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7700 East First Place
Denver, Colorado 80230
Phone: (303) 364-7700
www.ncsl.org

Highlights of State Pension Reform in 2012

Ronald Snell

Seven states have enacted sweeping structural pension reforms in 2012—Alabama, Kansas, Louisiana, New York, South Carolina, Virginia and Wyoming—affecting various sets of state and local government employees. This year's legislation affected almost all state and local government in employees in Alabama, Kansas, New York, South Carolina, Virginia and Wyoming, and focused on state government employees in Louisiana. In addition, major reforms were considered or are under consideration in California, Michigan, New Hampshire, Ohio, and Rhode Island, some of which could be enacted later in 2012.

Six of the seven states that enacted major legislation in 2012 had already undertaken pension reform in the past three years. The addition of South Carolina to the list has increased the number of states that have enacted major reforms from 2009 through the present to 44. California and Michigan are among the 43. The other six states either had acted before 2009, like Alaska, or, like Idaho and Tennessee, have been less damaged than most in the crisis of public pension funding that has swept the country.[i]

This multi-year wave of reform is intended to address the long-term funding issues of public pension plans. The severity of investment losses in the past two recessions, slow growth in the economy and the slow recovery of state revenues mean that average plan funding levels continue to disappoint. Figures from the Pew Center on the States indicate an average funding level for state plans in 2010 to be at 75.2 percent of actuarial liabilities. Another recent study sponsored by the National Conference of Public Employee Retirement Systems includes many municipal and county plans in its base, and reports a 2012 funding ratio of 74.9 percent.[ii]

This report provides an overview of changes enacted in the seven states listed in the first paragraph above. More detail on their legislation and on other states' enactments in 2012 is available in the NCSL report *Pensions and Retirement Plan Enactment in 2012 State Legislature.*[iii]

Alabama. Act 377 of 2012 (Senate Bill 388)

This legislation creates a new tier of membership for the Employees' Retirement System (ERS), the Teachers' Retirement System (TRS), and the ERS plan for state police, affecting those who first join one of the plans on or after January 1, 2013. It reduces employee contribution and reduces future benefits in a number of ways.

The legislation reduces required employee contributions for all Tier II members except state police members, in comparison with rates for Tier I members.

PLAN	TIER I	TIER II
ERS and TRS	7.5%	6%
ERS State Police Plan	10%	10%
ERS other law enforcement and fire	8.5%	7%

For all members, the base for final average salary is changed from the highest three of the last 10 years of service to the highest five of the last 10.

The Tier I provision for retirement in any of the plans after 25 years of service (25-and-out) will not apply to Tier II. Age and service requirements for normal retirement for TRS members and general state and local government employees are changed from age 60 with 10 years of service (the vesting requirement) to age 62 with 10 years of service.

For state police, the change is from age 52 with 10 years of service to 56/10. For other state and local law enforcement members and firefighters, the change is from the former provisions of 25-and-out or 60/10 to 56/10.

The service multiplier for TRS and ERS members (including law enforcement, other than state police, and firefighters) was reduced from 2.0125% of FAS for Tier I members to 1.65% of FAS for Tier II members, with benefits for Tier II members capped at 80% of final average salary. The multiplier for state police members was reduced from 2.875% to 2.375%.

Kansas. Chapter 171, Laws of 2012 (House Bill 2333)

The Kansas Legislature concluded a two-year reconsideration of its defined benefit (DB) plans for state and local government employees with provisions that will require higher contributions from most employees (depending on their tier and the option they individually elect for the future) in the DB plan. That plan will be closed to new members and replaced with a cash balance plan for those who are hired on or after January 1, 2015.

A cash balance plan

- Provides each member with an individual account.
- Employees and employers contribute to the account.
- The member cannot choose how the money is invested.

- Members' accounts are managed in one trust fund, and members are guaranteed a return on investment.
- If investment return makes it possible, member accounts can receive additional returns.
- In public plans, upon retirement, the member receives an annuity based on the account balance and may have additional benefit options.

The Kansas cash balance plan will have these features:

- Employee Contribution: 6%
- Employer Credit to Account: 3% to 6% depending on years of service (4% at 5 years, 5% at 12 years, 6% at 24 years).
- Guaranteed Interest Credit: 5.25% annually with possible additional dividends if investment experience warrants.
- Vesting in employer credits: 5 years.
- At retirement, all balances will be annuitized, except members may withdraw up to 30% of their balance in a lump sum.

