	51,176	84,836	625
Employer 8	1,987,964	19,291	69,007	61,725	35,425	185,448	15,645	–	16,453	32,098	83,839	(5,712)
Employer 9	16,777,717	162,811	582,393	520,941	248,356	1,514,501	132,040	–	284,543	416,583	707,576	8,405
Employer 10	5,641,888	54,749	195,843	175,178	95,465	521,235	44,401	–	44,356	88,757	237,938	(1,188)
Employer 11	8,512,562	82,606	295,490	264,312	136,453	778,861	66,993	–	148,543	215,536	359,005	1,254
Employer 12	3,499,761	33,962	121,485	108,666	52,145	316,258	27,543	–	64,354	91,897	147,597	453
Employer 13	1,443,418	14,007	50,104	44,818	23,156	132,085	11,360	–	33,453	44,813	60,874	(205)
Employer 14	131,785	1,279	4,575	4,092	1,968	11,914	1,037	–	894	1,931	5,558	147
Employer 15	44,757	434	1,554	1,390	1,456	4,834	352	–	698	1,050	1,888	7
Total for All Entities	$ 124,325,432	1,206,453	4,315,618	3,860,253	1,939,406	11,321,730	978,435	–	1,939,406	2,917,841	5,243,245	–

SCHEDULE 2

MEMORANDUM

TO: **TFFR Board**

FROM: **Fay Kopp**

DATE: **May 8, 2014**

SUBJ: **DOMA UPDATE**

Mary Kae Kelsch, Director of State and Local Division of the ND Attorney General's Office, will review the attached guidance from the IRS relating to DOMA (Defense of Marriage Act) and the ramifications of the notice on public pension plans like TFFR. She will also discuss the need for specialized legal expertise by outside tax counsel to review current statutes and advise the Board on what, if any plan amendments are needed to respond to this guidance, and the deadline for making any plan amendments if needed.

Enclosures

IRS

Treatment of Marriages of Same-Sex Couples for Retirement Plan Purposes

Today, the IRS issued Notice 2014-19, which provides guidance on how qualified retirement plans should treat the marriages of same-sex couples following the Supreme Court's decision in *United States v. Windsor*. The *Windsor* decision invalidated Section 3 of the 1996 Defense of Marriage Act (DOMA) that barred married same-sex couples from being treated as married under federal law.

The notice:

- gives examples of Code requirements under which the marital status of the participants is relevant to the payment of benefits,
- provides guidance on how to satisfy those requirements in light of *Windsor* and Revenue Ruling 2013-17, and
- describes when retirement plans must be amended to comply with *Windsor*, Revenue Ruling 2013-17, and Notice 2014-19

Recognition of marriages of same-sex couples for tax purposes

Following the *Windsor* decision, the IRS issued Revenue Ruling 2013-17, which holds that married same-sex couples are now treated as married for all federal tax purposes where marriage is a factor, if the couple is lawfully married under the laws of one of the 50 states, the District of Columbia, a U.S. territory or a foreign jurisdiction. Notice 2014-19 gives additional guidance on how qualified retirement plans should treat the marriages of same-sex couples.

Plan amendments required with respect to plan provisions inconsistent with *Windsor*

- If its terms are inconsistent with Windsor or Revenue Ruling 2013-17, a retirement plan must be amended to comply with *Windsor* and Revenue Ruling 2013-17. For example, a plan must be amended if it defines "spouse" by reference to section 3 of DOMA, or only as a person of the opposite sex.
- Not all plans need to be amended in order to be in compliance. An amendment generally is not required if a plan's terms are not inconsistent with *Windsor* or with Revenue Ruling 2013-17.
- Required amendments must be adopted by the later of December 31, 2014, or the applicable date under the IRS' general amendment guidance for qualified retirement plans, Revenue Procedure 2007-44.

Optional amendments

- Plan sponsors may also, but are not required to, reflect the outcome of *Windsor* for periods prior to the date *Windsor* was decided.
- In such a case, a plan amendment is required.
- Such optional amendment must be adopted by the later of December 31, 2014, or the applicable date under Revenue Procedure 2007-44.

FAQs for more information

See the FAQs on the treatment of same-sex marriages for additional guidance, including:

- beneficiary designations in profit-sharing plans after *Windsor*,
- amendments that reflect the outcome of *Windsor* for periods before the decision was issued, and
- application of the outcome of *Windsor* to 403(b) plans.

Additional resources

- IRS News - For Same-Sex Couples and Certain Domestic Partners
- Revenue Ruling 2013-17 – treatment of same-sex marriage for federal tax purposes
- FAQs on treatment of same-sex marriage for retirement plans

Page Last Reviewed or Updated: 04-Apr-2014

Application of the Windsor Decision and Rev. Rul. 2013-17 to Qualified Retirement Plans

Notice 2014-19

I. PURPOSE

The purpose of this notice is to provide guidance on the application (including the retroactive application) of the decision in United States v. Windsor, 570 U.S. ___, 133 S. Ct. 2675 (2013), and the holdings of Rev. Rul. 2013-17, 2013-38 I.R.B. 201 (Sept. 16, 2013), to retirement plans qualified under section 401(a) of the Internal Revenue Code (Code).

II. BACKGROUND

01. Qualified Retirement Plan Rules Relating to Married Participants

Several Code sections provide special rules with respect to married participants in qualified retirement plans, including, but not limited to, the following:

- Under section 401(a)(11), certain qualified retirement plans must provide a qualified joint and survivor annuity (QJSA) upon retirement to married participants (and generally must provide a qualified preretirement survivor annuity (QPSA) to the surviving spouse of a married participant who dies before retirement). If a plan is subject to these rules, the QJSA (or QPSA) may be waived by a married participant only with spousal consent pursuant to section 417. If such a plan permits loans to participants, then section 417(a)(4) requires a plan to obtain the consent of the spouse of a married participant before making a loan to the participant.

- Under section 401(a)(11)(B)(iii), certain qualified defined contribution retirement plans are exempt from the QJSA and QPSA requirements provided that a married participant's benefit is payable in full, on the death of the participant, to the participant's surviving spouse, unless the surviving spouse consents to the designation of a different beneficiary.

- Under the required minimum distribution rules of section 401(a)(9) and the rollover rules of section 402(c), additional alternatives are provided for surviving spouses that are not available to non-spousal beneficiaries.

- Under section 1563(e)(5), generally a spouse is treated as owning shares owned by the other spouse for purposes of determining whether corporations are members of a controlled group under section 414(b).

- Under section 318(a)(1), generally a spouse is treated as owning shares owned by the other spouse for purposes of determining whether an employee is a key employee under section 416(i)(1), including whether an employee is considered a 5% owner.

- Under section 409(n), an employee stock ownership plan (ESOP) that acquires certain employer securities generally must prohibit the allocation or accrual of those securities for the benefit of certain individuals, including the spouse of the seller and the spouse of any individual who owns 25% or more of the securities.

- Under section 409(p), no portion of the assets of an ESOP attributable to employer securities consisting of S corporation stock may accrue during a nonallocation year for the benefit of any disqualified person or certain family members of the disqualified person (including the spouse) in certain circumstances.

- Under section 401(a)(13)(B), the anti-alienation rules do not apply to the creation, assignment, or recognition of an alternate payee's right to receive all or a portion of the benefits payable to a participant under a plan pursuant to a qualified domestic relations order (QDRO) described in section 414(p), and, under section 402(e)(1), an alternate payee who is a spouse or former spouse of the participant is treated as the distributee of a distribution under a QDRO.

02. Defense of Marriage Act

Until the decision of the Supreme Court in Windsor found it unconstitutional, section 3 of the Defense of Marriage Act (DOMA) prohibited the recognition of same-sex spouses for purposes of Federal tax law. Specifically, section 3 of DOMA provided that:

> In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife.

1 U.S.C. § 7. As a result, same-sex spouses were not recognized for purposes of the Code with respect to qualified retirement plans.

03. Effect of the Windsor Decision and Rev. Rul. 2013-17

In the Windsor decision, the Supreme Court held on June 26, 2013 that section 3 of DOMA is unconstitutional because it violates Fifth Amendment principles. Subsequent to the Windsor decision, Rev. Rul. 2013-17 held the following:

(1) For Federal tax purposes, the terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same sex if the individuals

are lawfully married under state law, and the term “marriage” includes such a marriage between individuals of the same sex.

(2) For Federal tax purposes, the Internal Revenue Service (Service) adopts a general rule recognizing a marriage of same-sex individuals that was validly entered into in a state whose laws authorize the marriage of two individuals of the same sex even if the married couple is domiciled in a state that does not recognize the validity of same-sex marriages.

(3) For Federal tax purposes, the terms “spouse,” “husband and wife,” “husband,” and “wife” do not include individuals (whether of the opposite sex or the same sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state, and the term “marriage” does not include such formal relationships.

The holdings of Rev. Rul. 2013-17 apply for all Federal tax purposes, including for purposes of the Federal tax rules that apply to qualified retirement plans under section 401(a). The ruling provides that the holdings will be applied prospectively as of September 16, 2013. The ruling also provides that taxpayers may rely on the holdings retroactively with respect to any employee benefit plan or arrangement (or any benefit provided thereunder) for limited purposes with respect to certain employer-provided health coverage and fringe benefits that are specified in the ruling. The ruling further states that:

> The Service intends to issue further guidance on the retroactive application of the Supreme Court’s opinion in Windsor to other employee benefits and employee benefit plans and arrangements. Such guidance will take into account the potential consequences of retroactive application to all taxpayers involved, including the plan sponsor, the plan or arrangement, employers, affected employees and beneficiaries. The Service anticipates that the future guidance will provide sufficient time for plan amendments and any necessary corrections so that the plan and benefits will retain favorable tax treatment for which they otherwise qualify.

04. Authority under Section 7805(b)(8)

Under section 7805(b)(8), the Commissioner is authorized to prescribe the extent, if any, to which any judicial decision, or any administrative determination other than by regulation, relating to the internal revenue laws is to be applied without retroactive effect.

05. Remedial Amendment Period under Section 401(b)

Section 401(b) provides a period during which a plan may be amended retroactively to comply with the Code's qualification requirements. The deadline for amending a plan is generally the time prescribed by law for filing the return of the employer for its taxable year in which the amendment was adopted or such later time as the Secretary may designate.

Rev. Proc. 2007-44, 2007-28 I.R.B. 54, provides rules regarding the timing of amendments made to qualified retirement plans. Section 5.05 of Rev. Proc. 2007-44 provides that when there are changes to the plan qualification requirements that affect provisions of the written plan document, the adoption of an interim amendment generally is required by the later of the end of the plan year in which the change is first effective or the due date of the employer's tax return for the tax year that includes the date the change is first effective.

III. QUESTIONS AND ANSWERS

GENERAL RULES

Q-1. How does the Windsor decision affect the application of the Federal tax rules to qualified retirement plans?

A-1. In the Windsor decision, the Supreme Court held that section 3 of DOMA (which applied for purposes of determining an individual's marital status under Federal law) is unconstitutional. In the absence of section 3 of DOMA, any retirement plan qualification rule that applies because a participant is married must be applied with respect to a participant who is married to an individual of the same sex. For example, a participant in a plan subject to the rules of section 401(a)(11) who is married to a same-sex spouse cannot waive a QJSA without obtaining spousal consent pursuant to section 417.

Q-2. As of what date are qualified retirement plans required to be operated in a manner that reflects the outcome of Windsor and the guidance in Rev. Rul. 2013-17?

A-2. Qualified retirement plan operations must reflect the outcome of Windsor as of June 26, 2013. A retirement plan will not be treated as failing to meet the requirements of section 401(a) merely because it did not recognize the same-sex spouse of a participant as a spouse before June 26, 2013. For Federal tax purposes, effective as of September 16, 2013, Rev. Rul. 2013-17 (i) adopts a general rule recognizing a marriage of same-sex individuals that is validly entered into in a state whose laws authorize the marriage of two individuals of the same sex, even if the individuals are domiciled in a state that does not recognize the validity of same-sex marriages, and (ii) provides that individuals (whether part of an opposite-sex or same-sex couple) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state are not treated as married. Accordingly, a retirement plan will not be treated as failing to meet the requirements of section 401(a) merely because the plan, prior to

September 16, 2013, recognized the same-sex spouse of a participant only if the participant was domiciled in a state that recognized same-sex marriages. See Q&A-8 for the deadline to adopt plan amendments pursuant to this notice.

Q-3. May a qualified retirement plan be amended to reflect the outcome of Windsor as of a date earlier than June 26, 2013, and, if so, may the amendment reflect the outcome of Windsor for only certain purposes?

A-3. A qualified retirement plan will not lose its qualified status due to an amendment to reflect the outcome of Windsor for some or all purposes as of a date prior to June 26, 2013, if the amendment complies with applicable qualification requirements (such as section 401(a)(4)). Recognizing same-sex spouses for all purposes under a plan prior to June 26, 2013, however, may trigger requirements that are difficult to implement retroactively (such as the ownership attribution rules) and may create unintended consequences. Provided that applicable qualification requirements are otherwise satisfied, a plan sponsor's choice of a date before June 26, 2013, and the purposes for which the plan amendments recognize same-sex spouses before June 26, 2013, do not affect the qualified status of the plan. For example, for the period before June 26, 2013, a plan sponsor may choose to amend its plan to reflect the outcome of Windsor solely with respect to the QJSA and QPSA requirements of section 401(a)(11) and, for those purposes, solely with respect to participants with annuity starting dates or dates of death on or after a specified date.

PLAN AMENDMENTS

Q-4. For purposes of satisfying the Federal tax rules relating to qualified retirement plans, must a qualified retirement plan be amended to reflect the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice?

A-4. Whether a plan must be amended to reflect the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice depends on the terms of the specific plan, as described in Q&A-5 through Q&A-7 of this notice.

Q-5. Must a plan sponsor amend a qualified retirement plan if its terms with respect to the requirements of section 401(a) define a marital relationship by reference to section 3 of DOMA or if the plan's terms are otherwise inconsistent with the outcome of Windsor or the guidance in Rev. Rul. 2013-17 or this notice?

A-5. If a plan's terms with respect to the requirements of section 401(a) define a marital relationship by reference to section 3 of DOMA or are otherwise inconsistent with the outcome of Windsor or the guidance in Rev. Rul. 2013-17 or this notice, then an amendment to the plan that reflects the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice is required by the date specified in Q&A-8 of this notice.

Q-6. If a qualified retirement plan's terms are not inconsistent with the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice (for example, the term “spouse,” “legally married spouse” or “spouse under Federal law” is used in the plan without any distinction between a same-sex spouse and an opposite-sex spouse), must the plan be amended to reflect the change in meaning or interpretation of those terms to include same-sex spouses?

A-6. If a plan’s terms are not inconsistent with the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice, an amendment generally would not be required. If no amendment to such a plan is made, the plan nonetheless must be operated in accordance with the provisions of Q&A-2 of this notice. (Though not required, a clarifying amendment may be useful for purposes of plan administration.)

Q-7. If a plan sponsor chooses to apply the rules with respect to married participants in qualified retirement plans in a manner that reflects the outcome of Windsor for a period before June 26, 2013, is an amendment to the plan required?

A-7. Yes, if a plan sponsor chooses to apply the rules in a manner that reflects the outcome of Windsor for a period before June 26, 2013, an amendment to the plan that specifies the date as of which, and the purposes for which, the rules are applied in this manner is required. The deadline for this amendment is the date specified in Q&A-8 of this notice.

Q-8. What is the deadline to adopt a plan amendment pursuant to this notice?

A-8. The deadline to adopt a plan amendment pursuant to this notice is the later of (i) the otherwise applicable deadline under section 5.05 of Rev. Proc. 2007-44, or its successor, or (ii) December 31, 2014. Moreover, in the case of a governmental plan, any amendment made pursuant to this notice need not be adopted before the close of the first regular legislative session of the legislative body with the authority to amend the plan that ends after December 31, 2014.

Q-9. Is an amendment to a single-employer defined benefit plan that implements the outcome of Windsor and the guidance in Rev. Rul. 2013-17 and this notice subject to the requirements of section 436(c)?

A-9. In general, under section 436(c), an amendment to a single-employer defined benefit plan that increases the liabilities of the plan cannot take effect unless the plan’s adjusted funding target attainment percentage is sufficient or the employer makes the additional contribution specified under section 436(c)(2). However, this notice provides a special rule pursuant to § 1.436-1(c)(4)(iii). Under this special rule, a plan amendment that is described in Q&A-5 of this notice and that takes effect on June 26, 2013, is not treated as an amendment to which section 436(c) applies. In contrast, a plan amendment that is described in Q&A-7 of this notice is an amendment to which section 436(c) applies.

IV. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2013-17 is amplified by providing further guidance on the effect of the Windsor decision with respect to qualified retirement plans under section 401(a).

V. DRAFTING INFORMATION

The principal authors of this notice are Angelique Carrington of the Employee Plans, Tax Exempt and Government Entities Division, and Jeremy Lamb of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Carrington at *RetirementPlanQuestions@irs.gov* or Mr. Lamb at (202) 317-6700 (not a toll-free call).

MEMORANDUM

TO: **TFFR Board**

FROM: **Fay Kopp**

DATE: **May 8, 2014**

SUBJ: **Legislative Update**

1) Legislative Employee Benefits Programs Committee (LEBPC)

TFFR's technical corrections bill was submitted to the LEBPC prior to the April 1, 2014 deadline, and I will review the provisions of the bill with the Committee at their next meeting on June 5, 2014. Once the Committee takes jurisdiction over the bill, it will be submitted to Segal for actuarial analysis and technical review.

2) Legislative Government Finance Committee (LGFC)

The LGFC has been meeting regularly during the interim to study the state retirement plan (PERS), including an analysis of both a defined benefit and defined contribution plan, with considerations and possible consequences for transitioning to a state defined contribution plan.

At their April 23, 2014 meeting, the Committee heard presentations from four potential consulting actuaries for the Committee's study of state employee retirement plans. The Committee selected Arthur J. Gallagher & Co. to calculate/review costs of closing the State's defined benefit plan under various scenarios, review actuarial assumptions used by Segal, and other related actuarial services. The actuarial report will be delivered to the Committee by September 1, 2014.

2014 - 15
TFFR AND SIB MEETING SCHEDULE

July 2014
- 24 TFFR - 1:00 pm
- 25 SIB - 8:30 am

August 2014
- -- TFFR - No meeting
- 22 SIB - 8:30 am

September 2014
- 25 TFFR - 1:00 pm
- 26 SIB - 8:30 am

October 2014
- 23 TFFR - 1:00 pm
- 24 SIB - 8:30 am

November 2014*
- -- TFFR - No meeting
- 21 SIB - 8:30 am

December 2014
- -- No meetings

January 2015
- 22 TFFR - 1:00 pm
- 23 SIB - 8:30 am

February 2015
- 26 TFFR - 1:00 pm
- 27 SIB - 8:30 am

March 2015
- 26 TFFR - 1:00 pm
- 27 SIB - 8:30 am

April 2015
- 23 TFFR - 1:00 pm
- 24 SIB - 8:30 am

May 2015
- -- TFFR - No meeting
- 22 SIB - 8:30 am

June 2015
- -- TFFR – No meeting
- 26 SIB - 8:30 am

Notes:
1) SIB meetings scheduled for 4th Friday of each month, except for November* which is 3rd Friday due to Thanksgiving.
2) TFFR meetings scheduled for day preceding SIB meetings.
3) During 2015 legislative session, TFFR board scheduled to meet monthly at WSI.

05/08/14

NASRA Issue Brief:
Public Pension Plan Investment Return Assumptions

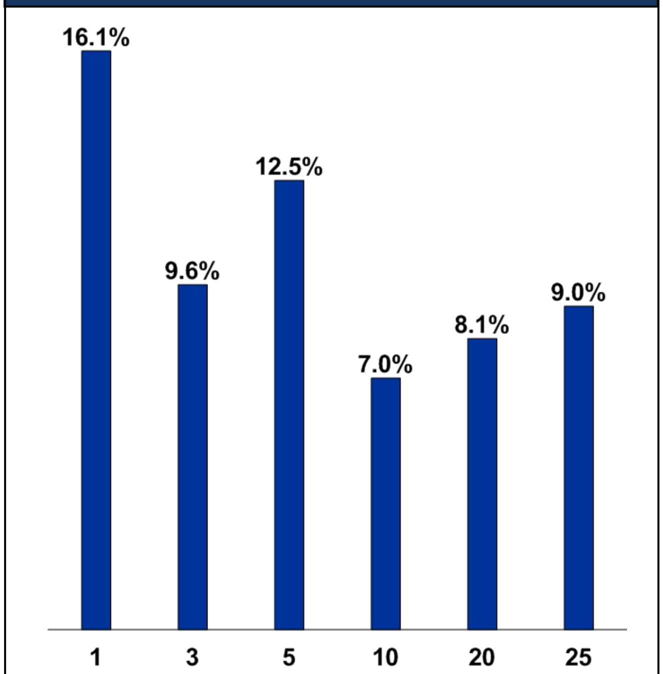
Updated April 2014

As of December 31, 2013, state and local government retirement systems held assets of $3.88 trillion.[1] These assets are held in trust and invested to pre-fund the cost of pension benefits. The investment return on these assets matters, as investment earnings account for a majority of public pension financing. A shortfall in long-term expected investment earnings must be made up by higher contributions or reduced benefits.

