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PENSIONS AND RETIREMENT PLAN ISSUES IN 1999 STATE LEGISLATURES

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INTRODUCTION

The major themes in pension legislation in 1999 were increased options and benefits for state and local employees.

A number of legislatures have considered the replacement of defined benefit plans with defined contribution plans. Some new defined contribution plans have been authorized.

More typically, though, legislatures increased employee options through reductions in vesting requirements, improved benefits for employees who leave covered employment without vesting or before reaching retirement age, and employer contributions to deferred compensation plans. Other new options are noted below.

Benefit increases have included changes in the multipliers used in calculating retirement annuities and changes in age and service requirements for an unreduced retirement annuity. Favorable investment experience has facilitated such changes, as well as reductions in required contributions in some states.

This report includes legislation enacted by the states in 1999 on the following topics:

- Systemic Redesign
- Targeted Defined Contribution Plans
- Defined Contribution Plans – 1999 proposals
- Vesting
- Retirement options
- Contribution rates
- Deferred Compensation Plan Matches
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- Retirement Options
- Formula Annuity Multipliers
- Cost of Living Adjustments
- Protection of Members' Benefits
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SYSTEMIC REDESIGN

Two states Montana and Missouri, enacted system-wide retirement plan revisions in 1999.

Montana has created an optional defined contribution plan for Montana Public Employees Retirement System (PERS) members to be effective by July 1, 2002 (HB 79). PERS includes about 28,000 state, university, county, municipal and school district employees other than teachers.

All current and future members of PERS will be eligible to opt for the DC plan or the existing DB plan, which will remain open for new enrollments. Current members will have one year after the effective date to elect the DC plan. New employees will be enrolled in the DB plan and will be given one year from the date of first employment to opt for the DC plan.

The DC contribution rate will be 6.9 percent from employees and 4.53 percent from employers. Employers who contribute to the DC plan will pay 2.37 percent of covered compensation to the DB plan to offset its unfunded actuarial liability. The latter amount may be adjusted as experience requires. Current DB contributions are 6.9 percent and 6.9 percent.

The transfer from the DB plan to the accounts of members who choose the DC plan will consist of their past contributions, the employer contribution less the amount required to offset the unfunded actuarial liability, and interest compounded at 8 percent. DC members

will be vested immediately in their own contributions and gradually vested in the employer contributions over a five-year period.

The current trustees of the Montana PERS will act as trustees of the DC plan, but are required to contract out for administrative, educational and investment services. The law requires the trustees to offer at least eight investment choices to DC members.

At the request of non-teaching employees of the state institutions of higher education, TIAA-CREF has been made a third option for them. Faculty will continue to have only the options of TIAA-CREF or the state teachers' retirement program.

The legislature has not resolved the issues of providing health and disability insurance for DC plan members. It will consider severing disability from pensions plans altogether. The health insurance issue is being studied.

Missouri closed its existing defined benefit plan for state employees and law enforcement personnel and replaced it with a new defined benefit plan that does not provide a separate benefit schedule for law enforcement personnel. Although the new plan provides some changes in existing benefit formulas and retirement eligibility, its distinctive feature is a formula multiplier of 2.5 percent in effect until a beneficiary reaches age 62 (and can thus become eligible for a Social Security annuity) and a multiplier of 1.7 percent thereafter. The program of benefits targeted at law enforcement personnel was done away with because of problems of definition. Normal retirement under the new program is according to the Rule of 80.

Members of the existing program may transfer to the new program.

Nebraska moved to give members of the Public Employees Retirement System (state and county employees), a defined contribution plan, more control over the investment of their accounts. Members now have three options, allowing them to place 25 percent, 50 percent, or 75 percent of their account in an indexed fund, as opposed to 1998 legislation that mandated that 45 percent of each member's account be placed in the index fund. In each case the balance of the account will remain in fixed-income investments. *LB 687*

TARGETED DEFINED CONTRIBUTION PLANS

Arizona legislation created an optional DC plan for exempt state employees and elected state officials who are subject to term limits. Contributions will be 2.66 percent of salary from employers and employees each. Active members of the Arizona State Retirement System who transfer to the new DC plan will receive a deposit of the actuarial accrued value of their benefits in their new account. Vesting will occur after one year. The plan will become effective on December 1, 2000.