Louisiana. Chapter 483, Laws of 2012 (House Bill 61)

Louisiana will close its defined benefit plans for most state employees, including employees in the higher education system, and replace them with a cash balance plan for new members as of July 1, 2013. The plan is optional for other education employees.

- Employee Contribution: 8%
- Employer Credit to Account: 4%
- Interest Credit: 1% below the actuarial rate of return for system, not to fall below zero. Additional interest credits are possible if investment experience allows.
- Vesting in employer contributions: 5 years, same a current plans.
- At a minimum of age 60 with five years of service, a member may retire with a lifetime annuity based on the account balance, or may choose a partial lump sum withdrawal and a reduced annuity.

New York. Chapter 18, Laws of 2012 (Senate Bill 6735/Assembly Bill 9558: identical bills)

In March 2012, New York created Tier VI retirement plans affecting most new members of the state and New York City retirement plans as of April 1, 2012.

The changes include a new contribution schedule in which the required employee contribution varies with compensation; an increase in the normal retirement age; a reduction of the retirement multiplier; a change in the computation of final average salary to base the average of five years instead of three; a cap on the total amount of salary that can be included in final average salary; and an optional DC plan for highly-compensated employees.

Members of Tier VI will contribute 3.5% of compensation to the plan until April 2013, when the following contribution schedule will go into effect. [For comparison, teachers in Tier V contribute 3.5% of salary and general state and local government employees contribution 3% of salary.]

- The schedule is based upon regular compensation in the year two years previously:
  - Wages of $45,000 or less..................3%
  - More than $45,000 to $55,000..........3.5%
  - More than $55,000 to $75,000..........4.5%
  - More than $75,000 to $100,000........5.75%
  - More than $100,000 to $179,000......6%
  - No contribution on earnings in excess of the governor's salary, currently $179,000

The legislation also:

- Increases the retirement age to 63 for retirement with an unreduced benefit (an increase of one year for most affected employees).
- Mandates a 5-year final average salary (FAS) calculation using regular compensation for determining retirement benefits. [Tier 5 for teachers and ERS: highest 3]
- Excludes from the FAS calculation wages exceeding the average of the previous four years by more than 10%. [currently for Tier 5 both teachers and ERS, previous two years]
- Multipliers for calculating pension benefits were changed to provide a financial inducement for employees to stay in service for 30 years.

South Carolina. Act 278, Laws of 2012 (House Bill 4967)

Act 278 increases employee and employer contribution rates for the South Carolina Retirement System. The increases affect current members and new hires. Employee contributions will increase from the current rate of 6.5% to 8% in 0.5% increments beginning on July 1, 2012 with the final increase effective on July 1, 2014.

The legislation also increases age and service requirements for retirement benefits, and reduces benefit levels.

- *Final Average Compensation*. For new general and Police Officer members as of that date, final average compensation will be based on the member's five highest years of earned compensation instead of the three highest years.
- *Retirement Eligibility*. Under existing law, general members may retire after 28 years of service to be eligible for full benefits and are eligible for reduced benefits at age 55 with at least 25 years of service. For new non-Police members as of July 1, 2012, full benefits will be available at age 65 with eight years of earned service credit or under the Rule of 90. Reduced benefits will be available at 60, with eight years of service. The benefit reduction will be 5% for each year the member is below the age of 65.
- *Vesting.* For new general and Police Officer members as of July 1, 2012, the vesting requirement will be eight years instead of the current five years.
- *Cost-of-living Increases.* Future cost-of-living increases will be capped at $500 a year.

Virginia. Act 702 of 2012 (HB 1130) and Act 822 of 2012 (Senate Bill 497)

Act 702 establishes a hybrid plan applicable to new state and local government employees. Except for those in law enforcement or hazardous occupations. The bill also makes some changes to existing defined benefit plans for non-vested employees, which are not summarized here.

The hybrid will have a defined benefit (DB) and a defined contribution (DC) component for each member. Each member of the hybrid plan will be required to make contributions to both the DB and DC component.