Funding a pension benefit requires the use of projections, known as actuarial assumptions, about future events. Actuarial assumptions fall into one of two broad categories: demographic and economic. Demographic assumptions are those pertaining to a pension plan's membership, such as changes in the number of working and retired plan participants; when participants will retire, and how long they'll live after they retire. Economic assumptions pertain to such factors as the rate of wage growth and the investment return on the fund's assets.

As with other actuarial assumptions, projecting public pension fund investment returns requires a focus on the long-term. This brief discusses how investment return assumptions are established and evaluated and compares these assumptions with public funds' actual investment experience.

Figure 1: Median public pension annualized investment returns for period ended 12/31/2013



Source: Callan Associates, Inc.

Public pension fund investment return assumptions have been the focus of growing attention in recent years. Some critics of current public pension investment return assumptions say that current low interest rates and volatile investment markets require public pension funds to take on too much investment risk to achieve their assumption. Because investment earnings account for a majority of revenue for a typical public pension fund, the accuracy of the assumption has a major effect on the plan's finances and actuarial funding level.

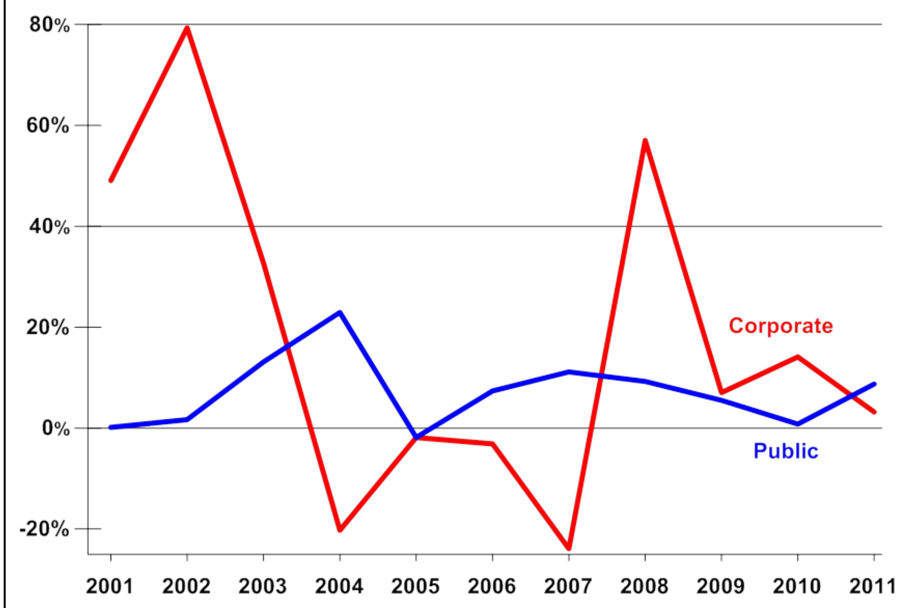
An investment return assumption that is set too low will overstate liabilities and costs, causing current taxpayers to be overcharged and future taxpayers to be undercharged. A rate set too high will understate liabilities, undercharging current taxpayers, at the expense of future taxpayers. An assumption that is significantly wrong in either direction will cause a misallocation of resources and unfairly distribute costs among generations of taxpayers.

Although public pension funds, like other investors, experienced sub-par returns in the wake of the 2008-09 decline in global equity values, median public pension fund returns over longer periods meet or exceed the assumed rates used by most plans. As shown in Figure 1, at 9.0 percent, the median annualized investment return for the 25-year period ended December 31, 2013, exceeds the average assumption of 7.72 percent (see Figure 5), while the 10-year return is below this level.

[1] Federal Reserve, *Flow of Funds Accounts of the United States: Flows and Outstandings, Fourth Quarter 2013*, Table L.118

Public retirement systems typically follow guidelines set forth by the Actuarial Standards Board to set and review their actuarial assumptions, including the expected rate of investment return. Most systems review their actuarial assumptions regularly, pursuant to state or local statute or system policy. Actuarial Standards of Practice No. 27 (Selection of Economic Assumptions for Measuring Pension Obligations) (ASOP 27) prescribes the considerations actuaries should make in setting an investment return assumption. As described in ASOP 27, the process for establishing and reviewing the investment return assumption involves consideration of various financial, economic, and market factors, and is based on a very long-term view, typically 30 to 50 years. A primary objective for using a long-term approach in setting public pensions' return assumption is to promote stability and predictability of cost to ensure intergenerational equity among taxpayers.

Figure 2: Annual change in contributions from prior year, corporate vs. public pensions



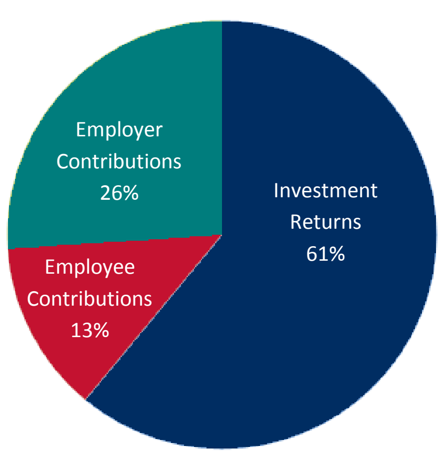
Source: U.S. Department of Labor, U.S. Census Bureau

Unlike public pension plans, corporate plans are required by federal regulations to make contributions on the basis of current interest rates. As Figure 2 shows, this method results in plan costs that are volatile and uncertain, often changing dramatically from one year to the next. This volatility is due in part to fluctuations in interest rates and has been identified as a leading factor in the decision among corporations to abandon their pension plans. By focusing on the long-term and relying on a stable investment return assumption, public plans experience less volatility of costs.

As Figure 3 shows, since 1982, public pension funds have accrued an estimated $5.3 trillion in revenue, of which $3.2 trillion, or 61 percent, is estimated to have come from investment earnings. Employer contributions account for $1.4 trillion, or 26 percent of the total, and employee contributions total $662 billion, or 13 percent.[i]

Public retirement systems operate over long timeframes and manage assets for participants whose involvement with the plan can last more than half a century. Consider the case of a newly-hired public school teacher who is 25 years old. If this pension plan participant elects to make a career out of teaching school, he or she may work for 35 years, to age 60, and live another 25 years, to age 85. This teacher's pension plan will receive contributions for the first 35 years and then pay out benefits for another 25 years. During the entire 60-year period, the plan is investing assets on behalf of this participant. To emphasize the long-term nature of the investment return assumption, for a typical career employee, more than one-half of the investment income earned on assets accumulated to pay benefits is received *after* the employee retires.

Figure 3: Public Pensions Sources of Revenue, 1982-2011



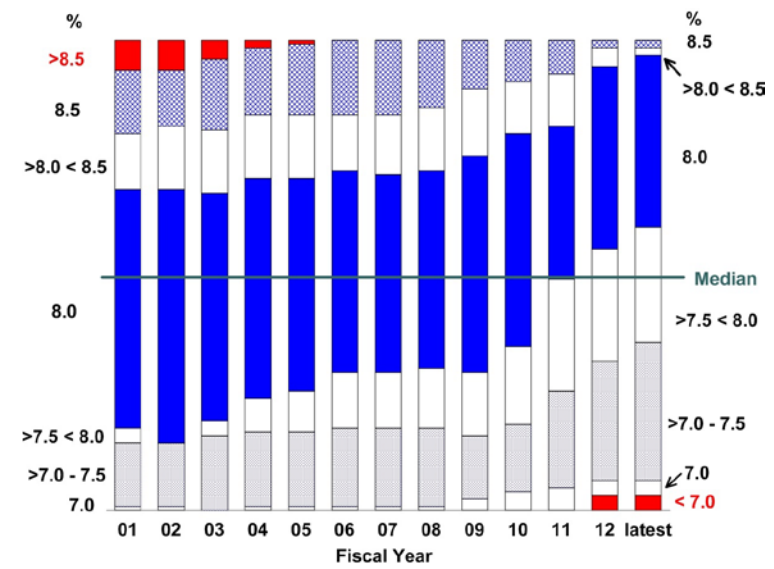
Source: U.S. Census Bureau

The investment return assumption is established through a process that considers factors such as economic and financial criteria; the plan's liabilities; and the plan's asset allocation, which reflects the plan's capital market assumptions, risk tolerance, and projected cash flows.

Standards for setting an investment return assumption, established and maintained by professional actuaries, recommend that actuaries consider a range of specified factors, including current and projected interest rates and rates of inflation; historic and projected returns for individual asset classes; and historic returns of the fund itself. The investment return assumption reflects a value within the projected range.

As shown in Figure 4, many public pension plans have reduced their return assumption in recent years. Among the 126 plans measured in the Public Fund Survey, more than one-half have reduced their investment return assumption since fiscal year 2008. The average return assumption is 7.72 percent. Appendix A details the assumptions in use or adopted by the 126 plans in the Public Fund Survey.

Figure 4: Change in distribution of public pension investment return assumptions, FY 01 through Dec. 2013

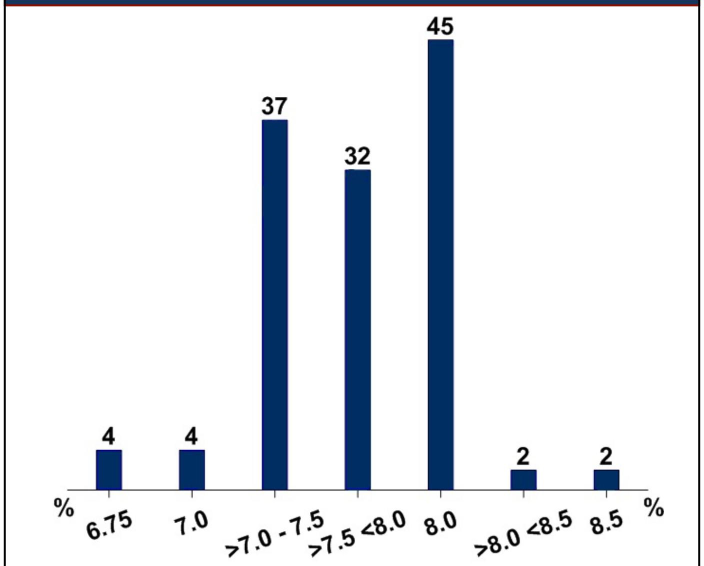


Source: Public Fund Survey, Dec. 2013

Conclusion

Over the last 25 years, a period that has included three economic recessions and four years when median public pension fund investment returns were negative, public pension funds have exceeded their assumed rates of investment return. Changes in economic and financial conditions are causing many public plans to reconsider their investment return assumption. Such a consideration must include a range of financial and economic factors while remaining consistent with the long timeframe under which plans operate.

Figure 5: Distribution of investment return assumptions



Source: Public Fund Survey, Dec. 2013

See Also:

Actuarial Standards of Practice No. 27, Actuarial Standards Board

The Liability Side of the Equation Revisited, Missouri SERS, September 2006

The Public Fund Survey is sponsored by the National Association of State Retirement Administrators and the National Council on Teacher Retirement (registration required)

Contact:

Keith Brainard, Research Director
keith@nasra.org

Alex Brown, Research Manager
alex@nasra.org

National Association of State Retirement Administrators
www.nasra.org

Appendix A: Investment Return Assumption by Plan

(Figures reflect the nominal assumption in use, or announced for use, as of December 2013)

Plan	Rate (%)
Alabama ERS	8.00
Alabama Teachers	8.00
Alaska PERS	8.00
Alaska Teachers	8.00
Arizona Public Safety Personnel	8.00
Arizona SRS	8.00
Arkansas PERS	8.00
Arkansas Teachers	8.00
California PERF	7.50
California Teachers	7.50
Chicago Teachers	8.00
City of Austin ERS	7.75
Colorado Affiliated Local	7.50
Colorado Fire & Police Statewide	7.50
Colorado Municipal	7.50
Colorado School	7.50
Colorado State	7.50
Connecticut SERS	8.00
Connecticut Teachers	8.50
Contra Costa County	7.25
DC Police & Fire	6.50
DC Teachers	6.50
Delaware State Employees	7.50
Denver Employees	8.00
Denver Public Schools	7.50
Duluth Teachers[2]	8.00
Fairfax County Schools	7.50
Florida RS	7.75
Georgia ERS	7.50
Georgia Teachers	7.50
Hawaii ERS	7.75
Houston Firefighters	8.50
Idaho PERS	7.00
Illinois Municipal	7.50
Illinois SERS	7.75
Illinois Teachers	8.00
Illinois Universities	7.75
Indiana PERF	6.75
Indiana Teachers	6.75
Iowa PERS	7.50

Kansas PERS	8.00
Kentucky County	7.75
Kentucky ERS	7.75
Kentucky Teachers	7.50
LA County ERS	7.50
Louisiana SERS	8.00
Louisiana Teachers	8.00
Maine Local	7.25
Maine State and Teacher	7.25
Maryland PERS[1]	7.70
Maryland Teachers[1]	7.70
Massachusetts SERS	8.00
Massachusetts Teachers	8.00
Michigan Municipal	8.00
Michigan Public Schools	8.00
Michigan SERS	8.00
Minnesota PERF[2]	8.00
Minnesota State Employees[2]	8.00
Minnesota Teachers[2]	8.00
Mississippi PERS	8.00
Missouri DOT and Highway Patrol	7.75
Missouri Local	7.25
Missouri PEERS	8.00
Missouri State Employees	8.00
Missouri Teachers	8.00
Montana PERS	7.75
Montana Teachers	7.75
Nebraska Schools	8.00
Nevada Police Officer and Firefighter	8.00
Nevada Regular Employees	8.00
New Hampshire Retirement System	7.75
New Jersey PERS	7.90
New Jersey Police & Fire	7.90
New Jersey Teachers	7.90
New Mexico PERF	7.75
New Mexico Teachers	7.75
New York City ERS	7.00
New York City Teachers	8.00
New York State Teachers	8.00
North Carolina Local Government	7.25
NC Teachers and State Employees	7.25

North Dakota PERS	8.00
North Dakota Teachers	8.00
NY State & Local ERS	7.50
NY State & Local Police & Fire	7.50
Ohio PERS	8.00
Ohio Police & Fire	8.25
Ohio School Employees	7.75
Ohio Teachers	7.75
Oklahoma PERS	7.50
Oklahoma Teachers	8.00
Oregon PERS	7.75
Pennsylvania School Employees	7.50
Pennsylvania State ERS	7.50
Phoenix ERS	8.00
Rhode Island ERS	7.50
Rhode Island Municipal	7.50
San Diego County	8.00
San Francisco City & County	7.58
South Carolina Police	7.50
South Carolina RS	7.50
South Dakota PERS[3]	7.25
St. Louis School Employees	8.00
St. Paul Teachers[2]	8.00
Texas County & District	8.00
Texas ERS	8.00
Texas LECOS	8.00
Texas Municipal	7.00
Texas Teachers	8.00
TN Political Subdivisions	7.50
TN State and Teachers	7.50
Utah Noncontributory	7.50
Vermont State Employees[4]	8.10
Vermont Teachers[4]	7.90
Virginia Retirement System	7.00
Washington LEOFF Plan 1[5]	7.90
Washington LEOFF Plan 2	7.50
Washington PERS 1[5]	7.90
Washington PERS 2/3 [5]	7.90
Washington School Employees Plan 2/3[5]	7.90
Washington Teachers Plan 1[5]	7.90
Washington Teachers Plan 2/3[5]	7.90
West Virginia PERS	7.50
West Virginia Teachers	7.50
Wisconsin Retirement System	7.20
Wyoming Public Employees	7.75

1. The Maryland State Retirement Agency Board of Trustees reduced the assumption used for its PERS and Teachers plans from 7.75 percent to 7.70 percent, effective 6/30/13, as the first step of a four-year phased reduction to 7.55 percent.

2. The Minnesota Legislature, which sets in statute investment return assumptions used by public plans in the state, established the use of "select-and-ultimate" rates for investment return assumptions. These plans will use an assumed rate of 8.0 percent for five years, through FY 16, then return to 8.5 percent. For more information on select-and-ultimate rates, please see Actuarial Standards of Practice No. 27: http://www.actuarialstandardsboard.org/pdf/asops/asop027_145.pdf.

3. The SDRS set the rate at 7.25% through FY 2018, after which it will rise to 7.50%.

4. The Vermont retirement systems adopted "select-and-ultimate" rates in 2011; the rates shown reflect the single rates most closely associated with the funding results for the respective plans, based on their projected cash flows.

5. For all Washington State plans except LEOFF Plan 2, the assumed rate of return will be reduced to 7.8% on July 1, 2015, and to 7.7% on July 1, 2017.

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[i] US Census Bureau, Annual Survey of Public Pensions, State & Local Data

Center for State & Local Government Excellence

Issue Brief

Defined Contribution Plans in the Public Sector: An Update

April 2014

The 2008 financial crisis prompted many state and local governments to make changes to their defined benefit pensions, most often raising employee and employer contributions and reducing benefits for new employees.

Did the fiscal pressures prompt governments to shift from defined benefit to defined contribution plans? While there has been much discussion of this approach, relatively few places have moved away from defined benefit plans.

Alicia Munnell, Jean-Pierre Aubry, and Mark Cafarelli point out that before the financial crisis, a number of states had introduced an optional defined contribution plan. Two states—Michigan and Alaska—introduced plans that required new hires to participate solely in a defined contribution plan. While Michigan's plan applied to general state employees, Alaska's plan required teachers, general state and local workers to participate.

Since the financial crisis, there has been a shift. The new plans are mandatory and are either a hybrid plan or a cash balance plan. Georgia, Michigan, Rhode Island, Utah, Tennessee, and Virginia established hybrid plans. Kansas, Kentucky, and Louisiana passed legislation to set up cash balance plans. The Louisiana plan was ruled unconstitutional.

The authors explore what factors were behind the movement to introduce defined contribution plans. Surprisingly, they found that Social Security coverage did not have any effect on the adoption of defined contribution plans before or after the financial crisis. In Alaska, for example, three-quarters of the public employees are not covered by Social Security. That means that state workers and teachers hired in Alaska since July 2006 do not have any form of defined benefit protection.

Even with the recent flurry of activity, defined benefit plans still dominate. About 11 percent of public sector workers have a primary defined contribution plan. By 2042, as the percentage of new employees grows, 19 percent of the public sector workforce will rely on defined contribution plans.

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

Elizabeth K Kellar

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

Defined Contribution Plans in the Public Sector: An Update

By Alicia H. Munnell, Jean-Pierre Aubry, and Mark Cafarelli*

Introduction

The financial crisis and its aftermath generated two types of responses from sponsors of state and local government pensions. The first was to cut back on existing defined benefit plan commitments by raising employee contributions, reducing benefits for new employees and, in some cases, suspending the cost-of-living adjustments for existing retirees. The second response was to initiate proposals to shift some or all of the pension system from a defined benefit to a defined contribution plan. This *brief* describes this flurry of defined contribution activity, identifies the factors that led to the changes occurring in the states where they did, and presents data on participation and assets to put the flurry into perspective. The data show that, while the introduction of defined contribution plans by some states has received considerable attention, activity to date has been modest.

Defined Contribution Activity

Most state and local workers are covered by a traditional defined benefit plan. In addition, these workers often have a supplementary 457 defined contribution plan that allows them to put aside a portion of their pay on a tax-deferred basis. These supplementary plans are not the topic of this *brief*.[1] Rather the focus is on changes at the primary plan level. For discussion purposes, it is useful to look at the pre-crisis and post-crisis periods separately.

Before the 2008 Financial Crisis

Before the financial crisis, a number of states had introduced a defined contribution plan to their structure. Most of these plans took the form of an optional defined contribution plan. That is, the sponsor retained its defined benefit plan and simply offered employees the alternative of participating in a defined contribution plan instead. Only two states, Michigan and Alaska, introduced plans that require all new hires to participate solely in a defined contribution plan.[2] The Alaska reform applied to both general state and local workers and teachers, while the Michigan reform was limited to general state workers. Three states—California, Indiana, and Oregon—adopted hybrid plans, where employees are required to participate in both a defined benefit and a defined contribution plan.[3] The timeline of the introduction of these defined contribution plans is interesting; much of the activity occurred in the wake of the fantastic performance of the stock market during the 1990s (see Figure 1, pg. 4).