Arizona legislation also created a 401(a) plan for term-limited officials and legislative staff members. The employer contribution is 5%. No member contribution is required. There is no provision for a transfer from other member accounts in the retirement system to the

deferred compensation account. This plan is an alternative to the DC plan described above, not a supplement to it. *SB 1238*

Louisiana legislation created an optional DC plan for a small group of unclassified state employees, including statewide elected officials and political appointees. Occupants of about 100 positions are eligible. The plan will be managed by the Louisiana State Employees Retirement System (LSERS). Enrollment in the new DC plan will be available for one year and will then be closed, according to current law.

Eligible state employees who are members of LSERS may transfer to the new DC plan, and those newly-hired to fill eligible positions may choose to join the DC plan within 60 days of beginning employment. If they make no choice, they default to the DB plan.

Participant and employer contributions to the DC plan will be the same amounts that would have been contributed if the participant remained in the state DB plan. *HB 1973*

North Dakota legislation created an optional defined contribution plan for present and future “exempt” or non-classified state employees, representing about 3,000 positions, over 75 percent of which are in higher education. (North Dakota has approximately 20,000 state employees in all.) Membership in the DC plan is optional for present members of the North Dakota Public Employees Retirement System (PERS), who must irrevocably choose whether to change to the DC plan by December 31, 1999.

Contributions to the DC plan will be 4 percent from employees and 4.12 percent from employers. Member contributions are immediately vested. Members will partially vest in employer contributions after two years of service and fully after four years of service. The actuarial present value of PERS members’ accrued benefit will be transferred to accounts of those who elect the DC plan as well as a prorated allocation of any asset surplus in the PERS fund (the latter according to the bill analysis).

The PERS board will govern and administer the DC plan as fiduciary and trustee. The board will make investment choices available to DC plan members.

The PERS board must establish a method for a member to use a portion of the member contribution to purchase disability insurance. The legislation is not clear on how members will become eligible for benefits under the Retiree Health Insurance Credit Fund. *H.B. 1257*

Other States A report from the Colorado Public Employees Retirement Association reports that Florida, Kansas, Virginia and Utah have allowed or soon will allow certain state employees the choice of DB or DC retirement plans.

DEFINED CONTRIBUTION PLANS – 1999 PROPOSALS

California legislation (passed by the Senate, under consideration by the Assembly) would allow certain appointed officials who under current law are not required to be (but may elect to be) members of the California Public Employees Retirement System to have the

additional option of participating in an DC retirement plan.. The DC plan they would join is the existing State Peace Officers' and Firefighters' Defined Contribution Plan that provides supplemental retirement benefits to specified state peace officers and firefighters. Eligible employees are legislative staff and certain members of the governor's staff. *SB 325*

Louisiana considered but did not approve an optional retirement plan for state teachers. Reportedly, teachers' opposition to the plan led to its demise.

Massachusetts Teachers' Retirement System has recommended to the legislature an optional retirement plan for superintendents and principals.

Ohio's legislature held numerous hearings on HB 199 which would provide optional defined contribution retirement programs as an alternative to the state DB plan. New state employees and members of the Public Employees Retirement System with less than five years' service would be eligible. The legislation would follow the precedent of the 1997 legislation that provided such choices for higher education employees. No action has been taken on the bill to date.

The **Ohio** State Teachers Retirement System will propose a defined contribution option for teachers later this year.

The **Wisconsin** Legislature has instructed the Wisconsin Board of Regents to submit legislation for the creation of an optional defined contribution retirement plan for higher education. The legislation has not yet been filed.

VESTING

Maine legislation reduced the vesting period for state employees, teachers, and legislators from 10 years to five years. *Public Law 1999, chapter 489.*

New York has reduced the vesting requirement for state and local employees to from 10 to five years.