- The employee contribution to the DB component will be 4%. The employer contribution will be actuarially determined, and will be the same as the employer contribution for the closed DB plan; this will provide additional employer funds, over time, to amortize the unfunded liability of the closed plan.
- The new DB plan will have a multiplier of 1% . Age and service requirements and the calculation of final average salary and benefits will be the same as in the closed DB Plan 2.
  The mandatory employee contribution to the DC component will be 1%, and employees may contribute up to 5% of salary to earn a partial employer match.
- Employer contributions to each employee's DC account will be as follows:
  - For the 1% mandatory employee contribution, 1% of salary.
  - For the first 1% voluntary employee contribution, 1%.
  - 0.5% for each additional 1% voluntary employee contribution, up to the full 5% that is subject to match.
  - The total possible employer contribution would be 3.5% on a 5% employee contribution.
- Vesting of employer contributions will begin at 25% after an employee has participated continuously in the program for one year, increasing at 25% a year until the employee is fully vested in the employer contribution after four years of continuous membership.

Act 822 of 2012 **(**Senate Bill 497) affects contributions to the Virginia Retirement System from local governments and local government employees. It provides that:

- School division and political subdivision employees whose employers currently pay all or part of the 5% Plan 1 or Plan 2 member contribution will begin paying the contribution on a salary reduction basis on July 1, 2012.
- Employers may, at their option, phase in the member contribution over five years, except that new or returning employees as of July 1 must make the entire 5% contribution.
- Localities and school boards are required to increase employee compensation on 7/1/12 to offset the member contributions.
- The offsetting raise is to be effective July 1 unless a government is phasing in the member contribution.
- Plan 1 or Plan 2 employees who were paying the member contribution or some portion of it as of January 1, 2012, will not receive an offsetting raise for the amount they were already paying as of that date.

Wyoming. Chapter 107, Laws of 2012 (Senate Bill 59) and Chapter 108, Laws of 2012 (Senate Bill 97)

Chapter 107 expresses the intent of the Legislature that the board of trustees of the Wyoming Retirement System (WRS) grant no post-retirement benefit increases until the system is fully funded with a likelihood of remaining so despite future investment fluctuations. The act instructs the Board of Trustees to educate members on the point and emphasize to them that public retirement benefits "should not be expected to provide one hundred percent (100%) of the member's required income in retirement…."

[Under existing law, as summarized in the WRS Public Employee Pension Plan Handbook, the WRS Board may grant an annual cost of living increase up to the actual inflation rate in Wyoming, but not above 3%. The COLA must be deemed affordable by the actuaries who compare total liabilities to assets of the plan.]

Chapter 108 increases age requirements and changes benefit provisions for normal and early retirement for members of the Wyoming Retirement System (WRS) whose service begins after August 31, 2012, as well as for previous members who return to covered service but who withdrew their contributions when they left covered service earlier, or who left with fewer than four years of service (certain exceptions apply).

- The calculation of final average salary will be based on the member's highest paid five years of continuous service (formerly, three highest continuous years);
- Normal retirement will be at age 65 with four years of service (formerly 60/4), or under the Rule of 85 as in existing law;
- Early retirement will be available at age 55 with four years of service or before age 55 with 25 years of service, in both cases with an actuarial reduction in benefits as set by the Board of the WRS (formerly, 50/4 or any age with 25 years of service and a 5% per year reduction);
- The multiplier for calculating benefits is set at 2% (formerly 2.125% for the first 15 years of service and 2.25% for additional years of service).
- The multiplier for firefighters will remain at 2.5% as previously.

Contact:
Ron Snell: ron.snell@ncsl.org
303-856-1534

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[i] National Conference of State Legislatures, *State Pension Reform, 2009-2011* (Denver, Colo., March, 2012). http://www.ncsl.org/issues-research/labor/state-pension-reform-2009-to-2011.aspx

[ii] Pew Center on the States, "The Widening Gap Update (Washington, D.C., June 2012). http://www.pewstates.org/research/reports/the-widening-gap-update-85899398241

National Conference on Public Employee Retirement Systems and Cobalt Community Research, *The NCPERS 2012 Fund Membership Study* (Washington, D.C., June 2012). http://www.ncpers.org/Files/2012_ncpers_public_fund_study_report.pdf

[iii] http://www.ncsl.org/issues-research/labor/2012-enacted-state-pension-legislation.aspx