Since the Financial Crisis

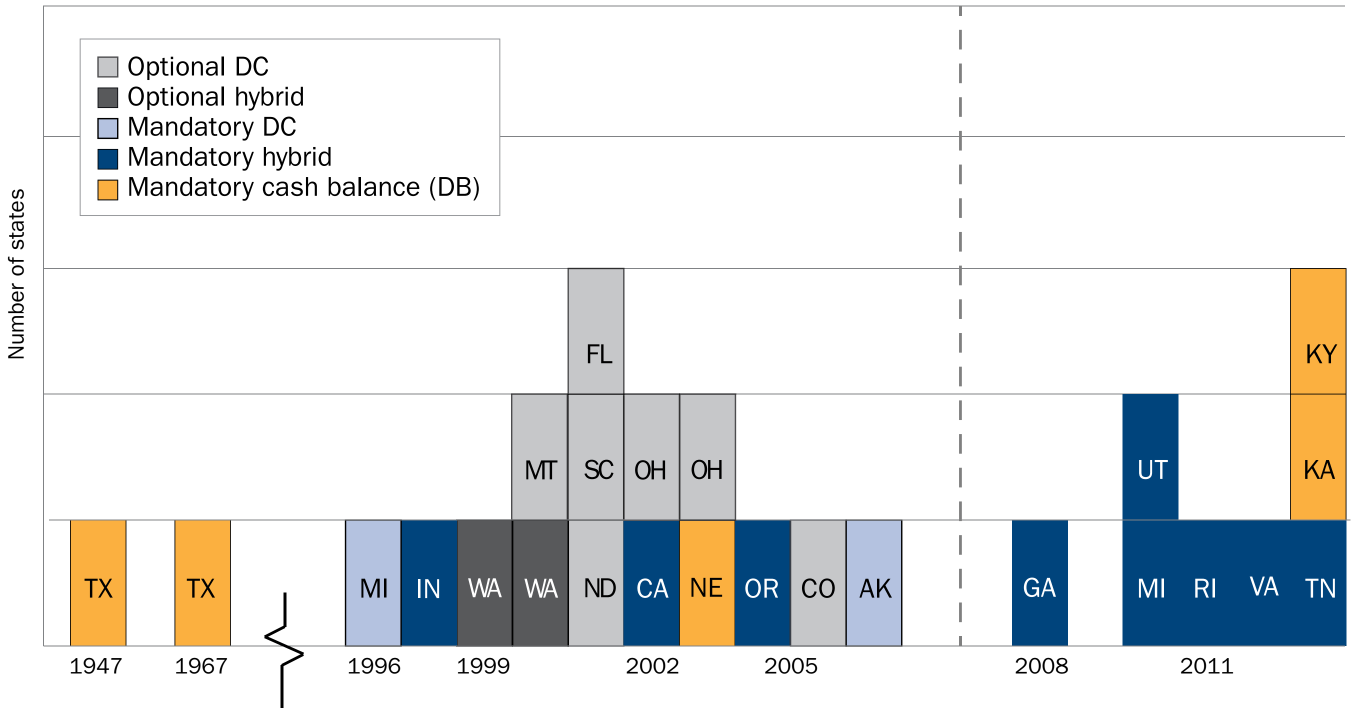
In the wake of the financial crisis, sponsors have once again shown interest in defined contribution plans. This second wave of initiatives is quite different from the pre-crisis changes. First, all the new plans are mandatory, as opposed to mainly voluntary in the pre-crisis period. Second, being mandatory, they apply only to new employees. Third, none of the sponsors has followed the earlier Alaska-Michigan model of forcing employees to rely solely on a defined contribution plan where the employee bears all the risks. Rather, the post-crisis plans consist of either a hybrid plan or a cash balance plan, which is a defined benefit plan that maintains notional individual accounts but provides some guaranteed base return.

Hybrid Plans. Since the financial crisis, six states have replaced their traditional defined benefit plan with a mandatory hybrid plan. The following provides a thumbnail sketch of these new initiatives.

Georgia. According to system administrators, the shift was driven mainly by the preference of young workers, who make up over 60 percent of the state's workforce, for wages over benefits.[5] In response, the state raised wages and introduced a hybrid pension plan with a smaller

* Alicia H. Munnell is director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor of Management Sciences at Boston College's Carroll School of Management. Jean-Pierre Aubry is assistant director of state and local research at the CRR. Mark Cafarelli is a research associate at the CRR. The authors would like to thank Keith Brainard, Steven Kreisberg, Ian Lanoff, and Nathan Scovronick for helpful comments.

Figure 1. *Introduction of State Defined Contribution Plans, by Year, 1947–2013*[4]



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

defined benefit plan and a 401(k) component for young mobile workers.[6] New hires are automatically enrolled in the 401(k) plan at 1 percent of salary with contributions up to 5 percent eligible for an employer match. The match is 100 percent of the automatic contribution and 50 percent of optional contributions, for a maximum match of 3 percent of salary. The defined benefit plan will pay 1 percent for each year of service on the annual average of the highest 24 months of earnings.[7] Members contribute 1.25 percent of salary to the defined benefit plan, and the state contributes the rest.

Michigan. Press reports suggest that containing future employer costs (including required contributions for retiree health insurance) was a major motivation for the new plan.[8] Despite the fact that Michigan general state employees have been enrolled in a defined contribution plan, the state decided to adopt a hybrid for public school employees. New employees automatically contribute 2 percent of salary to the defined contribution plan, with optional contributions up to the IRS limit. The sponsor matches 50 percent of the employee's first 2 percent of contributions.[9] The defined benefit plan pays 1.5 percent for each year of service on the annual average of the highest 60 months of earnings.[10] Employees will contribute 6.4 percent of salary to the defined benefit plan.

Rhode Island. The impetus for reform was the prospect of the system running out of money within ten years. Suspending the cost-of-living-adjustment (COLA) until the trust fund was 80 percent funded provided immediate relief. Current employees saw their defined benefit plan replaced by a hybrid plan and their expected worklife lengthened as the retirement age gradually rises to mirror that of Social Security. The reforms have been challenged in court. Through mediation, the parties agreed in February 2014 to adopt the reforms with only modest changes, but, in April 2014, the mediation agreement was rejected by police union members so the parties are headed back to court.

Utah. The motivation in this case was the state's desire to reduce its risk exposure. (The Utah plans are fairly well funded.) New employees have the option of participating in either a defined contribution plan or a hybrid. In the case of a defined contribution plan, the employer will automatically contribute 10 percent of an employee's compensation for most public employees and 12 percent for public safety and firefighter members.[11] Under the hybrid plan, the employer will pay up to 10 percent toward the defined benefit component; employees will contribute any additional amount to make the required contribution.[12] When the cost of the defined benefit plan is less than 10 percent, the difference is deposited into the employee's defined contribution account.

Tennessee. This hybrid plan is mandatory for all public employees, except local government workers. The defined benefit portion will provide 1 percent of final salary, financed by an employee contribution of 5 percent and a target employer contribution of 4 percent. The defined benefit portion includes a COLA based on the Consumer Price Index, capped at 3 percent. In the defined contribution portion, the employee is automatically enrolled at 2 percent while the employer contributes 5 percent.

Virginia. Under the hybrid plan, the defined benefit component will provide 1 percent of final salary (average of the last 60 months) for each year of service, financed by an employee contribution of 4 percent and an actuarially determined employer contribution.

The defined benefit plan includes a COLA, capped at 3 percent. On the defined contribution side, the employee is required to contribute 1 percent, but the employer will match contributions up to 5 percent—100 percent on the first 2 percent and 50 percent on the next 3 percent.

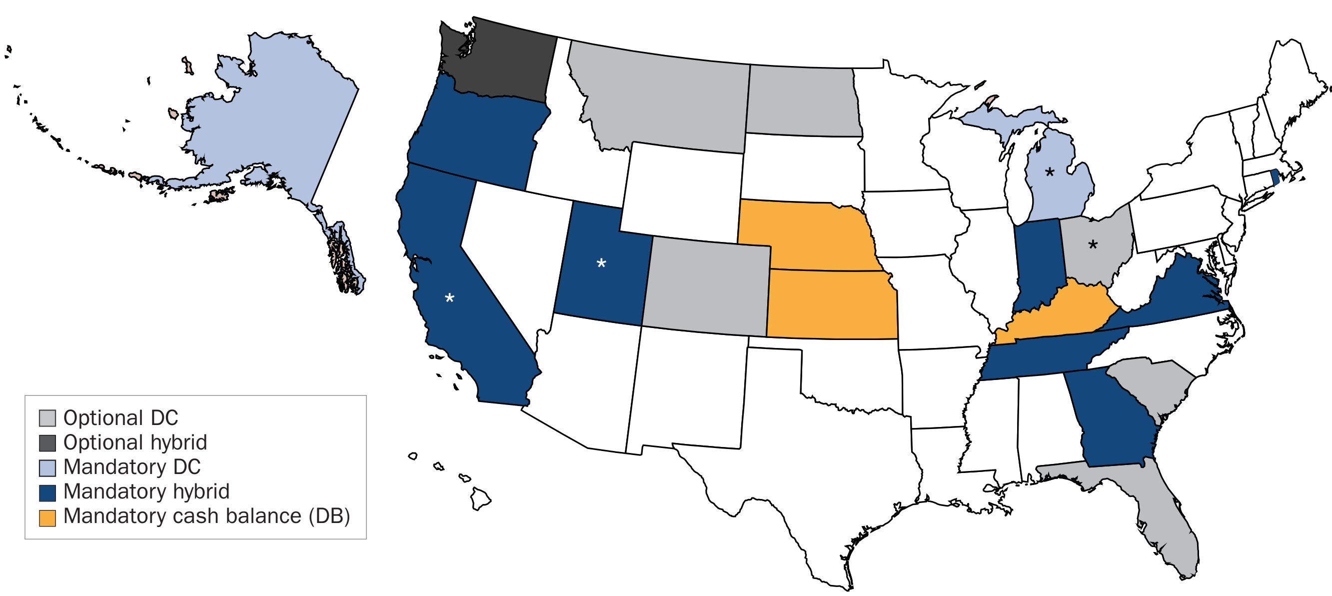
Cash Balance Plans. Three states have recently passed legislation to introduce cash balance plans. Cash balance plans are defined benefit plans where each member has a notional account to which the employer and, in the public sector, the employee, each make contributions, and the employer credits a return annually. These plans differ in two important ways from traditional defined benefit plans. First, they enhance the likelihood of making required contributions, thereby preventing the future buildup of large unfunded liabilities. Second, they allocate benefits more evenly between short- and long-term employees than the traditional back-loaded defined benefit plans. Four public sector systems—Nebraska (for state and county workers), the Texas Municipal Retirement System, the Texas County and District Retirement System, and the California State Teachers' Retirement System for part-time instructors at community colleges—have had cash balance plans for some time. Kansas, Kentucky, and Louisiana have just recently introduced cash balance plans. The Louisiana plan was ruled unconstitutional, so the discussion focuses on Kansas and Kentucky.

Kansas. The employee contributes 6 percent and the employer contributes 3–6 percent (depending on the employee's years of service). The guaranteed interest credit is 5.25 percent with possible additional dividends if investment returns warrant. At retirement, all balances will be annuitized, except that members may withdraw up to 30 percent of their balances in a lump sum.

Kentucky. The employee contributes 5 percent and the employer contributes 4 percent. The guaranteed interest credit is 4 percent plus 75 percent of any net investment return in excess of 4 percent. At retirement, members may choose either annuity payments or a lump-sum payment of the accumulated account balance.

Figure 2 shows where the changes have occurred by type of plan. With a few exceptions, the activity has occurred in states with smaller populations. California

Figure 2. *Location of Defined Contribution Initiatives*[14]



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

is clearly not a small state, but it has since withdrawn from the defined contribution business.[13] It is one thing to know where change has occurred; the other question is *why?*

Why Did Some States Introduce Defined Contribution Plans?

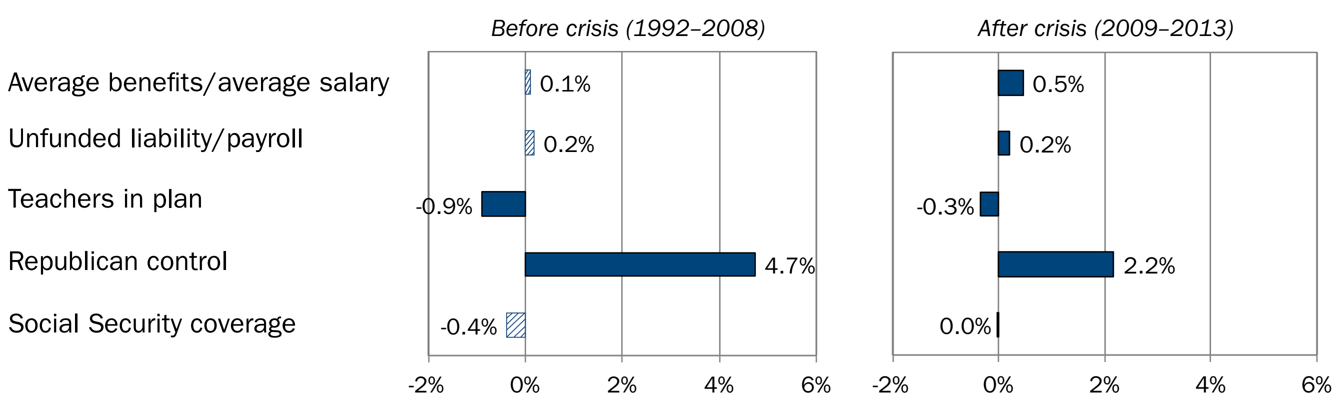
The motivation for introducing a defined contribution type plan seems to differ before and after the financial crisis. Before 2008, the motivation appears to have been offering employees an opportunity to manage their own money and participate directly in a rapidly rising stock market. After the financial crisis, the motivation appears to be more defensive—to avoid the high costs associated with large unfunded liabilities; to unload some of the investment and mortality risk associated with traditional defined benefit plans; and to have a less back-loaded benefit structure to increase the amount that short-term employees can take with them when they leave.

We undertook an empirical analysis in two time periods—before the financial crisis and after the financial crisis—to test the extent to which the motivating factors were related to the probability that a plan sponsor would introduce a defined contribution component, including the introduction of a cash balance plan. The analysis included data on each state-administered plan from 1992 through 2013. The dependent variable was set equal to zero if no action was taken and equal to 1 if the state introduced some form of defined contribution plan. The plan was removed from the sample once an action was taken. The independent variables included:

- Average benefits/average salary: This proxy for the costliness of the defined benefit plan would be expected to encourage a shift to a defined contribution plan.
- Unfunded liability/payroll: Plans with large unfunded liabilities relative to payroll are more susceptible to risk and therefore would be more likely to adopt a defined contribution approach to unload some of their investment and mortality risk.
- Teachers in plan: Teachers' representatives are generally more interested in benefits for career employees than for those with short tenure. Thus, teacher plans or plans with a significant number of teachers would be less likely to introduce a defined contribution plan in an effort to reward short-tenure workers.
- Republican control: Republicans are more likely to support employees' ability to control their own investments and match their assets to their tolerance for risk. Introducing a defined contribution plan when Republicans control the state governorship and legislature would be consistent with their political philosophy.
- Social Security coverage: Between 25 and 30 percent of state and local employees are not covered by Social Security. The hypothesis is that states where workers do not have this basic protection would be less likely to introduce a defined contribution plan, where employees would bear all the risks associated with retirement planning.

The results are shown in Figure 3 (with more details in Appendix A). The bars show the effect on the probability of introducing a defined contribution plan in a

Figure 3. *Impact on the Probability of Introducing a Defined Contribution Plan*



Note: Changes are one standard deviation for continuous variables and 0/1 for dichotomous variables. The striped bars indicate that the coefficients are not statistically significant. The solid bars indicate statistical significance at least at the 10-percent level.
Source: Authors' calculations.

single year. The effects are quite large given that only 20 percent of sponsors introduced some form of defined contribution plan before the financial crisis, and only 15 percent did so after the crisis.

Before the financial crisis, the probability of introducing a defined contribution plan appears to be positively affected only by political philosophy; neither the cost nor risk factors play a role. After the crisis, political philosophy is less important, while cost and risk factors play a significant role. Both before and after, the presence of teachers is associated with a lower probability of shifting away from a traditional defined benefit plan.

The fact that Social Security coverage did not have any effect on the outcome in either time period is surprising. The results are clearly driven by events in Colorado, Ohio, and Alaska, three states with a very high proportion of non-covered workers. In Colorado and Ohio, the defined contribution plans are optional and the take-up has been modest. Thus, most of these workers will continue to have the protection against investment risk and the promise of an annuity that comes with a defined benefit plan. In Alaska, however, the story is quite different. Despite the fact that nearly three quarters of Alaska's public employees are not covered by Social Security, all new hires are required to join a defined contribution plan. Therefore, state workers and teachers in Alaska hired since July 2006 do not have any form of defined benefit protection.

Current Level of 'DC' Activity

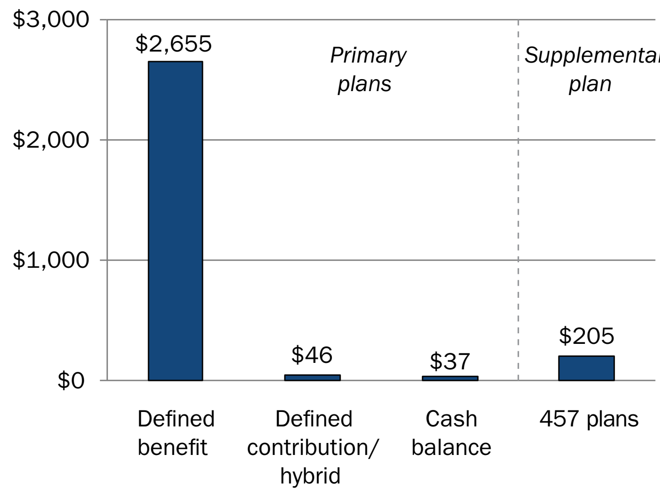
While the number of initiatives and the map make it look like a lot is happening on the defined contribution front, the amount of money in these plans is very small (see Figure 4 and Appendix B). Again the focus here is on primary plans; the amount in supplementary 457 plans is provided as a benchmark.

The small amount of money is the result of a number of factors. First, at a slight risk of overstatement, the introduction of an optional defined contribution plan has almost no effect. Virtually no one puts their money in the plan. Florida is a slight exception in that it has $7 billion, mainly because participants are allowed one opportunity to switch between the defined benefit and defined contribution plans after their initial choice. Second, only two states have a mandatory defined contribution plan: Alaska and Michigan. Third, the mandatory hybrid plans ultimately will have an impact on asset allocation between defined benefit and defined contribution, but they are too new for the effect to be visible. And the recent trend is toward cash balance plans, which are technically defined benefit plans.

In terms of participants, the numbers look somewhat more substantial even though all the mandatory provisions apply only to new employees. About 11 percent of public sector workers are currently covered by something other than a traditional defined benefit plan (see Figure 5).

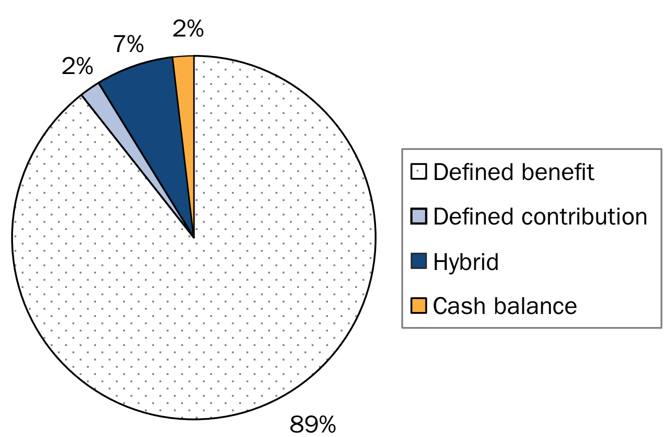
An interesting question is what the public pension landscape will look like in 30 years. Today, new employees are a tiny fraction of the workforce. In the future, they will constitute the entire workforce. Our rough estimates, *based on the changes made to date*, are that defined contribution participants will account

Figure 4. *Assets in State and Local Pension Plans, in Billions of Dollars, 2012*



Source: Actuarial and financial reports; and *Public Plans Database* (2012).

Figure 5. *Distribution of State and Local Participants by Plan Type, 2012*



Source: Actuarial and financial reports; and *Public Plans Database* (2012).

for 19 percent of the public sector workforce in 2042 and, at that time, defined contribution assets will account for 10 percent of total assets (see Table 1). The discrepancy is due to two factors. First, even in 2042, a sizable share of the assets belongs to retirees who were covered by the old defined benefit plan. Second, and somewhat less important, is that most of the mandatory changes have been to hybrid plans where roughly half the money goes to a defined benefit plan and half to a defined contribution plan.

Table 1. *Projected Distribution of State and Local Employees and Assets by Plan Type, 2042*

Plan type	Employees	Pension assets
Defined benefit	81%	90%
Defined contribution	2%	1%
Hybrid	13%	4%
Cash balance	4%	5%
Total	100%	100%

Source: Authors' calculations.

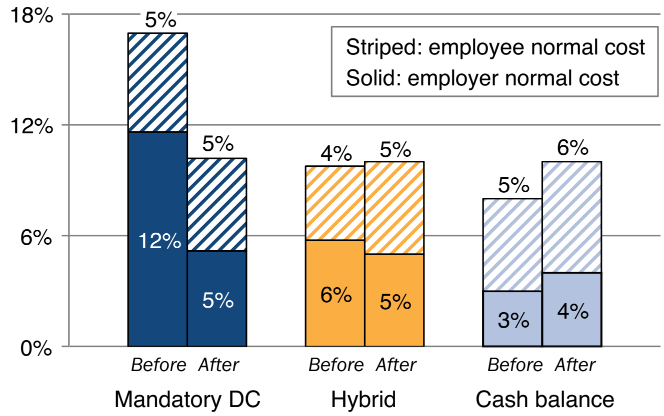
The Impact of the Shift to DCs on Benefits

The remaining question is what happens to benefit levels generally as plan sponsors move away from pure defined benefit plans. Critics argue that sponsors are not only changing the form of the benefit, but also the level.