Wisconsin in 1998 repealed the five-year vesting requirement that had been in effect for state plans since 1989.

RETIREMENT OPTIONS

Arkansas enacted a 28-years-and-out retirement option for members of the Arkansas Public Employees Retirement System, providing that elected officials and public safety officers must have 28 years of actual (as opposed to credited) service to take the option. *Act 104*

Texas legislation allows members of the Teachers Retirement System and the Employees Retirement System who have not taken advantage of the DROP program to take a lump-sum withdrawal at the time of retirement. The lump-sum can be no greater than 36 months' retirement annuity. The annuity of a person who makes a lump-sum withdrawal will be adjusted to reflect the withdrawal.

Virginia enacted the Rule of 80 for members of the Virginia Retirement System. *HB 1542.*

CONTRIBUTION RATES

Arizona legislation placed a floor of an annual employer contribution of 2 percent of salary to the DB retirement plan, regardless of actuarial requirement. *SB 1083*

Florida reduced contribution rates for employers' contributions to the Florida Retirement System from 15.5 percent to 10.2 percent for an estimated savings to state and local governments of \$1.2 billion in FY 2000.

Minnesota State Retirement System reduced contribution rates for employees and employers in 1997 and 1998 because the system is fully funded.

DEFERRED COMPENSATION PLAN MATCHES

Colorado legislation authorized the Public Employee Retirement Association to establish an annual matching contribution to members deposits in deferred compensation accounts no sooner than 2001 and after the PERA accrued actuarial liability is fully funded. PERA will determine the amount of the matching contribution. *SB 99-90*

Indiana legislation provides that the state, may adopt a defined contribution plan for the purpose of matching all or a specified portion of state employees' contributions to the state employees' deferred compensation plan. It provides that the Deferred Compensation Committee is the trustee of the plan. The bill provides that the plan shall be administered by the Auditor of State. The legislation does not specify the amount of the match, which will depend upon appropriations made for the purpose. *HB 1093*

For the 2000-2001 biennium, the legislature appropriated \$77 million for the program. The program will provide a \$15 match in each 2-week pay period (for a possible total of \$390 per year) for employee deposits in their deferred compensation plans.

Maryland legislation in 1998 supplemented the existing DB plan for State Employee Pension System (EPS) members with a match for employee contributions to a deferred compensation plan. The employer match will be dollar for dollar to a total of \$600 per employee per year, effective July 1, 1999. *HB 987 of 1998*

South Carolina public employers were authorized to contribute up to \$300 a year to employee deferred compensation accounts. Employees who make \$20,000 a year or more must match the employer deposit. Employees who make less than \$20,000 need not match the employer deposit. *H3696*

Virginia legislation in 1999 provided for an employer cash match for participants in the state's deferred compensation program and employees who participate in a tax-sheltered annuity or 403(b) plan. Employees are eligible for the match after 12 months of service and

must defer at least \$10 per pay period. The maximum employer match will be the lesser of \$50 or 50 percent of the employee contribution, to a maximum of \$2.5 million in FY 2000. The VRS board of trustees has adopted an employer cash match rate of \$10 per pay period (\$20 per month) for FY 2000. *Code of Virginia, § 51.1-606.*

NOTE: Oklahoma and Tennessee adopted similar plans in 1998. Their experience indicates that the match stimulates employee contributions (in Oklahoma from 20 percent of eligible employees to 78 percent and in Tennessee from 20 percent to 40 percent). *Virginia Retirement System Oversight Report No. 13 (December 30, 1999).*

WITHDRAWN CONTRIBUTIONS

Arizona legislation provided for an enhanced refund program. Arizona Retirement System members (all of whom vest immediately) with at least five years of credited service who terminate service will receive between 25 percent and 100 percent of the employer contributions on their behalf, depending on length of membership. The 100 percent level is reached at 10 years of credited service. *SB 1083*

Colorado legislation increased the match for employee contributions withdrawn by non-vested members of the system to 50 percent (from 25 percent) and increased the match for contributions left in the system until the person is retirement-eligible or age 65 to 100 percent (from 50 percent). *SB 99-90*

New York legislation provides that members who leave covered employment with between five and 10 years of service may vest in the system (vesting formerly was at 10 years) or may withdraw their contributions. If they leave their contributions in the system, the contributions will continue to earn 5 percent interest until retirement. To be eligible for an ordinary disability benefit, members must still have at least ten years of credited service.

