STATE PENSION REFORM, 2009-2011

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Introduction

From 2009 through 2011, 43 states enacted major changes in state retirement plans for broad categories of public employees and teachers to address long-term funding issues. Their changes were designed to reduce pension fund obligations by increasing employee contributions or age and service requirements for retirement, or both, and adjusting benefit provisions in various other ways that reduce costs. Such legislation was rare before 2005, but became national in scope from 2009 on. Ten states made such changes in 2009; 21 did so in 2010 and 32 did so in 2011. Several states acted more than once, for a total of 43 states over the three years.

By the end of the first decade of this century, state retirement plans had suffered an enormous reversal from their financial status in 1999, when the average funding ratio for 126 statewide plans (including the District of Columbia) reached a record high of 103 percent of accrued liabilities. Since then, two recessions have battered their assets. The slow recovery from the last recession has made it impossible for states to rebuild pension system assets. Some systems have also suffered from inadequate state contributions over a long period and from unfunded increases in benefits.¹ The Boston College Center for Retirement Research recently estimated the average funding ratio for the same 126 plans to be 77 percent in 2010.² Other analysts report similar numbers.³

Those ratios, however, depend on accepting state retirement plans’ assumptions about the value of their assets and the future investment return on them. Skeptics view the plans’ assumptions as unduly optimistic and have contended that some retirement funds are so poorly funded, when

¹ A recent survey of the interplay of declining asset values and inadequate contributions is Jagadeesh Gokhale, State and Local Pension Plans: Funding Status, Asset Management, and a Look Ahead,” (Cato Institute, Washington, D.C.:2012).
valued as the skeptics recommend, that they may run out of assets within a decade.\textsuperscript{4} The Boston College report does not make that claim, but does estimate that at market value, assets in 2010 covered only 67 percent of liabilities, and that under new accounting rules recommended by the Governmental Accounting Standards Board, assets would be measured as about 53 percent of liabilities for the same selection of plans.\textsuperscript{5}

Additional concerns are the aging of the state workforce and its increased propensity to retire, the inability of state budgets to accommodate higher employer contributions for years to come, questions about the different retirement policies provided by the private and public sectors, and a climate of opinion that questions public employee compensation compared to the grim outlook for employment, retirement benefits and health insurance in the country overall.

**Legislation in 2009-2011**

These issues have resulted in a record amount of legislation in the past three years to restructure the contribution and benefits provisions of state retirement plans.

Figure 1 shows the 43 states that enacted significant pension reform legislation for at least one statewide retirement plan for state employees or teachers from the beginning of 2009 through the end of 2011.

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\textsuperscript{4} Alicia Munnell, Jean-Pierre Aub, Josh Hurwitz and Laura Quinby, *Can State and Local Pensions Muddle Through?* (Center for Retirement Research at Boston College, March 2011, 2-3, and references.

Of the states not highlighted in the map, several acted on pension reform earlier in the decade, including Alaska, Kentucky and Oregon. Alaska and Kentucky continue to review the funding status and design of their retirement plans, and at the beginning of 2012, Ohio and South Carolina are considering major policy changes. Idaho and Tennessee have remained relatively immune from the storms that have battered the other states.

The following discussion of the kinds of changes states enacted generally does not identify the states making the changes for the sake of brevity. Individual state changes are reported for each year in NCSL’s annual summaries of retirement legislation. The changes made from 2009 through 2011 include:

**Employee Contributions**

- In 2009, six states increased mandatory employee contributions, in most cases only for new employees, but also for current employees in New Mexico and Rhode Island.

- In 2010, 12 states increased employee contributions. In seven states, the increase affected current employees and in five only new hires. Three of the latter group (Missouri, Utah and Virginia) previously had not required contributions for employees or had provided that employers would pay what was nominally an employee contribution. In Utah, the contribution requirement will come into effect only under certain actuarial conditions. Wyoming required that current and future employees make contributions that previously had been paid by employers.

- In 2011, 17 states enacted increases in employee contributions, including those required from at least some current employees in 14 of the 17 states. Since some states increased contribution requirements for different plans in different years within the period reviewed in this paper, 30 states in all have increased employees’ contributions from 2009 through 2011.

- A important trend in 2011 was to offset increases in employee contributions with reductions in employer contributions, which occurred in 10 states. In some instances the shift was described as temporary. Such a reallocation of the total contribution to a plan is not neutral for a retirement fund, even if the percentage changes are equal. That is because members who leave a system can withdraw their contributions. The change can mean such members can withdraw a higher share of the total contribution to the plan. Employee contribution increases that are coupled with employer decreases can reduce the growth of the employer’s obligation, but do not strengthen the funding of the retirement plan.

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Higher Age and Service Requirements for Retirement

- In 2009, five states enacted higher age and service requirements for pension benefits, generally only for new hires.
- In 2010, 11 states did so. However, in Vermont, the higher requirements will affect teachers who are more than five years away from retirement eligibility, and in Colorado members of the Public Employee Retirement Association who have less than five years’ membership.
- In 2011, 17 states enacted higher age and service requirements for benefits, again generally for new hires.