One measure of the benefit is the normal cost—that is, the amount that employers must put aside each year to cover the cost of accruing benefits. On that front—with the exception of the mandatory defined contribution plans in Alaska and Michigan—plan sponsors appear to be maintaining their previous level of contributions (see Figure 6).

The initial contribution, however, does not tell the whole story. Under the traditional defined benefit plan, participants are promised a return of about 8 percent. Under any defined contribution arrangement, workers will receive whatever returns the market offers, which could well be less than 8 percent. Under the cash balance plans introduced in Kansas and Kentucky, participants are guaranteed 5.25 and 4 percent, respectively, with the potential of some upside. So benefits have been reduced with the introduction of defined contribution arrangements.

Figure 6. *Normal Cost for Mandatory Plans Before and After Legislative Action*



Source: Authors' calculations based on actuarial and financial reports; National Association of State Retirement Administrators (2013); and Munnell (2012).

Conclusion

Although the introduction of defined contribution plans by some states has received a lot of press attention, activity to date has been modest. Moreover, most of the recent efforts have been a move to either hybrid plans, with a mandatory defined contribution and defined benefit component, or to cash balance plans, where participants are guaranteed a return of 4 or 5 percent.

Sponsors' shifts from complete reliance on traditional defined benefit plans appear to be driven by a desire to avoid future unfunded liabilities, to reduce investment and mortality risk, and to provide some benefits to short-tenure workers. Of course, moving away from defined benefit plans means that individuals must face the risk of poor investment returns, the risk that they might outlive their assets, and the risk that inflation will erode the value of their income in retirement—on at least a portion of their retirement savings in hybrid plans. Participants in cash balance plans do receive a guaranteed return but, among the plans adopted to date, it is less than the typical 8-percent guarantee in traditional defined benefit plans. But if some defined contribution component or cash balance arrangement enhances the likelihood of responsible funding, public sector employees may enjoy some increased security.

Endnotes

1 Forty-eight states provide access to a supplementary defined contribution plan (Ferrara 2002).

2 The District of Columbia also requires its general government employees to join a primary defined contribution plan, but the analysis here is limited to states. Other states have considered moving to a primary defined contribution plan. For example, California's governor proposed such a switch in 2004, but this plan generated substantial opposition from public employee unions and the proposal was dropped in 2005. For more details on other attempts to move into defined contribution plans, see American Federation of State, County and Municipal Employees (2007).

3 In addition, Washington state introduced a hybrid option for two of its plans.

4 Utah, which offers employees a choice between a hybrid and a defined contribution plan, is classified as mandatory hybrid because employees are required to have some defined contribution plan. Ohio PERS and STRS, which offer a choice of defined contribution, hybrid, or defined benefit, are classified as optional defined contribution since employees are not required to have any defined contribution plan.

5 Teacher Retirement System of Texas (2012).

6 In the public sector, the only defined contribution plans that are technically 401(k)s are grandfathered plans that were established by May 6, 1986; Georgia's plan was originally created before 1986 as an optional supplement to its primary defined benefit plan. See U.S. Government Accountability Office (2012).

7 The Board of Trustees can increase the benefit factor in the future to up to 2 percent if funds are available.

8 *GovMonitor* (2010) and Michigan Association of School Boards (2010).

9 Michigan House Fiscal Agency (2009).

10 While 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 COLA eliminated.

11 Liljenquist (2010).

12 Employers are also required to pay 5 percent of payroll to the Utah Retirement System to amortize legacy unfunded pension liabilities.

13 CalSTRS's defined benefit plan included a mandatory cash balance component from 2001–2010; this component is now discontinued and the contributions instead go into the defined benefit plan. California still has a small (400-person) optional cash balance plan for part-time employees at public schools.

14 Michigan SERS is a mandatory defined contribution plan, while Michigan MPSERS is a mandatory hybrid plan. CalSTRS' defined benefit plan included a mandatory cash balance component from 2001–2010, which was discontinued in 2011. Utah, which offers employees a choice between a hybrid and a defined contribution plan, is classified as mandatory hybrid because employees are required to have some defined contribution plan. Ohio PERS and STRS, which offer a choice of defined contribution, hybrid, or defined benefit, are classified as optional defined contribution since employees are not required to have any defined contribution plan.

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Appendix A

Table A1. *Summary Statistics for Regression on Probability of Introducing a Defined Contribution Plan, Pre-Crisis*

Variables	Number of observations	Mean	Standard deviation	Minimum	Maximum
Average benefits/average salary	1,024	0.45	0.17	0	1
Unfunded liability/payroll	1,024	50.54	48.14	0	289
Teachers in plan	1,024	0.53	0.50	0	1
Republican control	1,024	0.19	0.39	0	1
Social Security coverage	1,024	0.77	0.42	0	1

Sources: Authors' calculations.

Table A2. *Summary Statistics for Regression on Probability of Introducing a Defined Contribution Plan, Post-Crisis*

Variables	Number of observations	Mean	Standard deviation	Minimum	Maximum
Average benefits/average salary	1,177	0.45	0.16	0	1
Unfunded liability/payroll	1,177	61.94	52.51	0	289
Teachers in plan	1,177	0.51	0.50	0	1
Republican control	1,177	0.20	0.40	0	1
Social Security coverage	1,177	0.80	0.40	0	1

Sources: Authors' calculations.

Table A3. *Regression Results for Probability of Introducing a Defined Contribution Plan*

Variables	Pre-crisis	Post-crisis
Average benefits/ average salary	0.006 (0.012)	0.010 * (0.007)
Unfunded liability/payroll	0.000 (0.000)	0.000 ** (0.000)
Teachers in plan	–0.009 ** (0.005)	–0.003 ** (0.003)
Republican control	0.047 * (0.017)	0.022 *** (0.011)
Social Security coverage	–0.004 (0.006)	0.000 (0.002)
Pseudo R^2	0.197	0.222
Number of observations	1,024	1,177

Note: Robust standard errors for state-level clustering are in parentheses. The coefficients are significant at the 10-percent level (*), 5-percent level (**), or 1-percent level (***).

Source: Authors' calculations.

Appendix B

Table B1. *Characteristics of Primary Defined Contribution Plans*

Plan name	Year enacted	Participants 2007	Participants 2009	Participants 2010	Participants 2011	Participants 2012	Assets (millions) 2007	Assets (millions) 2009	Assets (millions) 2010	Assets (millions) 2011	Assets (millions) 2012
Optional defined contribution plans											
Colorado PERA – PERAChoice	2004	489	3,039	3,479	4,029	4,362	$3	$37	$53	$64	$83
Florida FRS Investment Fund	2000	98,070	121,522	127,940	137,900	148,837	3,687	4,075	5,050	6,738	7,100
Montana PERS – DCRP	1999	1,563	1,949	2,019	2,026	2,035	41	44	58	77	85
North Dakota PERS – DCRP	2000	301	300	293	287	283	18	14	17	21	23
Ohio PERS – Member-Directed Plan	2002	8,579	9,824	11,010	12,215	12,815	124	201	279	317	410
Ohio STRS – Member-Directed & Combined Plans	2001	4,268	4,500	4,503	4,614	4,671	283	297	384	519	568
South Carolina SCRS – State ORP	2000	16,081	19,902	19,574	19,681	20,021	502	561	696	830	965
Utah – Tier II Defined Contribution Plan	2010	0	0	0	0	524	0	0	0	0	19
Optional hybrid plans											
Ohio PERS – Combined Plan	2000	6,905	7,354	7,627	8,024	8,418	157	223	301	334	420
Washington PERS – Plan 3	1999	25,290	30,367	31,126	32,175	32,656	1,348	1,188	1,374	1,689	1,724
Washington SERS – Plan 3	1998	36,564	38,138	38,585	38,996	39,541	1,052	918	1,053	1,269	1,278
Washington TRS – Plan 3	1988	58,349	58,952	60,146	60,309	61,312	3,971	3,419	4,025	5,032	5,171
Mandatory defined contribution plans											
Alaska PERS – DCR Plan	2005	2,862	7,516	9,716	11,736	13,643	9	56	104	184	246
Alaska TRS – DCR Plan	2005	646	1,997	2,663	3,240	3,762	6	27	48	84	110
Michigan SERS	1996	24,043	25,540	266,335[a]	27,155[a]	28,000[a]	2,547	2,750	1,481	1,909	2,461[a]
Mandatory hybrid plans											
California CalSTRS – DB Supplement Program	2001	455,453	458,243	440,824	417,262	403,117	3,951	5,636	6,412	8,054	8,042
Georgia GSEPS	2008	0	2,105	6,835	11,093	15,246	0	310	361	440	450
Indiana PERF – ASA	1997	138,863	147,792	149,877	147,933	145,519	2,694	2,669	2,780	2,805	2,749
Indiana TRF – ASA	1997	39,307	45,046	46,433	46,633	47,885	2,715	2,920	3,423	3,665	3,936
Michigan MPSERS	2010	0	0	1,800	18,803	24,340	0	0	64	79	308
Oregon PERS – IAP	2003	43,541	58,097	69,227	80,753	76,002	1,877	2,109	2,928	4,037	4,392
Rhode Island ERSRI	2011	0	0	0	22,504	25,723[a]	0	0	0	7,489	7,284
Tennessee – TCRS State and Teachers	2013[b]										
Utah – Tier II Contributory Hybrid	2010	0	0	0	4,429	9,949	0	0	0	3	18
Virginia VRS Hybrid	2012[b]										

continued

Table B1. *Characteristics of Primary Defined Contribution Plans, continued*

		Participants					Assets (millions)				
Plan name	**Year enacted**	**2007**	**2009**	**2010**	**2011**	**2012**	**2007**	**2009**	**2010**	**2011**	**2012**
Mandatory cash balance											
Kansas KPERS	2013[c]										
Kentucky RS	2013[b]										
Louisiana SERS	2013										
Louisiana TRS	2013										
Nebraska County ERS	2002	4,156	5,446	5,645	5,639	5,796	$116	$130	$166	$200	$209
Nebraska State ERS	2002	9,051	11,323	11,739	11,200	11,263	421	470	594	689	702
Texas Municipal TMRS	1947	98,440	102,419	101,240	101,151	100,517[a]	14,203	16,306	17,992	18,571	
Texas County & District TCDRS	1967	116,858	123,446	122,889	121,919	121,963	16,910	15,556	17,730	17,626	19,885

a Authors' estimates.

b Effective for new hires Jan. 1, 2014.

c Effective for new hires Jan. 1, 2015.

Sources: Public Plans Database (2007 and 2009); and various financial and actuarial reports.

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

Effects of Pension Plan Changes on Retirement Security

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Center for State & Local Government Excellence

NASRA

This report was prepared by the research teams of the:

Center for State and Local Government Excellence: Danielle Miller Wagner, Joshua Franzel, Elizabeth Kellar, Amy Mayers, and Bonnie Faulk

National Association of State Retirement Administrators: Alex Brown, Keith Brainard, Jeannine Markoe Raymond, Dana Bilyeu, and Ady Dewey

Effects of Pension Plan Changes on Retirement Security[1]

Introduction

Since 2009, fiscal constraints have forced state governments to reduce costs, often by laying off or furloughing employees, imposing salary freezes and/or reducing benefits. In fact, according to the National Conference of State Legislatures, since 2009, more than 45 states have made significant changes to their retirement plans, including increasing employee contributions, reducing benefits, or both. Other states have modified their plan design, choosing to transfer more of the risk associated with providing retirement benefits from the state and its political subdivisions to its employees.

While we know a great deal about the unfunded liabilities of public pension plans, we know little about the effects pension plan changes will have on the retirement income of public employees.

This report calculates the retirement income state and participating local employees hired under the new benefit conditions may expect, and compares it with the retirement income they would have earned before the plan was changed. The report also summarizes interviews conducted with state human resource executives and retirement experts from 10 states that have made significant pension plan changes.

Key findings

- Pension reforms reduced the amount of retirement income new employees can expect to receive compared with that of existing employees. Reductions ranged from less than 1 percent to 20 percent.
- New employees can expect to work longer and save more to reach the benefit level of previously hired employees.
- Hybrid plans adopted in five states produce a wide range of retirement incomes. The Rhode Island, Tennessee, and Utah plans may increase retirement income, a fact that can be partially attributed to higher required contributions to their defined contribution plan. Georgia and Virginia have lower statutory contribution rates and their hybrid plans may produce lower retirement incomes.
- Changes to retirement plans include an increase in the number of years included in the final average salary calculation (21 states); a reduction in the multiplier (12 states); and a change to both of these variables (nine states).

Although newly hired employees will need to work longer or save more to have the level of retirement benefit that employees previously earned, state human resource officials say that wage stagnation and the increased cost of benefits for employees is a more immediate concern. To address the savings gap, many plan administrators are providing enhanced financial education and sponsoring and promoting supplemental savings opportunities.

Reasons for the recent wave of state pension reforms are numerous and usually are unique to each state, its finances, and its workforce. In most cases, the primary objectives have been to reduce the costs of providing retirement benefits and to transfer a greater portion of the associated risks from employers to employees. This study does not address the rationale for modifications, but instead analyzes the effects of the resulting changes at the individual employee level by 1) measuring **how recent reforms affect the retirement income that will be provided to state employees** who are hired under new benefit conditions; and 2) looking at **human resource measures states have taken to directly or indirectly address the impacts of pension reform**.

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

Financial Impact on Retirees

Background & Methodology

The states chosen for this analysis include a wide range that have made changes to their benefit program and/or contribution rates for general employees since 2009.[2] States that have changed their benefit to a combination hybrid (defined benefit/defined contribution) plan since that year are included in this study, while states that have changed their plan design to cash balance are not.[3]

Assumptions

Our analysis includes both a quantitative and qualitative component of the effects of pension reform on retirement income. The following assumptions were used for the quantitative component:

Career Employee

For the purpose of this analysis, the career employee is defined as one who works for 30 consecutive years for a state or local government or covered agency and who participates in the statewide retirement plan. The age at which employees begin working and the age at which they retire are irrelevant as it pertains to the quantitative analysis, but are discussed in the qualitative component.

Salary

Salaries for public employees vary among states and occupations, depending on their level of education and experience at the time they are hired. That said, the ability to project pension benefits for an individual employee depends heavily on identifying an appropriate variable for his/her salary and accurately projecting the growth of that salary over the period for which the individual is actively employed. For this reason, the analysis presented in this paper uses a standardized variable for employee salary. The starting salary was selected based on data provided by the U.S. Bureau of Labor Statistics' National Compensation Survey. For 2010, the latest year available, the mean hourly earnings for all U.S. workers was $22.77, or $47,362 annually.[4]

The factor used to account for growth in wages over the 30-year period was derived from the average rate of wage growth as evidenced by the past 15 years of data[5] measured by the Employment Cost Index (ECI)[6], which is also published by the BLS.[7] The rate of growth applied to salaries in this study is 2.5 percent annually.

Methodology

The goal of this analysis was to calculate the change in retirement income a career employee of a state government could expect to earn under the reformed benefit structure when compared to the pre-reform benefit structure. The standard pension calculation is as follows:

Annual benefit = (Years of Service) × (Final Average Salary) × (Multiplier)

Since this analysis focuses on career employees, the "Years of Service" variable was held constant at 30. The "Final Average Salary" and "Multiplier" variable were derived from official plan documents and other comprehensive sources of public pension data.

For each state we analyzed the benefit produced under each set of calculations—one using the terms in place prior to the reform, and one using the terms that were created by the altered plan. It is important to note that for the purposes of this analysis, the terms "pre" and "post" altered were isolated to the day prior to and the day after the effective date of the modification. Benefit conditions were not extended back 30 years or forward 30 years—calculations are produced assuming that the two sets of terms are "frozen." Where relevant, a discussion of the fluid nature of modifications to benefit terms accompanies any data or statistical reference.

These calculations are used to produce, as a percentage, the change in retirement income for new career employees (whose benefits are calculated using the terms of the new tier). An additional offering is the difference in the income replacement ratio for new career employees, expressed as a supplemental savings balance based on lower level and higher level savings plans.

Changes to employee contribution rates are isolated and expressed as a percentage change in take-home pay, since contributions are typically deducted from employee wages as they earn over the course of their career.

Data Analysis

As reflected in Figure 1 (pg. 4), the post-reform benefits for each state in our analysis produced a diminished retirement benefit compared with the previous benefit.[8] Different types of changes produced different results, and the study revealed that the type of change, as well as different combination of changes, has the greatest effects on retirement income.

Types of Changes

Since the variable for "Years of Service" was held constant, the only types of changes considered in our calculation were changes to the variables "Final Average Salary" and "Multiplier." Final average salary refers to the period used to determine an employee's final average salary when calculating his or her annual pension benefit. In each case the period used to calculate final average salary was lengthened (to produce a reduced final average salary figure).

"Multiplier" refers to a change in the factor by which "Years of Service" and "Final Average Salary" are multiplied in the benefit calculation. In each case, it was reduced. Twenty-four states included in our analysis changed one or two of these variables while retaining the defined benefit structure as the primary retirement benefit; 21 states chose to increase the period used to calculate final average salary; while 12 states chose to reduce the multiplier. Additionally, nine states elected to modify both of these variables, to varying degrees.

In virtually every case analyzed, the reforms result in a diminished pension benefit. The average benefit for the 24 states that changed variables in their benefit calculation equaled approximately 92.5 percent of the benefit produced under the prior conditions. A state-by-

Table 1. *Change in Annual Benefit, Post Pension Reform*

State	Benefit Calculation	% Change in Annual Benefit	Effective Date
Alabama	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.65% from 2.0125%.	-20.0%	1/1/2013
Arizona	FAS based on highest average 5 years, up from 3 years.	-2.4%	7/1/2011
California	FAS based on highest average 3 years, up from 1 year.	-2.4%	1/1/2013
Colorado	FAS based on highest average 3 years with a cap on annual increases, up from highest average 3 years (uncapped)	No change	1/1/2011
Connecticut	FAS based on highest average 5 years, up from 3 years	-2.4%	7/1/2011
Florida	FAS based on highest average 8 years, up from 5 years.	-3.5%	1/1/2011
Hawaii	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.75%, from 2%.	-14.6%	7/1/2012
Illinois	FAS based on highest average 8 years, up from 5 years.	-3.5%	1/1/2011
Iowa	FAS based on highest average 5 years, up from 3 years.	-2.4%	7/1/2012
Maryland	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.5%, from 1.8%	-18.7%	7/1/2011
Massachusetts	FAS based on highest average 4 years, up from 3 years.	-1.2%	4/1/2012
Mississippi	Retirement multiplier reduced to 2%, from a graded 2–2.5%.	-4%	7/1/2011
Montana	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.7857%, from 2%.	-12.9%	7/1/2011
Nevada	Retirement multiplier reduced to 2.5%, from 2.67%.	-6.4%	1/1/2010
New Hampshire	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.52%, from 1.67%.	-11.2%	7/1/2011
New Jersey	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.66%, from 1.818%.	-10.9%	7/1/2010
New Mexico	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 2.5%, from 3%.	-18.7%	7/1/2013
New York	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to graded 1.67–1.75%, from 1.67-2%.	-7.0%	4/1/2012
Ohio	FAS based on highest average 5 years, up from 3 years.	-2.4%	1/7/2013
Oklahoma	FAS based on highest average 5 years, up from 3 years.	-2.4%	7/1/2013
Pennsylvania	Retirement multiplier reduced to 2%, from 2.5%.	-20%	1/1/2011
South Carolina	FAS based on highest average 5 years, up from 3 years.	-2.4%	7/1/2012
Texas	FAS based on highest average 5 years, up from 4 years	-1.2%	9/1/2013
Wyoming	FAS based on highest average 5 years, up from 4 years. Retirement multiplier reduced to 2%, from graded 2.125–2.25%.	-9.7%	7/1/2011

state breakdown is shown in the table below:

The benefit reduction produced under post-reform conditions in 10 states is higher than the average benefit reduction for the sample. Nine out of 10 states made changes to both the period used to calculate final average salary and the benefit multiplier. In the tenth state, Pennsylvania, a 0.5 percent reduction in the multiplier produces a benefit 20 percent lower than the previous benefit.

Another trend among states that have passed recent pension reforms is the movement from a final average salary based on an employee's highest three years of earnings, to a calculation that considers an employee's highest five years of earnings. Six states in our study made this change (Arizona, Connecticut, Iowa, Ohio, Oklahoma, and South Carolina) and this change alone produced a benefit diminished by 2.4 percent compared to the previous benefit.[9]

New employees in the states referenced above receive reduced defined benefit pensions. Given this new reality, supplemental savings likely will be needed for employees to reach a targeted level of retirement income. Most experts recommend retirement income that is sufficient to replace 70 to 85 percent of final salary. Some employees may be able to rely on other income sources, such as Social Security, a supplemental defined contribution plan, or individual retirement savings.

Table 2 (pg. 5) shows the additional amount needed, in the form of a starting balance, in order to reach lower and higher level income replacement levels of 75 percent and 85 percent of final salary, respectively, for employees hired under pre-and post-reform terms.[10]

In each case, more savings are required and in some states new employees will need to save more than $100,000 to reach their target level of income replacement in retirement. Nearly all public employees in four states listed in the table—Colorado, Massachusetts, Nevada, and Ohio—do not participate in Social Security, so the balance of their savings would have to come from a supplemental retirement account or personal savings, or they would need to find employment after retirement in a job that is covered by Social Security.

Changes to Contribution Rates and Retirement Eligibility Criteria

This analysis considered the entire scope of pension reforms, in addition to those changes that directly affected retirement income through modification of the variables used to calculate the pension benefit.

Figure 1. *Percent Change in Annual Benefit*

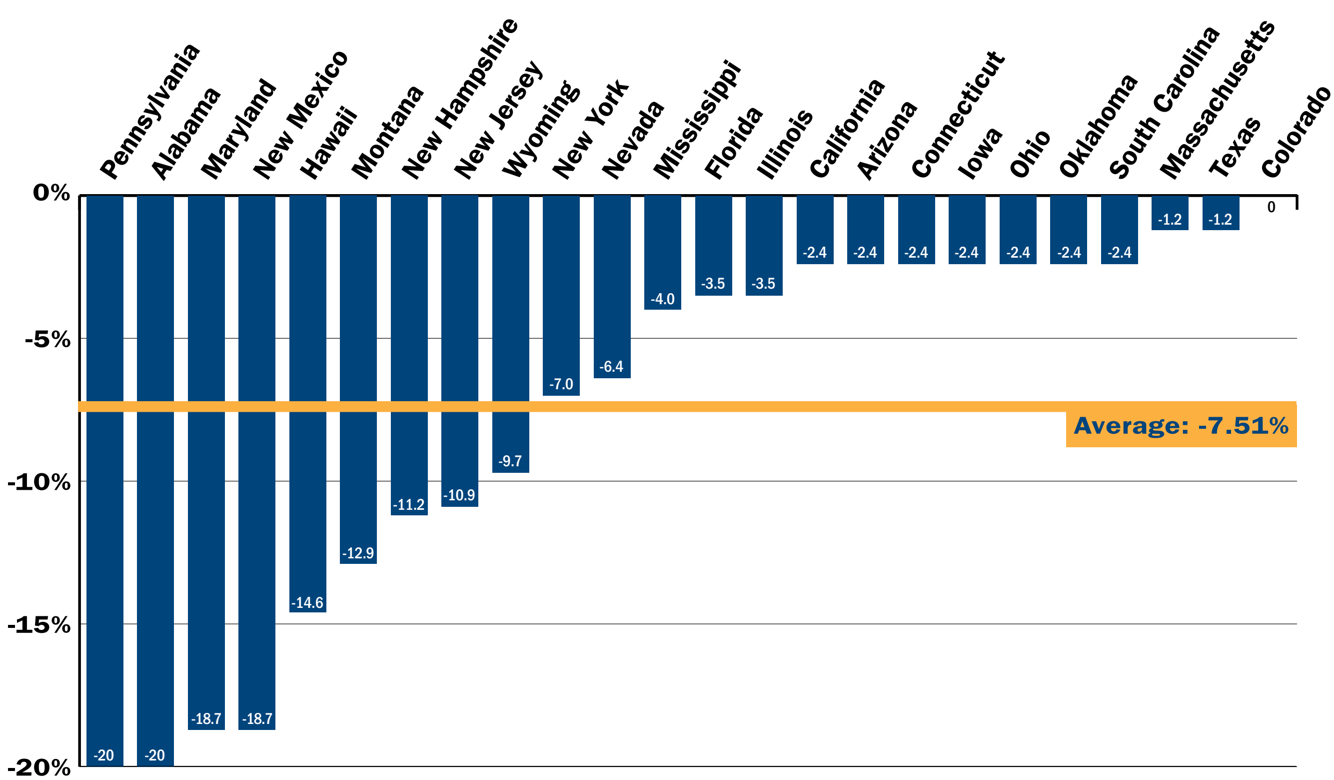


Table 2. *Additional Supplemental Savings Needed to Attain Lower and Higher Level Savings Targets*

State	Employee Group	Lower Level Savings Plan (75% of Final Salary)	Higher Level Savings Plan (85% of Final Salary)
Alabama	Pre	$202,531	$328,440
	Post	$350,737	$476,646
Arizona	Pre	$161,065	$286,974
	Post	$179,858	$305,767
California	Pre	$188,863	$314,771
	Post	$207,139	$333,047
Colorado	Pre	$22,844	$148,753
	Post	$22,895	$148,804
Connecticut	Pre	$454,093	$580,002
	Post	$465,855	$591,764
Florida	Pre	$368,724	$494,632
	Post	$389,104	$515,013
Hawaii	Pre	$207,139	$333,047
	Post	$314,762	$440,671
Illinois	Pre	$343,542	$469,451
	Post	$364,813	$490,722
Iowa	Pre	$207,139	$333,047
	Post	$224,826	$350,735
Maryland	Pre	$280,856	$406,765
	Post	$404,699	$530,607
Massachusetts	Pre	$391,433	$517,341
	Post	$398,120	$524,028
Mississippi	Pre	$185,710	$311,619
	Post	$216,055	$341,963
Montana	Pre	$207,139	$333,047
	Post	$301,919	$427,828
Nevada	Pre	Benefit exceeds 75% of final salary	$86,093
	Post	$22,844	$148,753
New Hampshire	Pre	$328,773	$454,681
	Post	$397,504	$523,412
New Jersey	Pre	$274,222	$400,130
	Post	$347,139	$473,048
New Mexico	Pre	Benefit exceeds 75% of final salary	Benefit exceeds 85% of final salary
	Post	$44,954	$170,863
New York	Pre	$288,228	$414,137
	Post	$333,949	$459,857
Ohio	Pre	$133,421	$259,330
	Post	$152,877	$278,786
Oklahoma	Pre	$207,139	$333,047
	Post	$224,826	$350,735
Pennsylvania	Pre	$22,844	$148,753
	Post	$207,139	$333,047
South Carolina	Pre	$273,485	$399,393
	Post	$289,580	$415,489
Texas	Pre	$106,815	$232,724
	Post	$116,903	$242,812
Wyoming	Pre	$138,028	$263,937
	Post	$216,055	$341,963

Italicized states are non-Social Security for virtually all public employees

Changes to the contributions required from employees to fund their benefits, as well as changes to the eligibility requirements for normal retirement, were also considered. A state-by-state summary of these changes

Table 3. *Changes to Required Employee Contributions and Eligibility for Normal Retirement*

State	Contributions and Eligibility	Notes	Effective Date
Alabama	Employee contributions decreased, to 6% from 7.5% Eligibility for normal retirement at 62/10 (from 60/10 or any/25)		1/1/2013
Arizona	Eligibility for normal retirement at 65/any, 60/25, or 55/30 (from 65/any, 62/10, or Rule of 80)		7/1/2011
California	Employee contributions increased, from 5% of pay to 50% of the annual normal cost (6.25% for FY14), for current as well as new employees Eligibility for normal retirement at 62/5 (from 60/5)		1/1/2013
Colorado	Employee contributions increased, from 8% to 10.5% Eligibility for normal retirement at Rule of 88 with a minimum age of 58 (from any/35 or Rule of 80)	Contribution rate increase for FY12 only	1/1/2011
Connecticut	Eligibility for normal retirement at 63/25 or 65/10 (from 60/25 or 62/10)		7/1/2011
Delaware	Employee contributions increased from 3% to 5% of annual compensation after the first $6,000 Eligibility for normal retirement at 65/10, 60/20, or any/30 (from 62/5, 60/15, or any/30)		1/1/2012
Florida	Plan began requiring employee contributions of 3% after previously being noncontributory (for current as well as new employees) Eligibility for normal retirement at 65/8 or any/30 (from 62/6 or any/30)	Changes affect current and new employees	1/1/2011
Georgia	New hybrid plan requires employee contributions of 1.25% for the defined benefit component and 1% (auto-enrolled) for the defined contribution component.		7/1/2009
Hawaii	Employee contributions increased from 7.8% to 9.8% Eligibility for normal retirement at 65/10 or 60/30 (from 62/5 or 55/30)		7/1/2012
Illinois	Eligibility for normal retirement at 67/10 (from 60/8 or Rule of 85)		1/1/2011
Iowa	Employee contributions set to increase over time, from 5.38% to 5.95% by FY15 (for current, as well as new employees)	Contribution rates rise to 5.95% by FY15. Increases affect current and new employees.	7/1/2012
Maryland	Employee contributions increased from 5% to 7% (for current as well as new employees) Eligibility for normal retirement at 65/10 or Rule of 90 (from any/30, 62/5, 63/4, 64/3, or 65/2)	Contribution rate increase affects both current and new employees	7/1/2011
Massachusetts	Eligibility for normal retirement at 67/10 (from 65/10)		4/1/2012
Mississippi	Eligibility for normal retirement at 60/8 or any/30 (from 60/8 or any/25)		7/1/2011
Missouri	Plan began requiring employee contributions of 4% after previously being noncontributory Eligibility for normal retirement at 67/10 or Rule of 90 with a minimum age of 55 (from 62/5 or Rule of 80 with a minimum age of 48)		1/1/2011
Montana	Employee contributions increased from 6.9% to 7.9% Eligibility for normal retirement at 70/any or 65/5 (from any/30, 65/any or 60/5)		7/1/2011

continued

State	Contributions and Eligibility	Notes	Effective Date
Nevada	Employee contributions increased from 12.25% to 13.25%		1/1/2010
New Hampshire	Employee contributions increased from 5% to 7% Eligibility for normal retirement at 65/any (from 60/any)	Contribution rate increases for both current and new employees	7/1/2011
New Mexico	Eligibility for normal retirement at 65/8 or Rule of 85 (from 65/5, 64/8, 63/11, 61/17, any/30, or Rule of 85)		7/1/2013
New York	Employee contributions increased from 3% to a range based on salary, from 3.5-6% Eligibility for retirement at 63/10 (up from 62/10)		4/1/2012
North Dakota	Increased employee contributions from 4% to 5% (increases to 6% for FY13 and 7% for FY14, for current as well as new employees)	Contribution rates rise to 7% on 1/1/14 and affect current and new employees.	7/1/2012
Ohio	Eligibility for normal retirement at 55/32 or 67/5 (from 60/5, 55/25, or any/30)		1/7/2013
Pennsylvania	Eligibility for normal retirement at 65/any or Rule of 92 (from 60/3 or any/35)		1/1/2011
Rhode Island	New hybrid plan requires employee contributions of 3.7% for the defined benefit component and 5% for the defined contribution component. The legacy defined benefit plan required contributions of 8.75%.	Changes affect both current and new employees	7/1/2012
South Carolina	Employee contributions increased from 6.5% to 7% (increasing to 8% by FY14, for current as well as new employees) Eligibility for normal retirement at 65/8 or Rule of 90 (from 65/5 or any/28)		7/1/2012
Tennessee	New hybrid plan requires employee contributions of 5% for the defined benefit component and 2% (with opt-out feature) for the defined contribution component. Plan was previously noncontributory. Eligibility for normal retirement at 65/any or Rule of 90 (from 60/5 or any/30)		7/1/2014
Texas	Employee contributions increased to 6.6%, up from 6.5% (rising to 7.7% by FY17, for current as well as new employees)	Contribution rates rise incrementally to 7.7% by FY17. Changes affect current and new employees.	9/1/2013
Utah	New hybrid plan requires employee contributions to the defined benefit portion only if the normal cost of the plan exceeds the employer contribution (10%). Contributions to the defined contribution plan are optional. Provision allowing normal retirement at any age modified from any/30 to any/35		7/1/2011
Vermont	Employee contributions increased to 6.3% from 5% (for current, as well as new employees) Eligibility for normal retirement at 65/any or Rule of 87 (from 62/any or any/30)	Contribution rate increases from 7/1/11-6/30/16, for current and new employees	7/1/2011
Virginia	New hybrid plan requires contributions of 4% to the defined benefit plan and 1% (minimum) to 5% (maximum) to the defined contribution plan. Previously, contributions of 5% were required.		1/1/2014
Wisconsin	Increased employee contributions, from 5% to 5.8%	Contribution rates increase to 6.65% for FY13 and 7% for FY14, for current and new employees	7/1/2011
Wyoming	Eligibility for normal retirement at 65/4 or Rule of 85 (from 60/4 or Rule of 85)	Actual contribution rate is 7% (employers pick up remaining 5.57% for most state employees).	7/1/2012

is shown in the table below:

Increases in required contributions affect employees' take-home pay during the period in which they are actively employed. Such increases affect retirement income only in the sense that an additional percentage of the employee's salary is diverted to fund his/her retirement benefit and, as such, these dollars are not available for use in alternate investments. Changes to retirement eligibility may require that employees work longer to become eligible to receive a benefit that is equal to, or less than, the benefit produced under previous conditions. Such outcomes, however, may not always be the case. The results shown in Figure 2 apply to a worker with the same final average salary as a worker enrolled in the plan before the reform was passed. An increased age of eligibility for normal retirement does not preclude an employee from accruing additional years of service at a higher salary, which would produce a higher benefit. The ultimate impact of a change in retirement eligibility would depend on the extent to which increased annual pension payments do, or do not make up for the savings resulting from a shorter retirement period for the employee. Another consideration not taken on in this analysis is early retirement. Extending the age for normal retirement can lead to an increase in early retirement elections, which diminish the value of benefits (by a set percentage) employees would have received in full before the reform was passed.

For the states represented in this study, the average new employee would have to work approximately two years, eight months longer to reach the benefit level available to employees hired previously, assuming variables for years of service and salary are held constant.

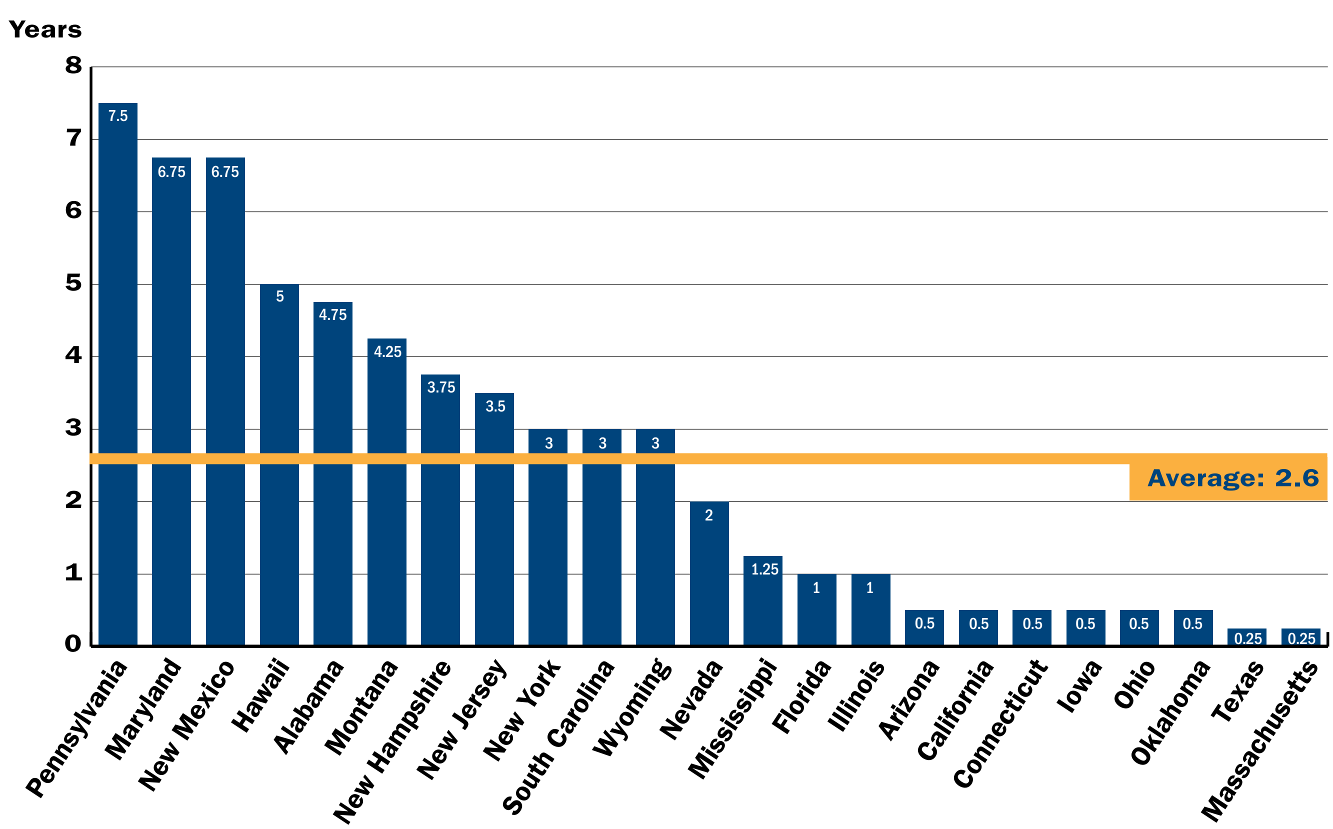
Hybrid Plan Analysis

Five of the states in this study implemented combination hybrid plans for new employees or for both current and new general employees. In each of these states, those covered by the hybrid plan will receive a benefit that is made up of a defined benefit and defined contribution component. Since 2009 four states have passed hybrid plans for new employees. Rhode Island implemented a hybrid plan for both new and existing (non-vested) employees.

Methodology

The benefit levels for the hybrid plans in this study are calculated by applying an annuitized defined contribution benefit to a base defined benefit pension.

Figure 2. *Additional Years of Service Required to Reach Pre-Reform Benefit*



Each state's defined contribution balance is based on variables for contributions and market performance. In most cases the statutory contribution rates were applied, with actual plan experience factored in where possible. The defined contribution accounts are estimated to earn an average of 6.5 percent compounded return on investments over a 30-year period, with the balance annuitized for a 25-year period.[11] As with the defined benefit plan analysis, the hybrid plans analysis calculates the benefits earned by an employee who spent his/her career, assumed to be 30 years, in state government or in a participatory political subdivision. For a detailed description of the methodology used to calculate defined contribution accounts for the hybrid plans analysis, please see Appendix 2.

Results

The defined benefit in each of the five states analyzed features a reduced multiplier, and two of the states modified the period used to calculate final average salary. A description of the changes to the defined benefit plan, as well as changes in benefit and income replacement levels by state, appears in the table below:

In two of the five states studied, the hybrid plan may produce a diminished benefit when compared to the original defined benefit plan. In three of the five states, the hybrid plan may yield a benefit that is greater than the original defined benefit plan, using the contribution and performance variables described above. In the cases where the hybrid plan yields an enhanced benefit, the excess is made up exclusively of annuitized defined contribution earnings over time (See Figure 3).