Reduced Commitment to Post-Retirement Benefit Increases (COLAs)

- In 2009, three states reduced the amount of post-retirement benefit increases they will pay retired people in the future.
- In 2010 eight states did so. In four of those eight, the reduction will affect only new hires when they eventually retire. In Rhode Island, the policy affected current members with less than 10 years of membership, and in Colorado, Minnesota and South Dakota, the reduction affected people already retired as well as those who retire in the future. The legislation faced legal challenges in each of those last three states as an unwarranted breach of contract.
- In 2011, 10 states reduced their commitments for future post-retirement benefit increases. In six of those states (Arizona, Florida, Maine, Maryland, New Jersey and Rhode Island), the changes affect current employees. In Maine, New Jersey and Rhode Island, the change will affect people who have already retired as well. Changes in Washington eliminated or limited future benefit increases for members of two closed plans.

Changes in the Formula for Calculating Benefits

All state defined benefit plans use a formula to calculate benefits based on a person’s final average salary and years of service credit. Final average salary usually is the average of between three and eight years’ compensation. The formula then provides a percentage of the average for each year of service credit. Increasing the number of months or years used to calculate final average salary usually means a lower benefit. A number of states have provided for longer periods for calculating average salary. A smaller number of states have reduced the percentage multiplier for calculating the actual benefit.

- In 2009, one state adopted a longer period for average salary and one other state reduced the percentage multiplier.
- In 2010, eight states provided for longer periods for calculating final average salary and four states reduced the percentage multiplier for some employees.
- In 2011, eight states provided for longer periods for calculating final average salary and seven, mostly the same states, reduced the percentage multiplier for some employees.
Other Changes

- In 2009, three states reduced benefits available to those who take early retirement. In 2010, nine states did so, and 10 did so in 2011.
- In 2010, nine states imposed greater restrictions on retirees who return to employment that is covered by the retirement plan from which they are receiving a benefit. Six states did so in 2011.

Almost all the legislation enacted in 2009, 2010 and 2011 was within the framework of traditional defined benefit retirement (DB) plans, the standard retirement design in the public sector. In 2010, two states broke with tradition to adopt fundamentally restructured plan designs—Michigan for the School Employees Retirement System, which includes teachers and other school employees, and Utah for all state and local government employees. Rhode Island did so in 2011 for teachers, almost all state employees except some public safety members and judges, and for the state-sponsored plan for municipal employees.

The Michigan plan includes these provisions:

- The new plan replaces a defined benefit (DB) plan for employees hired after July 1, 2010 with a hybrid plan that includes a defined benefit component with higher age and service requirements and a lower benefit than the former DB plan.
- The second component of the hybrid plan, applicable to all members, is an opt-out defined contribution (DC) plan, with an employer match for employee contributions. Within limits, school districts may negotiate levels of employee contributions and employer match. “Opt-out” means that all new members are enrolled in the DC component, but may withdraw from it if they wish to do so.
- There will be no post-retirement benefit increases for the DB portion of the plan.

The Utah plan will offer new employees a pair of choices.

- One is a straightforward DC plan, like those in the private sector, to which the employer will contribute 10 percent of compensation for general employees and teachers, and 12 percent for public safety employees. Employees are not required to contribute to the plan but may do so if they wish. There will be no employer match for any contributions employees make.
- The second possible choice, and the default plan for those who fail to make a choice, is a hybrid plan with a DB and a DC component. Employers will contribute 10 percent of compensation (more for public safety employees) to the DB element. Employees are not required to contribute unless the employer contribution is inadequate to maintain the actuarial soundness of the plan’s trust fund. In that situation, employees will be required to make up the shortfall. In the event that the employer contribution is more than is needed to
maintain the actuarial soundness of the plan, the unneeded share of the employer
collection will be deposited in an individual account for each employee. Employees may
contribute to their individual account, but are not required to do so.

The 2011 Rhode Island plan is also a hybrid plan somewhat similar to those in Michigan and Utah.

- It will continue a reduced defined benefit plan for all employees, and also enroll all
employees in individual accounts.

- The Rhode Island plan makes the individual accounts a more important part of eventual
benefits than in Michigan and Utah. In Rhode Island, all employees will be required to
contribute to them—5 percent of salary for employees covered by Social Security, and up to
9 percent of salary for employees who are not covered by Social Security. Employers will also
contribute to the accounts, in amounts ranging from 1 percent of salary to 3 percent of
salary, depending on the category of employee and whether the employee is covered by
Social Security.

- The Rhode Island plan is unique for including all current employees in the restructuring,
though all current employees will retain all benefits earned through July 1, 2012, when the
transition goes into effect.

As the legislative record shows, few states have moved toward defined contribution plans on the
private sector model. Utah became the first state to adopt a defined contribution plan for public
employees, even as an optional plan, since Alaska did so in 2005. Indiana provided one as an option
for new employees in 2011. A number of other states considered the adoption of defined
contribution plans as basic coverage in 2011, although none of them adopted one. The issue remains
under consideration; for example Arizona and Kansas study commissions will make
recommendations on the issue to their legislatures in early 2012. The Massachusetts legislature has
commissioned a study of defined contribution and hybrid plans.

In part, the reluctance to move away from traditional defined benefit plans grew out of concerns
about transitional costs. Adopting a new plan which may in itself be less expensive for employers
does not directly address any existing unfunded liability for a closed defined benefit plan. Legacy
costs could mean an increased burden of employer contributions for closed plans as their
membership falls over time. Support for such changes remains strong (as does opposition to such
changes) and the issue will remain alive in 2012, as will the need to enact less fundamental plan
revisions to address the ongoing pension funding problem.