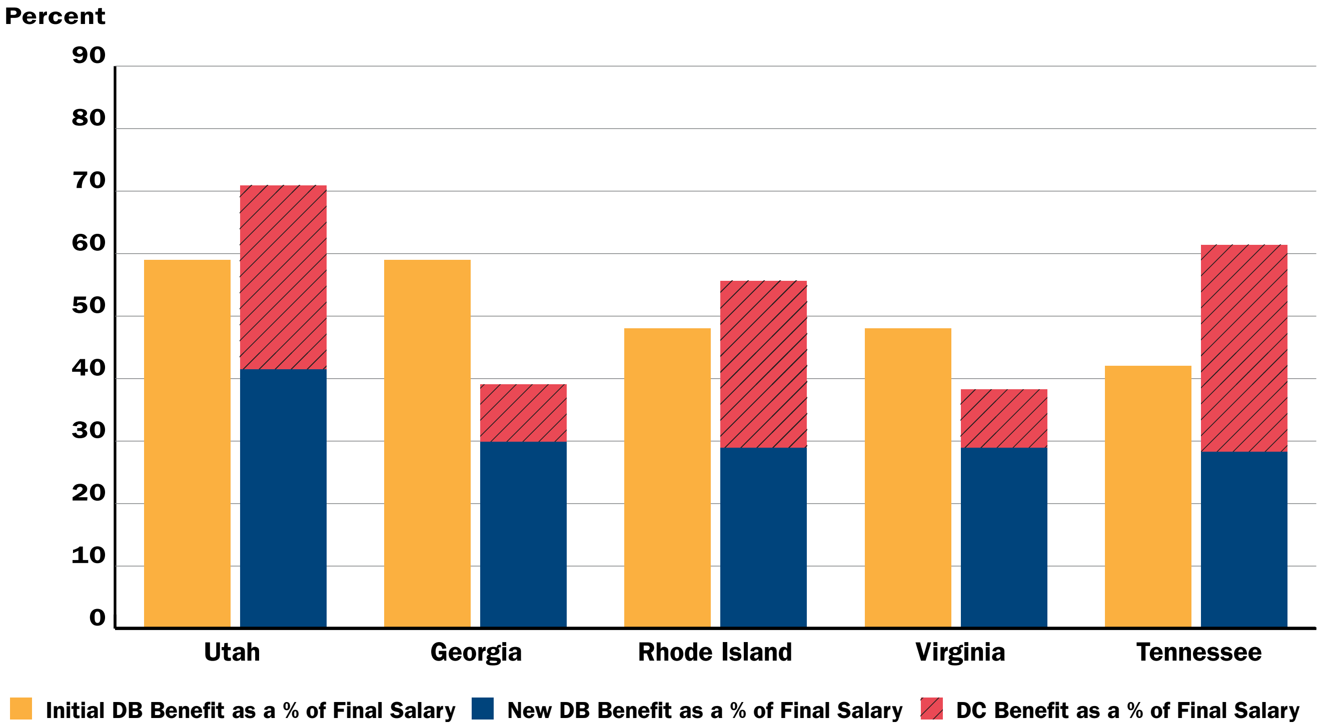
There are some elements of defined contribution plans that this study does not address. Some issues worth noting are:

- **Contributions Matter:** Holding the pattern of annual investment returns constant across all five plans, the distinguishing characteristic is the contribution rate. Simply put, the more money going into a defined contribution plan, the greater the balance will be at the end of the 30-year term. Not surprisingly, the three states with the highest contribution rates are those for which the combination hybrid benefit exceeds the benefit produced by the defined benefit plan it replaces. The contributions used in this calculation are

Table 4. *Elements of Newly Created Hybrid Plans*

State	Changes to Defined Benefit Calculations and Employee Contributions	Combined Contributions to New DC Plan[12]
Georgia ERS	Retirement multiplier reduced to 1% from 2% Employee contribution remains at 1.25%	1% automatic employee enrollment; employee may increase or reduce contribution; may opt out within 90 days of hire 100% employer match on employee's first 1% of salary and 50% match on next 4% of salary, for a maximum employer contribution of 3%
Rhode Island ERS	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1% from a graded 1.67%-2.5% Employee contribution changed from 8.75% to 3.75%	Mandatory 5% employee. 1% employer
Tennessee CRS	Retirement multiplier reduced to 1% from 1.5% Previous plan was non-contributory for employees.	2% automatic employee enrollment; employee may increase, reduce, or eliminate contribution. 5% employer contribution
Utah RS	FAS based on highest average 5 years, up from 3 years. Retirement multiplier reduced to 1.5%, from 2% Employee contributions are required if the cost of the DB plan exceeds 10% (in the amount of the excess). Previous plan was non-contributory for employees.	No employee contributions required. If the cost of the DB plan is <10%, the employer contributes the difference to the DC plan. In FY 14, that difference is 1.59%.
Virginia RS	Retirement multiplier reduced to 1% from 1.65% Employee contributions increased from 0% to 4%.	1% automatic employee enrollment, with option of up to 5% 1% employer contribution, increasing with employee contributions up to 3.5% maximum

Figure 3. *Initial Defined Benefit Plan and Hybrid Plan, as a Percentage of Final Salary, by Element*



Initial benefit levels do not account for cost-of-living adjustments. Defined contribution balances calculated using a 6.5% return assumption and a balance annuitized for 25 years.

derived from statutory minimums and/or plan experience, but they do not represent the full range of possibilities in each plan. Employees in Georgia and Tennessee can opt out of the defined contribution component of their hybrid plan, and employees in Utah are not required to make any contribution to their defined contribution accounts. In this analysis the two states with the lowest total contribution rate produce benefits that are diminished vis-à-vis the previous defined benefit plan, while those with higher contribution rates produce benefits that exceed the pre-reform plan.

- **Investment Risk:** This analysis assumes a straight 6.5 percent compounded investment return for the example defined contribution account. We know from experience, however, that the nature of annual investment returns is volatile and unpredictable.[13] One or more years of slow returns or investment losses, especially if incurred at or around the age an employee is set to retire, can significantly affect the balance of a defined contribution account and put a secure retirement at risk.
- **Longevity Risk:** This analysis incorporates an annuitized DC plan balance for a 25-year period, which is assumed to be the balance of the employee's retired lifetime. Should that period exceed 25 years, the retiree would draw a monthly (or as this analysis shows, annual) annuity that is less than the amounts shown in the chart above. Of course, this is dependent on whether they annuitized at all. Each of the five states in this analysis offers an annuity option for the defined contribution benefit, but it is not the default or mandatory option in any state and full or partial lump sums remain an option for most participants.

Retirement Benefits and State-Provided Services

The 2008-2009 financial crisis greatly affected individual retirement assets for many U.S. workers, including those at or near retirement. From 2008 to 2009, individual retirement accounts lost approximately $1.1 trillion in assets, collectively.[14] Assets held in private sector defined contribution plans fell by a collective $1.2 trillion over the same period and did not recover their pre-2008 value until 2010.[15]

There is a correlation between the depletion of retirement assets and the number of retirees living in poverty. According to a 2012 report by the Employee Benefits Research Institute (EBRI), poverty rates rose for individuals aged 65+ from 2007 to 2009. During that period, poverty rates for the age 65–74 cohort increased from 8.2 percent to 9.4 percent, while rates for those aged 75–84 rose from 8.7 percent to 10.7 percent. Individuals aged 85 and older are most likely to be living in poverty, and rates for this group rose from 13.9 percent in 2005 to 14.6 percent in 2009.[16]

The EBRI study shows that poverty rates drop for those aged 65–84 compared with those aged 50–64. EBRI hypothesizes that this is related to the fact that individuals generally begin drawing on their Social Security payments by age 65. Poverty rates begin to rise for those over the age of 85, which suggests a depletion of personal retirement savings.[17]

This research demonstrates the importance of retirement savings in keeping retired workers out of poverty and avoiding reliance on government-provided social services. A 2012 study of the effects of pension benefits on retiree financial well-being reported that 16.4 percent of households with no pension income received public assistance in 2010, compared with just 4.7 percent for households that received a defined benefit pension through either of the spouse's employer.[18] Federal spending on social assistance programs rose by approximately 23 percent from 2008 to 2009, compared with increases of nearly 6 percent for 2010 and 2 percent for 2011,[19] when financial markets began to recover.[20]

Different studies highlight the importance of a reliable income stream in retirement that cannot be reduced through either misappropriation or market forces. When retirement income is diminished by such forces, retirees may rely on taxpayer supported public assistance programs, particularly when their retirement accounts represent their sole source of income.

Human Resource Considerations

To understand the human resource program and policy changes states have implemented to address recent pension reform changes, either directly or indirectly, a series of interviews (via telephone and email) was conducted with 12 human resource and retirement officials in 10 states. The interviewees were selected based on the recommendations of leaders of the National Association of State Personnel Executives and the International Public Management Association for Human Resources. In addition, SLGE and NASRA researchers identified representatives from states that have made significant pension plan changes and those that have had a history of responsibly managing pension funding and liabilities in the past. Appendix 1 offers the list of interviewees.

The interviews covered:

- whether states analyzed what retirement income they expect new hires to have after spending a career in government.
- what steps have been taken to mitigate the impact of retirement benefit changes;
- whether there has been a shift among employee groups toward bargaining for increased salaries instead of focusing on benefit changes; and
- whether the state has taken any steps to help employees take greater responsibility for saving for retirement.

Key Findings

Analyses of plan changes on retirement income

Most respondents said that analyses were conducted to examine the impact of retirement plan changes on employees' retirement eligibility and retirement income. A few human resource officials were not aware of the findings and referred researchers to pension plan administrators for information about the analyses.

All respondents indicated that employees would need to work longer to earn the same retirement benefit as employees hired before changes were enacted. Representatives of Colorado, Missouri, Ohio, and South Carolina indicated that while the multiplier[21] was not changed, employees will need to work more years to receive comparable benefits. Howard Schwartz of the California Department of Human Resources said that new employees will need more years of service or must work to an older age to receive the same benefit as those employed prior to the enactment of pension reform legislation. According to Jackie Graham of the Alabama Personnel Department, "[Alabama's Tier 2] plan is so very different that the benefits are not comparable." New hires in Alabama contribute less to their retirement accounts, but the multipliers were also reduced, leading to a lower retirement income.

Interviewees from Virginia and Tennessee, which are introducing new hybrid plans in 2014, said that employees will have to work additional years to earn about the same benefit, but with some market risk. In some cases, plan administrators have called the pension plan reforms a net positive for affected employees, especially teachers who may not spend an entire career in the government but will be able to access retirement benefits after a shorter tenure.

Mitigating the impact of retirement benefit changes

Offsetting future retirement income losses States in the interview group have not taken any steps, such as increasing wages or enhancing other benefits, to offset the loss of future retirement income. Respondents noted that some mitigating steps could be occurring at the individual agency level, in which case state human resource directors and plan administrators may not be aware of such activities.

The question regarding mitigation measures assumes that state officials are concerned about the adequacy of the new retirement benefits and the effects of pension plan changes on recruitment and retention. However, respondents are far more concerned with stagnant wages and increasing costs of benefits for all employees (i.e., health care premiums), as discussed below. In addition, respondents' ability to address adequacy of retirement benefits was discussed in the context of the final question about steps employers have taken to help employees save for retirement (e.g., through supplemental savings accounts and financial education). Respondents challenged the premise of this question because the plan changes are too new and data are not available to draw conclusions about recruitment and retention.

With the exception of the Colorado Public Employees Retirement Association, which enacted all of its pension plan changes in 2010, most of the plan changes in the states represented in the interviews affect new hires only. Changes have been in place for two years or less, with the exception of Tennessee, which will introduce its hybrid plan on July 1, 2014, and Virginia whose hybrid plan takes effect January 1, 2014. Therefore, changes are too new to allow HR officials to determine what effect these changes will have on retention in those states.

In addition, public employer job growth is relatively weak, which means that recruitment has not been a high area of concern except for certain traditionally hard-to-fill positions, such as finance, public health and safety, and IT, according to James Honchar of the Pennsylvania Governor's Office of Administration and Sara Wilson of the Virginia Department of Human Resources. Wilson added, "When the economy improves and the job market picks up, it will be easier to assess the impacts of the new [pension] benefits on recruitment and retention." Jackie Graham of the Alabama Department of Personnel expressed a similar sentiment: "I think there will be recruitment and retention challenges, but we won't see the impacts until the economy improves and workers can find jobs with more competitive wages." In part because of retention challenges that are anticipated in the future, South Carolina and Pennsylvania are heavily focused on workforce planning.

Respondents' primary concerns were not about the retirement earnings of future hires, but rather about wage stagnation and rising costs to employees of benefits that affect their take-home pay, morale, and retention. Several states have provided no wage increases for several years:

- Alabama will be granting its first wage increase since 2009 in calendar year 2014; in 2013, Virginia is providing its first raise, of two percent, since 2007,[22] but is also initiating a 5 percent employee retirement contribution from all employees at the same time employee health care contributions and other costs are rising.
- Pennsylvania's previous governor froze wages for all non-union employees between 2008 and 2011, during which time the average wage increases for union employees totaled 12.75 percent, while the non-union employees' salaries remained frozen. In Pennsylvania, the first wage increases in more than five years were granted to management and other non-union employees in 2012–2013 by Governor Corbett.
- Tennessee has created a task force to study total compensation; preliminary findings show that benefits are higher and wages lower than the private sector. As a first step in addressing these findings, the Tennessee Department of Human Resources provided a 4.75 percent raise to all employees who had salaries below the mid-point of their salary range, which affected 86 percent of the workforce, according to Rebecca Hunter of the Department of Human Resources.

Improving morale and retention While respondents are not taking any specific steps to offset the impact of future pension plan losses, many have launched initiatives to help improve employee morale and retention. For example, professional development and leadership training is a high priority in several states and is seen as a way to invest in employees and support retention goals. Pennsylvania's robust leadership development training is geared toward management positions and includes learning academies, an emerging leaders training program, and a leadership development institute that has been in existence for 20 years. Its institute has more than 1,000 graduates, 70 percent of whom continue to work in the Commonwealth.

Tennessee's Department of Human Resources created a chief learning officer position that oversees professional development and training across the state workforce. The state leadership development program, "Leadership Tennessee," is now in its fifth year and offers customized management and leadership programs for managers, supervisors, and IT professionals.

South Carolina's Department of Human Resources offers four certification programs employees view as valuable to their career advancement. Agencies nominate and pay for employees to participate in these programs, which include an 18-month certified public manager program, an associate public manager program, a public professional development program for entry level employees, and an HR professional development training program. South Carolina's Department of Human Resources also encourages agency human resource managers to use reward programs such as flexible and low-cost peer recognition programs to boost employee morale.

Another low or no-cost benefit that employers can offer employees is a flexible work schedule or telecommuting. Pennsylvania provides flexible schedules to its workers. Virginia has a teleworking goal of 20 percent of employees. Tennessee's wellness initiative allows employees to combine their two 15-minute breaks per day into a single 30-minute break, which can be used for exercise.

Shifting Priorities of Employee Groups

Respondents said that they have seen no changes in the priorities of employee groups which generally seek to retain as many employee benefits and wages as possible while also working to ensure the long term viability of the retirement plan. Several of the representatives interviewed are from right-to-work states including Alabama, Missouri, South Carolina, Tennessee, and Virginia, and do not have collective bargaining. However, all states represented worked with employee groups in some capacity—from presentations to employee groups in Alabama, Missouri, and Tennessee, to substantive engagement with employee groups to help craft legislation in Colorado. Their range of involvement varied among the states represented in the interviews, and the outcomes resulting from these efforts were significant. For example, employee group feedback in Tennessee resulted in a legislative requirement for enhanced financial education and a new employee benefit that provides the option of purchasing units of the state's defined benefit investments for the defined contribution portion of the hybrid accounts.

Helping Employees Plan and Save for Retirement

The plan administrators and human resource officials interviewed in this study recognize that retirement incomes will take longer to attain, may not be assured due to market risks borne by employees and retirees, or may be reduced. Therefore, many respondents are focusing attention on financial education and supplemental savings vehicles to support the future retirement security of state workers.

Colorado's Public Employees' Retirement Association (PERA) enacted pension reform in 2010 and has taken steps to encourage employee participation in voluntary retirement savings plans. Specifically, the Colorado PERA Board of Trustees approved comprehensive changes to its defined contribution and supplemental savings plans in 2011. Changes included providing participants with access to custom and diversified investment options, investment advisors at no additional cost, and investment professionals for account management services. These changes allowed PERA to lower costs for participants. Finally, PERA communicates with members on a regular basis about the importance of saving for retirement beyond the pension plan and participating in supplemental retirement plans.

In April 2009, the Missouri State Employees Retirement System (MOSERS) made target date funds the default investment option in the State of Missouri Deferred Compensation Plan. The move cut investment management fees to approximately 25 basis points, compared with the previous average of 90 basis points. This endeavor also included mapping assets from the old fund offerings to new, custom target date funds. Participants were offered the option to opt out of the mapping and remain in the now-frozen, legacy fund lineup. Less than 17 percent of assets remained in these old funds.

In July 2012, MOSERS began automatically enrolling new employees in its deferred compensation plan at 1 percent of pay and offering a 30 day opt-out window. The average opt-out rate since inception is 12 percent.

According to Gary Findlay of MOSERS, "MOSERS has always offered a number of financial education opportunities, including workshops held throughout the state for participants in the defined benefit plan. They offer pre-retirement seminars for employees approaching retirement and Money Matters workshops for any employee interested in general financial education, budgeting, managing credit card debt, estate planning, and more. In addition to participating in both the pre-retirement and Money Matters workshops, our deferred compensation plan education specialists also provide one-on-one consultations to both participating and eligible employees as well as seminars on building a portfolio, participating in the Roth 457, utilizing target date funds, and investing for retirement, to name a few."

According to Sara Wilson of Virginia's Department of Human Resources, "We used to offer financial education seminars, but didn't reach employees who truly needed it." So, in July 2009 the department began offering an employee loan program in partnership with a credit union for up to $500 twice per year to provide an alternative to payday loans. The payback period on these loans is up to 6 months with a less than 1 percent charge-off rate. To date, more than $10 million has been loaned to state workers. According to Ms. Wilson, "These loans help us identify those who need financial education." Users must take basic financial education classes in order to participate in the program.

According to Stephen Van Camp of the South Carolina PEBA, "The state is exploring tools such as auto enrollment and auto escalation in our voluntary deferred compensation program to help employees save additional money for retirement. These auto features would require legislative action. The state is encouraging greater participation in our deferred compensation plan and we are conducting outreach and financial education to achieve that. In addition, 30,000 employees choose to participate in the state's defined contribution plan in lieu of the defined benefit plan. PEBA is working to provide improved financial education for those individuals as well."

According to Howard Schwartz, California is working to reduce the fees associated with deferred compensation plans, such as its 457 plan, to encourage employee participation and to reduce costs for employees.

In Tennessee, the Consolidated Retirement System has set goals for financial education and retirement readiness. The third party administrator who runs the deferred compensation plan is planning web-based education and in-person meetings to help employees learn about asset allocation.

Conclusions

State pension plan administrators and human resource officials generally agree that pension plan changes will result in employees working longer to achieve similar, reduced, or less certain retirement benefits as compared with those employees who were in legacy plans. These officials view wage stagnation and increased costs of benefits to employees as more critical concerns than future retirement income because these issues have been ongoing for several years[23] and they hurt employee morale and retention.

In response, several states are in the process of providing wage increases for the first time in many years. Plan administrators and human resource officials are not, however, focusing on reductions in future retirement income for new hires at this time. Instead, they are strengthening efforts to help all employees achieve their retirement goals by providing enhanced financial education and training, and by offering and promoting supplemental savings vehicles such as 457 plans. In addition, as a tool for improving employee morale and retention, human resource officials are providing robust leadership development and technical training opportunities to employees, as well as flexible work schedules and telework arrangements.

Almost all of the state leaders interviewed said that they had worked with employee groups or unions to share information, gather input, and/or help craft the pension plan reform legislation.

Takeaways

Elected and appointed officials can learn a great deal from states that have undertaken significant pension reforms. This study shows the significance of pension plan changes on future retirement income and can help inform those who manage public sector workforces and their retirement programs.

- **Result: a diminished benefit:** In virtually all the states analyzed that made reforms while retaining the defined benefit structure, the result was a diminished pension benefit. The average benefit change in this analysis was –7.5 percent.
- **Need for increased supplemental savings:** Given the benefit reductions, aside from Social Security (if the employee is eligible), public employees will need to take advantage of supplemental savings vehicles to maintain similar salary replacement rates in retirement, pre and post reform. In some states, employees will need to save more than $100,000 on their own. As a result, many plan administrators are providing enhanced financial education and offering and promoting supplemental savings vehicles.
- **Working longer:** In the states analyzed in this report, reforms to retirement eligibility and employee contributions mean that the average new employee will have to work approximately 2 years, eight months longer (holding all other variables constant) to reach the benefit level available to employees hired previously.
- **Mixed results for hybrid plans:** Two of the five state hybrid plans analyzed using the model's assumptions, produce a diminished benefit, post reform, while the other three yield a benefit greater than the previous defined benefit structure.
- **Stagnant wages and increasing costs of benefits, overall:** While pension reform is important, many state executives view employee compensation as a greater problem, especially after a period of low or no wage increases along with higher employee costs for benefits. Employee pay is a concern for both staff recruitment as well as retention.
- **Employee morale:** The squeeze on compensation has affected employee morale. To help offset the effects of pension reform and decreased take-home pay, many public employers are providing non-monetary benefits in the form of leadership development, technical training, flexible work schedules, and telework options.

Appendix 1

List of the organizations interviewed for the 'Human Resource Considerations' section:

- Alabama Personnel Department
- California Department of Human Resources
- Colorado Public Employees' Retirement Association
- Department of Human Resources Development, Hawaii
- Missouri State Employees Retirement System
- Ohio Public Employees Retirement System
- Commonwealth of Pennsylvania Governor's Office of Administration
- South Carolina Human Resources Division
- South Carolina Public Employee Benefit Authority
- Tennessee Consolidated Retirement System
- Tennessee Department of Human Resources
- Virginia Department of Human Resources Management

Appendix 2: Hybrid Plans Analysis Methodology

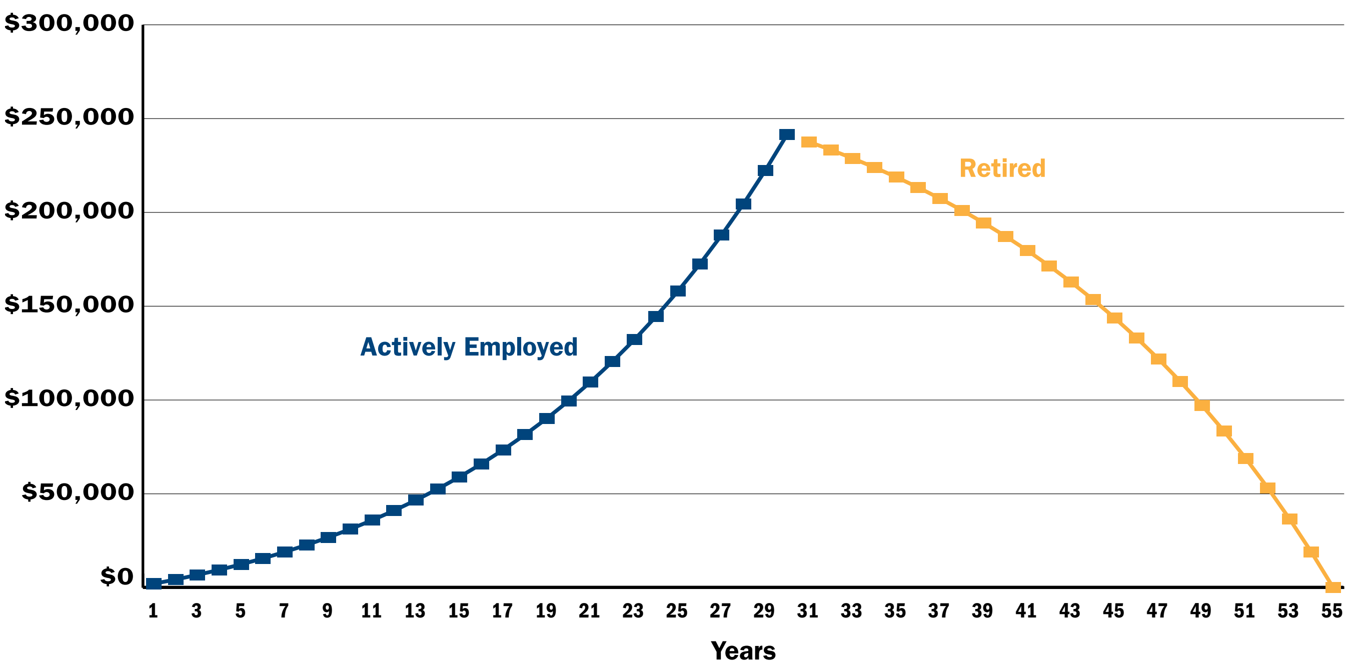
The hybrid plans analysis relies on assumptions made by the researchers about the accumulation of funds in a defined contribution account and their disbursement upon an employee's retirement. To determine the benefit produced by the newly created hybrid plans as a percentage of the Final Average Salary replaced of the old defined benefit, a 30-year annuitized DC benefit was combined with the benefit produced by the new hybrid DB benefit.[24] The purpose of this appendix is to provide insight into the methods used to determine the defined contribution account balances used to calculate the annual annuity values for the new hybrid plans.

The chart below illustrates the end-of-year balance in a defined contribution account using the wealth accumulation tool built for this analysis.

This example assumes that the employee spends 30 years as an active employee contributing to his or her retirement account. After 30 years the employee becomes retired, and draws a annuity for 25 years.

In the example above the employee's defined contribution account earns approximately $241,591 over the 30-year period. That amount becomes the starting principal from which the 25-year monthly annuity is calculated, and the employee would be expected to draw about $18,597 per year over the 25-year term. In this example the total payments from the defined contribution account equal approximately $464,930. **To obtain the complete benefit level used for comparison the new, annual hybrid defined benefit is combined with the annual defined contribution annuity, in this case, $18,597.**

Sample Defined Contribution Account



Assumptions			
Active Employee		**Retiree**	
Tenure	30 Years	Annuity Term	25 Years
Starting Salary	$40,000	Annual Growth Rate	6.5%
Annual Salary Growth Rate	2.5%		
Retirement Contribution Rate	5%		
Annual Investment Return	6.5%		

Notes

1 The research teams would like to thank Robert Clark of NC State, Jean-Pierre Aubry of the Center for Retirement Research at Boston College, and Jeffrey Esser and Barrie Tabin Berger of the Government Finance Officers Association for reviewing this report.

2 Georgia passed a major pension reform in 2008 to take effect on July 1, 2009. It is included in our analysis.

3 Most cash balance plans have a set rate of return that is applied to member cash balances, with excess credits available depending on the plan's investment performance. Since the amount of the benefit depends somewhat on investment performance, it is difficult to accurately project.

4 U.S. Bureau of Labor Statistics, National Compensation Survey (data extracted on October 1, 2013); http://www.bls.gov/data/#wages

5 U.S. Bureau of Labor Statistics, Employment Cost Index Archived News Releases, http://www.bls.gov/schedule/archives/eci_nr.htm#1999

6 The ECI is a quarterly measure of the change in the cost of labor, defined as compensation (wages & salaries and benefits) per employee hour worked.

7 The average 12-month percent change in Employment Cost Index (not seasonally adjusted) for the past 15 years (period ending December) is 2.63 percent.

8 Benefit levels do not account for inflation or cost-of-living adjustments. Some states have reduced or eliminated COLAs for new or existing employees or retirees. For a description of these changes and their effects please see NASRA Issue Brief: Cost of Living Adjustments (http://www.nasra.org/content.asp?contentid=125).

9 The U.S. Bureau of Labor Statistics reports annualized wage and salary growth of less than 2% for state and local workers for each of the past five years (period ending 2013 Q3). Applying this lower rate of salary growth to the last five years of the hypothetical employee's career in this analysis would lessen the impact of extensions of the FAS period. Conversely, if a higher rate of salary growth were used in place of the 2.5% used in this study, the extensions of FAS would produce a greater disparity between the original benefit and the benefit produced under post-reform conditions.

10 Balances were calculated based on an annuity term of 25 years and 6.5% annual growth (compounded), based on 16-year average return of 6.33% as reported by Towers Watson, "DB Versus DC Investment Returns: The 2009–2011 Update," May 22, 2013: http://www.towerswatson.com/en/Insights/Newsletters/Americas/insider/2013/DB-Versus-DC-Investment-Returns-the-2009-2011-Update

11 Calculations derived from online annuity calculator available at http://www.annuitycalc.org/

12 The rates in this column represent the statutory minimums. In some cases, employees may opt out of the defined contribution component altogether.

13 For the 20-year period 1992-2011 individual investors underperformed returns for major asset classes (BlackRock: "Volatility Propels Emotional Investing," December 3, 2012: https://www2.blackrock.com/us/financial-professionals/market-insight/chart-of-the-week/volatility-propels-emotional-investing

14 U.S. Federal Reserve: Flow of Funds Accounts of the United States, Flows and Outstandings Fourth Quarter 2011, Table L.225.i Individual Retirement Accounts, page 117

15 Flow of Funds, Table L.118.c Private Pension Funds: Defined Contribution Plans, page 117

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21 The factor that is used to determine the size of the annuity received by the retiree expressed as a percentage of final average salary (FAS) times years of service.

22 Virginia employees are also receiving a one-time five percent bonus in 2013 to cover employee contributions to the retirement plan, a new requirement of all employees

23 Center for State and Local Government Excellence, "State and Local Government Workforce: 2013 Trends," May 2013.

24 Each of the newly created hybrid plans is a combination hybrid plan, featuring a smaller defined benefit combined with an individual defined contribution account.

Effects of Pension Plan Changes on Retirement Security

About the Center for State and Local Government Excellence

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

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NASRA is a non-profit association whose members are the directors of the nation's state, territorial, and largest statewide public retirement systems. NASRA members oversee retirement systems that hold more than two-thirds of the $3.6 trillion held in trust for 15 million working and 8 million retired employees of state and local government. Learn more at www.nasra.org.

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GOVERNING MAGAZINE

Public Pensions and the Lessons of Success

Some state and local retirement systems have found a formula for stability.
BY ELIZABETH K. KELLAR | APRIL 9, 2014 |GOVERNING

Do we learn more from success or failure? When it comes to state- and local-government pensions, we tend to focus on the plans that are struggling. But there are valuable lessons to learn from public-sector retirement plans that have remained well funded and from governments that have successfully negotiated changes to put their pension systems on a path to full funding.

Well funded in Illinois: Given all the headlines about Illinois' seemingly endless struggle to reform its pensions, some might be surprised to learn that that the Illinois Municipal Retirement Fund (IMRF), the state's second-largest public pension, is a model of fiscal responsibility.

What distinguishes the IMRF from Illinois' other three statewide plans, which are struggling, is that all 2,969 governments that participate in it are required to pay 100 percent of their annual required contribution. As a result, the IMRF has remained more than 80 percent funded, even after the investment losses that public and private plans suffered from the 2008 recession.

It is also noteworthy that the IMRF is separate from the Illinois state government and its assets are not included in the state's financial statements. (State law does, however, determine employee benefits, including retirement age, employee contributions, vesting period and cost-of-living increases.)

The IMRF maintains fully funded reserves for employees and retirees, has a highly diversified portfolio and assumes a conservative 7.5 percent return on investments, even during periods of stock-market growth. This long-term approach helps the fund ride out market swings.

Navigating change in Georgia: Some governments focus all their attention on costs when they look at pension-plan changes. Because pensions are part of a broader human-resources strategy, it's important to involve employees in the discussions and to consider recruitment and retention issues.

In 2007, Gwinnett County, Ga., decided to take control of its defined-benefit plan, which had been managed by the Association County Commissioners of Georgia. Key drivers of the county's desire for change were to gain control over the county's pension assets and control cost increases.

The county sought to put new employees into a defined-contribution plan. Before making the change, county staff conducted benefit comparison studies, carried out market research to learn what benefits were important to young professionals, and analyzed the short- and long-term costs of closing the defined-benefit plan to new employees. (When a pension plan is closed, the unfunded liabilities are amortized over a shorter period in keeping with sound actuarial principles, and with a fixed group of employees to serve, demographic assumptions must be revised.)

While county staff calculated that closing the defined-benefit plan would be more costly in the short run, the analysis showed long-term cost savings. County commissioners voted to move forward.

Although the costs to service the closed plan were higher than expected due to asset losses from the 2008 economic downturn, the county has continued to make its full annual required contribution. The closed plan was 70.2 percent funded in 2010 and reached the 76.8 percent level in 2012. So far, the county has not experienced any measurable changes in its ability to recruit or retain workers.

Legislating stability in Iowa: Sometimes, as in the case of the Iowa Public Employees' Retirement System (IPERS), state legislation is needed so it is possible to make the full annual required contribution (ARC). While the IPERS' funded ratio had remained relatively good, it was trending downward.

One problem IPERS had was a statutory required contribution rate that was well below the ARC. It had not been adjusted since 1979. The Iowa General Assembly authorized changes in 2006, 2010 and 2012 to increase the combined employer-employee contribution. Now IPERS has the authority to adjust the contribution rate to an annually adjusted cap and the funded ratio is over 80 percent again. For fiscal year 2014, the required contribution rate is at 100 percent of the ARC.

As these stories illustrate, there's no one-size-fits-all approach to strengthening state and local pension plans. Each has a unique legal framework, and a solution that works for one government may be totally off the mark elsewhere. But while solutions for retirement plans can vary from place to place, there's no debate about the importance of an adequate retirement income for government workers.

Rhode Island's Winding Road to Serious Pension Reform

If all the parties approve it, a recent agreement will preserve most of the benefits of a sweeping reform law.
BY CHARLES CHIEPPO | MARCH 5, 2014

More than two years after the passage of landmark state legislation, Rhode Island's pension-reform saga may finally be coming to an end. When governments wait too long to address looming pension troubles, they often end up boxed in by the need to save money on one side and prohibitions against diminishing current employees' pensions on the other. But in this case, the final product has been worth the wait.

The pension-reform legislation was enacted in November 2011. Public-employee unions filed a lawsuit challenging it the following year. That December, a state Superior Court judge ordered the sides into talks brokered by a federal mediator. The recent agreement reached by outgoing Gov. Lincoln Chaffee, state Treasurer Gina Raimondo (who is running for governor) and the unions is fair and preserves most of the savings provided by the 2011 legislation.

The law provided that retirees would get cost of living adjustments (COLAs) just once every five years until the state pension fund has 80 percent of the money it needs to fund projected expenditures. It raised the retirement age for most state employees to the age at which they can begin to collect Social Security. And it scaled back the traditional defined-benefit portion of the pension plan while adding a defined-contribution element that requires all but public-safety employees to contribute 5 percent of salary to an individual retirement account, matched by a 1 percent employer contribution.

Under the settlement, individuals who retired before June 30, 2012, would get a one-time 2 percent COLA. Going forward, COLAs would be awarded every fourth year (instead of every fifth under the original legislation) until state pensions are 80 percent funded. And COLAs would be calculated using a new formula based on both inflation and the pension fund's investment returns.

Another change from the 2011 law is that employees with 20-plus years of service would move out of the hybrid 401(k)-style pension plan and back into a traditional one, where the amount those workers contribute to the pension fund would increase. In some cases, the minimum retirement age would be lowered and benefits would accrue more quickly.

The deal still has to be approved by retirees, current state workers and the legislature, and they should approve it without delay. If not for reform, Rhode Island's unfunded liability would stand at an estimated $8.9 billion. Under the 2011 law, unfunded liability fell to $4.8 billion, and the settlement would increase it only to $5.05 billion.

Had the lawsuit continued, there is always the chance that the public-employee unions would have prevailed, a result that the *Providence Journal* editorialized would have been a "catastrophe" from which there would be "little hope of recovery in our lifetimes."

Credit rating agencies seem to agree. Moody's noted that the deal only modestly reduces the savings from reform and said that settling the lawsuit removes a lingering source of fiscal uncertainty. It termed the agreement "credit positive," which means it would help the state maintain or improve its bond rating.

Rhode Island is only the latest state or local government to discover just how thorny it gets if you wait too long before moving to fix public-employee pension problems. But in the end the state and its employees and retirees were lucky. Even though it took more than two years, it seems likely that the Ocean State will indeed avert a catastrophe.

A Misguided Pension Reform for Government

Pressure is building for state and local governments to switch their workers to defined-contribution retirement plans. But defined-benefit plans have advantages that should not be ignored.

BY MICHAEL H. GRANOF | SEPTEMBER 26, 2013

Detroit's bankruptcy filing, following similar filings by Stockton and San Bernardino, Calif., and Central Falls, R.I., has brought renewed calls for public-pension restructuring. Probably the most frequently proposed reform is that state and local governments should switch from defined-benefit retirement plans to defined-contribution plans. Such a change, however, would be misguided.

Defined-contribution plans are, of course, the darlings of businesses. They let their sponsors avoid the uncertainties associated with defined-benefit plans. Once a company makes its annual contributions to its employees' accounts, it is off the hook forever for any further payment. As a consequence, the employers don't have to desecrate their balance sheets with pesky long-term liabilities or their income statements with expenses that are determined as much by changes in the stock market as they are by any actions of the employers themselves.

But almost any actuary will tell you that defined-contribution plans are inherently less efficient than defined-benefit plans. Indeed, some will say that the worst defined-benefit plan is more efficient than the best defined-contribution plan. In part, this is because defined-benefit plans tend to be better managed and earn higher investment returns. The primary advantage of defined-benefit over defined-contribution plans, however, is inherent in their nature: Defined-benefit plans can take advantage of the law of averages.

In a defined-contribution plan, the employer maintains a separate account for each employee. The employee is dependent upon the balance in that account for his or her retirement income. If an employee retires at age 65, then, if fortunate, he or she may live another 30 or more years. Therefore, upon retirement, the balance in that account -- and the pre-retirement contributions to attain that balance -- must be sufficient to provide an annuity for at least that number of years.

By contrast, in a defined-benefit plan, a single, common account is maintained for all eligible employees. If the employees retire at age 65, then on average they can be expected to live no more than about 20 years. Therefore, the balance per employee and the pre-retirement contributions can be far less.

It's true that many state and local governments' defined-benefit plans are fiscal debacles. The Center for Retirement Research at Boston College estimates that, collectively, state and local government plans are only 73 percent funded -- a shortfall of at least $1 trillion. But that is due more to imprudent policy decisions than to the nature of the plans. Simple, common-sense practices can restore them to fiscal health.

Most importantly, governments must consistently contribute to the plans the amounts that their actuaries calculate are necessary to sustain their long-term fiscal well-being. In the past, they have failed to do this, and particularly in years in which stock prices were high they have cut back on their contributions. They must acknowledge the law of fiscal gravity: What goes up also comes down.

In addition, governments can eliminate provisions that increase payments to retirees but otherwise make little economic sense. These include those that permit "spiking" (the practice by which employees work extensive overtime in their last year of employment to boost the basis on which their pensions are calculated) and that allow employees who retire at a young age to start collecting benefits well before they reach a normal retirement age.

Retirement benefits are but one element of a comprehensive compensation package. To be sure, retirement plans for government employees are typically more generous than those of private-sector workers. The Center for Retirement Research concludes, however, that, even taking account of benefits, private-sector workers enjoy on average a 4 percent compensation advantage over their state- and local-government counterparts.

To retain a qualified workforce, governments should offer their employees compensation packages that are competitive with the private sector. Simply moving from a more efficient to a less efficient pension plan is hardly consistent with that objective.

Rhode Island Workers, Retirees Mull Pension Deal
Providence, RI   March 30, 2014 (AP)
By David Klepper, Associated Press

The fate of Rhode Island's landmark pension overhaul — a model cited in other states wrestling with escalating retirements — now hinges on the votes of the same government workers and retirees who sued to block the law.

Thousands of teachers, firefighters, police and other state and municipal workers and retirees are voting on a proposed settlement in the legal challenge to the 2011 pension law, which raised retirement ages and suspended pension increases.

The proposed settlement offers retirees a modest pension increase — $500 — with the promise of additional increases sooner than the current law. But it retains most of the sweeping changes approved by lawmakers — and the billions of dollars the law is expected to save the state and its municipalities in coming decades.

The settlement must be approved by public workers, retirees and state lawmakers. If the proposal is rejected at any stage, the lawsuit would continue.

Public workers and retirees interviewed by The Associated Press expressed a range of opinions — from resigned support to dissatisfaction with their own union leaders.

"I think they caved on a lot of things," said Matt DiMaio III, 57, of North Providence, who retired last year after spending 30 years in the state's insurance regulation office. "I worked for less money (in a state job) for years because it was going to be made up at the end. I think we need to take the chance in court."

But the risk of losing an expensive legal fight — and getting nothing — has other workers endorsing the settlement. University of Rhode Island employee Mike McDonald, who is vice president of his local union, said the deal would bring closure to years of bruising political and legal wrangling between public workers and retirees and state leaders.

"It's never going to be as good as it was, but it's better than what we have now," the 54-year-old McDonald said. "It's 'take what you can get.' I'd like to put this to bed. Get it over with."

Rhode Island had one of the most troubled pension systems in the nation before lawmakers passed the overhaul in a special legislative session. The Rhode Island Retirement Security Act was designed to save an estimated $4 billion for the economically troubled state over the next 20 years.

Many of the 66,000 state workers, teachers and municipal workers and retirees covered by the state retirement system complained that the changes amounted to broken promises and an unconstitutional change to their benefits. The legal challenge to the law was the subject of closed-door settlement negotiations for more than a year, while the law was heralded — and derided — across the country as other states looked to address their own pension problems.

Under the law, cost-of-living pension increases were suspended for five years, with regular increases expected to return when the pension fund grew to healthier levels. The settlement would give retirees a $500 increase, with increases of up to 3.5 percent every four years beginning in 2017.

Also, as part of the deal, employees with 20 years of service could keep their existing pension plan instead of receiving a hybrid plan that combines a pension with a 401(k)-type account. All other workers would receive the hybrid plan, though governments would contribute slightly more to workers with more years of service. Employees would also pay slightly more toward their own retirement than under current law.

Pension bill passes Oklahoma state Senate committee
By Randy Ellis, Published: April 2, 2014

A bill designed to switch new state employees who participate in the Oklahoma Public Employees Retirement System from a defined benefit plan to a 401(k)-style defined contribution plan was approved Tuesday by the state Senate Pensions Committee.

House Bill 2630 passed the committee 5-2 on and will now go to the full Senate.

Committee Chairman Rick Brinkley, R-Owasso, debated in favor of the bill, contending changes are needed in Oklahoma’s pension system to attract and better serve young workers who change jobs often.

The proposed defined contribution system would enable new workers to contribute between 3 and 7 percent of their salaries into the retirement system and receive a dollar for dollar match from the state. Participants would become 20 percent vested in the retirement system after one year and that percentage would increase annually until they become completely vested after five years.

Employees who leave their jobs after one year or more would be entitled to not only get their own contributions back, but also a percentage or all of the state’s contribution, plus investment earnings, depending on how long they worked for the state.

Under the existing defined benefit system, workers don’t become vested at all until they have worked 7.5 years for the state, which means employees who leave before then only receive their personal contributions back, with no investment earnings or state match.

Brinkley said the state benefits financially at the expense of employees if they leave before 7.5 years, a situation he described as “unconscionable.”

State Sen. Tom Ivester, D-Elk City, debated against the bill, questioning whether enough financial analysis had been done to make sure this was the best move for the state.

Kentucky Teachers' Pension System Still Underfunded in New State Budget

BY JONATHAN MEADOR | KENTUCKY PUBLIC RADIO

An attorney with Kentucky's public schoolteachers' pensions says that the fund could run out in about 20 years if lawmakers don't act.

In the recently passed $20 billion state budget, lawmakers gave only half of the requested amount to the Kentucky Teachers Retirement System, which provides pensions for the state's public school teachers.

Beau Barnes is general counsel for the KTRS. He says that he's optimistic that lawmakers will begin addressing the underfunded pension, which currently has nearly $13 billion in debt, but a plan must be implemented soon, or the debt will grow exponentially larger.

"If a pension fund does not have a funding plan in place, then we'll have to use a worst-case scenario projection of what the actual unfunded liability's going to be. In that case it's almost going to double our unfunded liability to about $23 billion," he said.

Barnes says if nothing is done soon, the pension will have to start selling off some of its assets just to make payroll

Actuaries note risks, costs in changes to Alaska teacher pension fund

Pat Forgey, April 3, 2014

JUNEAU -- A new actuarial analysis released Thursday shows that a legislative plan to slow payments into the Teachers' Retirement System will save money early but cost the state in the long term.

"The models do show a cost for proposed delayed funding. Costs are increased by billions of dollars in order to save on funding today," said the analysis, by Gabriel Roeder Smith & Company, which was contracted for by the Legislative Budget and Audit Committee, chaired by Sen. Anna Fairclough, R-Anchorage.

The legislative plan's supporters disputed the analysis.

GRS is an actuarial consulting firm that has also worked for the Alaska Retirement Management Board, overseeing the work of the state's primary actuaries, and was already familiar with the Alaska retirement systems.

The House Finance Committee earlier this week proposed a radical change to the Teachers' Retirement System under which instead of setting aside money in trust funds to pay for pension and health care benefits that are being earned, and have already been earned, would shift those costs to future generations.

Known as a pay-as-you-go plan, it would deplete the Teachers' Retirement System trust fund and eventually rely on annual appropriations to pay retirement benefits. It was proposed by Rep. Bill Stoltze, R-Chugiak, and Legislative Finance Director David Teal.

The committee adopted that change prior to receiving the actuarial analysis that was released Thursday, and over the objection of Rep. Cathy Munoz, R-Juneau, and several other committee members.

The GRS actuarial analysis shows that under the Stoltze/Teal plan, costs for TRS contributions over the coming decades will increase from $8.9 billion to $24.9 billion, and will extend the length of time for which the state and school districts would be on the hook for making those payments for 20 to 30 years, likely to 2073.

But Teal called the GRS comparison of current and future payments "nothing short of nonsense."

"The billions of dollars in future costs cannot be compared to current dollars unless one believes money has no time value," Teal said.

The GRS analysis also warned the pay-as-you-go plan would result in risk to the state or to retirees that benefits might not be paid.

"Any time that funding is decreased to a pension system, that pension system is introduced to greater risk -- namely, the risk that a volatile event could quickly deplete the funds within the trust," the analysis said.

Teal agreed that his proposal to decrease funding did increase risk but pointed out there was already risk of market volatility, such as a fall in stock values, under any system in which the state is responsible for employees' retirements.

GRS's comments aren't specific to his plan, Teal said. "It is a condemnation of defined-benefit plans in general."

The proposed change to TRS, which provides traditional retirement for those who began work before the defined-benefit plan was replaced with a 401(k)-style plan in 2006, is one of the major changes made by the House Finance Committee to Gov. Sean Parnell's omnibus education bill, House Bill 278. It is scheduled for a House floor vote Friday.

Alaska has about $12 billion in combined unfunded liability in its TRS and the Public Employees' Retirement System.

Parnell has proposed paying $3 billion into the PERS and TRS plans this year, including the $1 billion required annual payment and an extra $2 billion in order to reduce future costs. Legislators removed that amount from the budget Parnell proposed but until the action on TRS this week had not said what they planned to do instead.

And legislators have still not said how they would deal with the PERS unfunded liability, but the questions asked of GRS suggest they are looking at a similar pay-as-you-go plan.

For PERS, the actuary said, that method would boost costs from $15 billion to $42.7 billion.

No such plan has been introduced in public yet, and Sen. Pete Kelly, R-Fairbanks, has said he's still working on the PERS issue.

Contact Pat Forgey at pat(at)alaskadispatch.com.

Lawmakers close to finalizing revisions for state retirement system

By Bill Cotterell, Scripps/Tampa Tribune Capital Bureau, April 3, 2014

TALLAHASSEE — Legislative leaders are closing in on a compromise to revise the massive Florida Retirement System, building on a failed measure from last year that scuttled a major overhaul of the pension plan covering nearly a million Floridians.

House Speaker Will Weatherford has sought for years to close the traditional “defined benefit” plan, citing an unfunded liability of some $21.6 billion that costs government employers $500 million a year to shore up. But organized labor, particularly school teachers and law-enforcement unions, want to keep things as they are, saying the plan is by all measures a healthy one.

“I think there’s some very positive comment coming from the Senate,” Weatherford said after the House adjourned on Wednesday. “I’m cognizant that the bill I filed last year is not going to pass the Senate this year, so we’re working on a middle ground.”

The Florida Retirement System is the pension plan for state employees along with workers in 186 cities, 267 independent hospitals and special districts, and other jurisdictions. It has 627,800 active members and 348,000 retirees, according to legislative staff analysis.

Sen. Jack Latvala, R-Clearwater, said Wednesday any major pension changes will be a tough sell in the Senate. Senate President Don Gaetz, R-Niceville, said last month he was advised there were at least 18 “no” votes on pension reform, so even a couple of undecided or wavering senators could stop anything from passing the 40-seat body.

“I’m talking to them about how we might get to a point that I’d be comfortable with, and some of the folks who didn’t want any drastic changes would be comfortable with,” Latvala said. “The votes are not there to make changes in the FRS, anything major, unless we could work out a sensible bill. The votes just aren’t there.”

PAST EFFORTS

Last session, Weatherford won House passage of a bill that would have closed the traditional “defined benefit” pension plan to newly hired employees after July 1 of this year, directing them to join a 401(k)-style “defined contribution” investment plan. Weatherford estimated this would save $60 billion over 30 years as current employees phase out of the pension system and are replaced by workers in the investment plan.

That idea flopped in the other house, where Sen. Wilton Simpson countered with a bill that would have let new FRS members continue joining the traditional pension plan, with its guaranteed monthly payouts, while offering them financial incentives to opt into the investment plan. The incentive included a reduction in their salary contribution from 3 percent to 2 percent.

Simpson, R-Trilby, also proposed making elected officials and members of the senior management employment class join the investment plan. But his bill evenly split the Senate in the closing days of the 2013 session and nothing passed.

This year, Simpson proposed a “cash balance” pension compromise, in which new employees would be offered an investment plan with a guaranteed 2 percent earning rate. Any losses would be born by employers, and workers could build up a large retirement fund that they could roll over into an IRA or new employer’s plan when they left state government.

But Simpson conceded this week that the cash-balance option was doomed and, with no Senate prospect of passing Weatherford’s close-the-FRS plan, he reverted to the bill he had last year.

This time, the powerful speaker is more amenable. A bill on the House State Affairs Committee agenda for Friday embodies the parts of Simpson’s failed plan from last year.

SEARCH FOR SUPPORT

The House and Senate ordered up an actuarial study on pension options Jan. 17, six weeks before the session, but the figures are not expected to be delivered until April 21 — when there will be just two working weeks left in the session. Gaetz this week told the Division of Retirement to quit costing out the cash-balance plan and start updating the numbers on Simpson's bill from last session, plugging in new projections of wages and numbers of employees.

As bait for union support, several legislators proposed a "carve out" for law enforcement, firefighters and other first responders. They are in the "special risk" retirement plan, with a higher annual accrual rate and shorter career span because of the danger and rigors of their work.

Matt Puckett, executive director of the Florida Police Benevolent Association, said the union remains uncommitted. The union wants to see the numbers, both in the actuarial study and in whatever bill is hammered out between Simpson, Latvala and the House leadership.

"I'm really uncomfortable making any comment until I see what's going to be out there," Puckett said. "I want to see what the deal is going to be."

Weatherford said Wednesday he might have overreached last year, with his bill closing the FRS to new hires and putting all new workers in the investment plan.

"In your first session (as speaker), you tend to swing for the fences a little bit," Weatherford said. He estimated that Simpson's proposal from last year could save "somewhere in the $26 billion to $27 billion range" over 30 years, or half what his plan might have cut pension costs.

"That's significant improvement. That's game-changing for our pension system," the speaker said.

Simpson emphasized that "we're not messing with anybody's pension" and that any changes would only apply to first-time members of the FRS hired after July 1, 2015, or another date well in the future chosen by lawmakers. Current employees could keep what they have, if they like it, he said.

GROWING LIABILITY

But Simpson also stressed that if the Legislature doesn't make changes, the unfunded liability will grow, threatening the finances of current employees and older retirees.

"You need to turn the plan like you would a battleship. The bill we had last year turns it 45 or 50 degrees and I think that's a very good place to start from," Simpson said. "It's not a question of 'What can you pass?' It's that we need to do this for the future of the retirement system in Florida."

Simpson cited cities like Detroit and states like California, where long-simmering pension costs have boiled over. He said Florida can't carry an unfunded liability indefinitely.

"The truth is, the best way to probably kill the pension is to do nothing," he said.

Opponents of the reform measures disagree, calling them a solution in search of problem.

They contend that any funding level above 80 percent, as is the case with the Florida Retirement System, is considered healthy by pension actuaries. They say closing the traditional plan to new members would work like an hour glass as more employees retire year-by-year and fewer active members remain in the pension plan to fund their benefits.

“We see no reason, no rationale, no data, no justification for any change to the FRS,” Rich Templin, legislative and political director of the Florida AFL-CIO, said Thursday. “The fund is in great shape by any actuarial measure. We’re just on this merry-go-round every year, where they just try to see what they can do for political reasons.”

Templin noted that Gov. Rick Scott levied a 3 percent pension fee on FRS member salaries in 2011, his first legislative session. He said that is popular with the Republican base, for this election year, but that there is no need for the state to shut down the traditional pension plan.

“We’ve just had a sweeping overhaul of the pension system, the 3 percent, that’s generating $900 million to $1 billion for employers,” said Templin. “This is not about public policy, but about politics.”

Minn. teacher retirement funds would get aid

ST. PAUL - Minnesota legislators are looking into ways to help two teacher retirement funds.

An overall pension bill that nears a full House vote would provide $15 million a year to ensure a successful merger of the financially troubled Duluth Teachers Retirement Fund Association and the Teachers Retirement Association, an organization serving teachers across the state. The bill also would provide $7 million annually to keep the St. Paul Teachers Retirement Fund Association fiscally sound.

The money involved with the Duluth fund would continue for 24 years. Leaders of that fund have told lawmakers that a better financial picture is doubtful because more retirees are getting benefits than there are current teachers to fund the system.

Pace of pension reform ebbs after 49 states change laws

Post-recession focus shifts to making DC plans mandatory

By: Hazel Bradford, PENSIONS & INVESTMENTS, Published: April 14, 2014

As the flood of reform efforts aimed at public pension funds becomes a trickle, the main concern is whether the newfound fiscal discipline will hold.

While the sense of urgency has diminished, reform attempts have become a legislative staple, as public retirement systems continue to grapple with unfunded liabilities and political pressure to change.

The financial crisis and its aftermath sparked some kind of pension reform in every state except Idaho. Now “it appears to be the slowest pace of reforms since 2008,” said Keith Brainard, Georgetown, Texas-based research director of the National Association of State Retirement Administrators. In a study of 32 plans in 15 states representing 65% of participants in its public plans database, the Center for Retirement Research at Boston College found most already have taken steps to reduce future pension costs by some combination of increasing employee contributions, raising age and tenure requirements, trimming salary calculation formulas used to set pension levels and shrinking or stopping cost-of-living increases.

Surprisingly, while reform debates were often seen as taking a page from the private sector and moving away from defined benefit plans, research due later this spring from the center will show less activity than expected. CRR researchers found that just 15% of public plan sponsors introduced some form of defined contribution plan after 2008, compared with 20% pre-crisis.

A key distinction of the post-recession approaches to DC plans is their mandatory nature, unlike earlier moves that gave employees the option of having a DC plan. Six states — Georgia, Michigan, Rhode Island, Utah, Tennessee and Virginia — shifted to a mandatory hybrid plan since 2008, while Kentucky and Kansas went the cash balance plan route. Louisiana tried to mandate DC participation but was blocked by the courts after participants sued. Only Michigan and Alaska require new hires to participate solely in a defined contribution plan.

Many of the reforms to date have focused on newly hired workers. Those savings will take longer to realize, “but in the long run these cuts are going to get the costs below what they were before the recession,” said Alicia Munnell, director of the retirement research center. “That does take care of the criticism that they can't afford DB.”

In terms of reform attempts, the National Conference of State Legislatures found 29 states saw 166 pension bills introduced in 2014 alone, many of which addressed minor changes or proved too controversial to survive. One of the most high-profile reform bids came from Chuck Reed, the mayor of San Jose, Calif., who sought a voter referendum to allow local governments to renegotiate pension benefits for public employees. That bid was defeated in court last month.

Alive in just a few states

With many state legislative bodies already adjourned for the year, major pension reform is alive for now in just a few states: Lawmakers in Florida and Oklahoma are considering a shift to DC plans only for newly hired workers; in Pennsylvania, Gov. Rick Corbett is pushing the idea of a hybrid plan.

But the political prospects in all three states are far from certain.

One big reason things have gotten quieter is the improving economy.

Wilshire Consulting, a unit of Wilshire Associates Inc., Santa Monica, Calif., found the aggregate funding ratio of 134 state defined benefit plans reached 75% in the fiscal year ended June 30, thanks largely to strong global equity markets that saw pension fund assets growing faster than liabilities.

The U.S. Census Bureau found that the 100 largest public pension funds reached their highest combined asset levels in 2013 since its first survey in 1968. Assets reached $3.192 trillion last year, a 12.5% increase from 2012.

For many public pension plans, investment losses since 2008 are just making their last appearance on balance sheets, but recent investment gains haven't been booked yet. Reforms passed in recent years should be given time to work before judging plans' ongoing health, say public pension experts.

While some of the most recent reform efforts were driven by ideology, in other cases “it has been an effort to simply not pay for years of underfunding” or to avoid other spending cuts, said Steven Kreisberg, director of collective bargaining for the American Federation of State, County and Municipal Employees, Washington.

“We are seeing a few governors going back to the well out of political desperation. Beyond that, there's not much new or different.”

Jordan Marks, executive director of the National Public Pension Coalition in Washington, whose members include public-sector unions, said: “There's no question that we are seeing public pension funds on the mend, but we'd be doing a lot better if politicians made their payments.”

David Draine, senior researcher with Pew Charitable Trust's Public Sector Retirement Systems Project, Washington, said he's seen recent improvement, with some legislatures passing laws or even amending state constitutions to ensure pension payments are made, regardless of who is in office.

Commitment

“What you're seeing is a commitment by policymakers to good pension funding practices. There's no single thing that will absolutely guarantee fiscal discipline, but policymakers are understanding that they need to pay pension bills,” said Mr. Draine.

“We need to be serious about funding these plans,” agreed Ms. Munnell. “You can either pay it off in a systematic fashion, or not, but these amounts are going to be paid.”

One new wrinkle in 2014 that could dampen recent improvements is Governmental Accounting Standards Board rules that will, for the first time, add another number to the political equation: net pension liability. Until now, public pension fund executives focused on their actuarially required contribution when setting annual pension funding targets.

Adding a system's total unfunded liability, instead of just the current amount due, to its financial reports will make an underfunded plan look worse, and even a relatively well-funded one look less so. “I worry about losing the ARC,” said Ms. Munnell. “After the new GASB kicks in, it will just be harder to judge whether sponsors are doing a good job.”

Dana Bilyeu, Salt Lake City-based executive director of the National Association of State Retirement Administrators, is optimistic. “Change is inevitable because we live in a different world today since 2008. But the basic pillars of plan design — mandatory participation, shared financing, benefit adequacy, pooled investment and longevity risks, and lifetime benefit payouts — have not changed,” she said.

Pension subsidies pass the House

By Charley Shaw, Session Daily, April 11, 2014

The long-term financial outlook for Minnesota pensions would improve if a bill that passed the House Thursday becomes law.

The omnibus pension bill, HF1951, sponsored by Rep. Mary Murphy (DFL-Hermantown), which passed 79-52, contains several provisions aimed at shoring up unfunded liabilities for public pensions. It now goes to the Senate, where Senate President Sandy Pappas (DFL-St. Paul) is the sponsor.

The bill would merge the Duluth teacher pension fund into the statewide Teachers Retirement Association. The Duluth pension was 54 percent funded as of July 1, 2013, and the demographics of the plan suggest it won’t be able to recover on its own, according to testimony earlier this session in the Legislative Commission on Pensions and Retirement. The merger comes with $15 million in annual state aid for 24 years so TRA members won’t have to cover the unfunded liabilities in the Duluth plan.

Rep. Mike Benson (R-Rochester) unsuccessfully tried to amend the bill to delay the merger and study moving the Duluth pension to a defined contribution plan similar to those offered in the private sector. He said the current defined benefit style of pension, in which the government assumes the risk for paying retiree benefits, could create larger pension costs in the future. "We're going to pump money into a system that can't survive," Benson said. "It's going to continue to shrink. And we're going to be back here when the market has a 30 percent correction going, 'What are we going to do now?'"

Rep. Michael Nelson (DFL-Brooklyn Park) said the problems with the Duluth pension are the result of bad policies enacted by previous state Legislatures. "These pensions are things that people earn while they were working, and we owe them that promise," Nelson said.
Similar to the state aid for Duluth, the bill would provide $7 million in annual funding to stabilize the St. Paul teachers pension fund, which was 64 percent funded as of July 1. But the bill leaves the St. Paul pension independent rather than merging it with TRA. Rep. John Lesch (DFL-St. Paul) said it would cost more than $38 million to merge St. Paul teachers with TRA. "This is far less expensive to do it this way," he said.
The bill also contains contribution increases for employers and employees in two statewide pension plans: the Minnesota State Retirement System and the Public Employees Retirement Association. Because the two pensions have had funding deficiencies for the last two years, state law requires them to request increased contribution rates to stabilize the plans.

Finding Common Ground

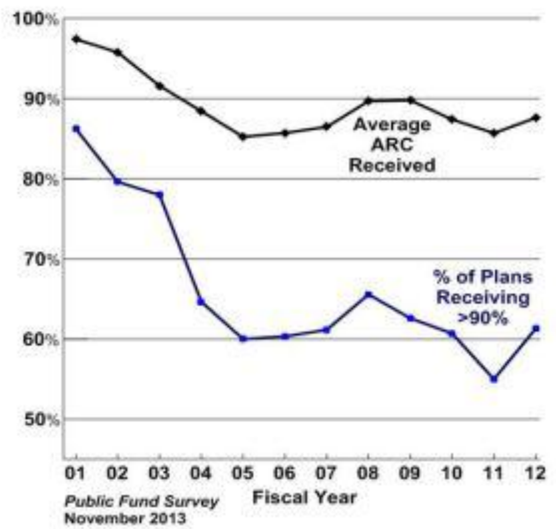
Pension Dialogue - April 17, 2014

In a week of yet more questionable research, dire predictions, and differing agendas, one analysis focused on what is particularly important: improving pension funding discipline.

As we've said before, employees always pay their full required contribution. Likewise, it is vital that municipalities make what actuaries say is needed to meet annual obligations, known as the ARC.

The Public Fund Survey Summary of Findings shows the effects of declining ARC effort during and after the Great Recession. While subsequent alterations to plans have increased some employees and employer contributions,

Implementing higher contributions, from employees and employers, takes time, as the effect of changes, such as investment losses, must first be measured through an actuarial valuation; then a legislature or other governing body must approve new contribution rates. This cycle, from actuarial event to implementation of higher contribution rates, can take several years.



Along the way, other political pressures could come to play as what happened this year for New Jersey and Maryland.

As Columbia Management Investment Advisers said,

We believe that, while in some cases extremely painful in the short-term, improved annual funding is key to the long-term sustainability of these pension plans and that full ARC funding should lower unfunded liabilities in the long-term, provided various actuarial assumptions are met.

The significance of funding is the one thing nearly everyone can agree on. Consider three quotes from a recent *Pensions & Investments* article:

'There's no question that we are seeing public pension funds on the mend, but we'd be doing a lot better if politicians made their payments.' Jordan Marks, executive director of the National Public Pension Coalition

'What you're seeing is a commitment by policymakers to good pension funding practices. There's no single thing that will absolutely guarantee fiscal discipline, but policymakers are understanding that they need to pay pension bills.' David Draine, senior researcher with Pew Charitable Trust's Public Sector Retirement Systems Project

'We need to be serious about funding these plans. You can either pay it off in a systematic fashion, or not, but these amounts are going to be paid.' Alicia Munnell, director of the Center for Retirement Research at Boston College

How do you get lawmakers to pay the ARC?

Calling for government action is easier said than done. At a 1978 panel discussion with the Society of Actuaries discussing the funding of public plans, Mr. E. Allen Arnold, explains:

An actuary has two kinds of problems: Actuarial problems and people problems.

The people problems actuaries encounter, working with public retirement systems, transcend those of private plans. There are three reasons:

First: Politics

Second: The need to satisfy more individuals, committees, legislative bodies and possible conflicting interests, rather than one individual or committee. And

Third: Politics.

Politics is counted twice: internal politics arising from differences on the retirement board, administrative dichotomy and employer-employee conflicts; and external politics as practiced by elected officials and those with special interests.

There are some who are finding ways to make lawmakers accountable—or to at least pay attention.

The Kentucky Government Retirees used social media to relentlessly message about the need to secure the ARC. They called on fellow retirees to send letters and make phone calls to legislators, as well as publishing op-ed pieces and letters to the editor to garner public support. Governor Steve Beshear included the full ARC in his 2015 budget request, and lawmakers concurred. The full ARC will add $191 million to employer contributions starting next fiscal year, money that is sorely needed given the plan's current 23.2 percent funding ratio.

Tennessee is debating a bill that would require cities, school districts, utilities and other entities with their own pension plans to contribute of their ARC. If they fail to do so, the state could then divert tax money normally disbursed to the municipality to pay the bill.

For those states and local governments who have not been paying their ARC, why are not all energies and efforts—by stakeholders including unions and retirees, as well as the various interested reformers—focused on this most critical aspect