Ohio legislation (not enacted) would require payment of interest on members' withdrawn contributions for members of the Public Employees Retirement System and would provide for payment of a portion of the employer's contribution – 33 percent after five years of membership, and 67 percent after 10 years. The same provisions would apply to a payment to a member's survivor. *SB 144.*

RETIREMENT OPTIONS

Texas legislation allows members of the Teachers Retirement System and the Employees Retirement System who have not taken advantage of the DROP program to take a lump-sum withdrawal at the time of retirement. The lump-sum can be no greater than 36 months' retirement annuity. The annuity of a person who makes a lump-sum withdrawal will be adjusted to reflect the withdrawal.

Maryland broadened eligibility for membership in the contributory benefits programs of the Employees' Pension System and the Teachers Pension System. *Senate Bill 363*

FORMULA ANNUITY MULTIPLIERS

Arizona increased the formula annuity multiplier from 2 percent to 2.1 percent effective July 1, 2000. *SB 1083*

Arkansas increased the formula annuity multipliers for both contributory (from 1.7 percent to 1.72 percent) and non-contributory systems (from 2.05 percent to 2.07 percent). *Act 496*

Nebraska increased the formula annuity multiplier for future retirees of the school employees retirement system from 1.8 percent to 1.9 percent. *LB 674*

South Dakota increased formula annuity multipliers for Class A and Class B system members. *SB 10*.

COST OF LIVING ADJUSTMENTS

Arizona increased the limit on the annual cost of living adjustment from 3 percent to 4 percent and repealed a provision limiting the COLA to the change in CPI. The actual annual COLA is determined by applying a formula to the amount of investment return above the actuarial assumption of 8 percent. The threshold for a calculation was reduced from a 9 percent investment return to 8 percent to coincide with the actuarial investment assumption.

Arkansas set the annual COLA at 3 percent and eliminated its tie to the CPI. *Act 39*

Mississippi increased the COLA for retired members. *H. B. 472*

PROTECTION OF MEMBERS' BENEFITS

Maine legislation established that the listed benefits provided in law are solemn contractual commitments of the State protected under the contract clauses of the Constitution of Maine and the United States Constitution once the right to those benefits attaches. Attachment occurs when a member has attained the amount of service credit needed for retirement and where relevant has met any age requirement. This enactment is intended to supplant the holding of the U.S. Court of Appeals for the First Circuit in *Parker v. Wakelin et al.* 123 F.3d 1 (1997) which held that the Maine Retirement Law creates no enforceable private contractual right preventing the modification of members' retirement benefits until those benefits are actually receivable. *Public Law 1999, chapter 489*; Maine Legislature, "Enacted Law Summary LD 267 (1999).

TAXATION

Colorado increased the amount of public and private pension and annuity income exempt from state income taxes from \$20,000 to \$24,000. *HB 99-1151*.

Delaware increased the income tax exclusion of income from dividends, interest, rents, employer pensions and qualified retirement plans for those age 60 and over from \$5,000 to \$12,500, beginning with tax year 1999. *SB 245*.

New Jersey increased the amount of public and private pension and annuity income exempt from state income taxes as follows:

- Tax year beginning before January 1, 2000: \$10,000 for married filing jointly; \$5,000 for married filing singly; \$7,500 for an individual filing as a single taxpayer
- Tax year beginning after 1/1/2000 and before 1/1/2001: \$12,500, \$6,250, \$9,375
- Tax year beginning after 1/1/2000 and before 1/1/2002: \$15,000, \$7,500, \$11,250
- Tax year beginning after 1/1/2002 and before 1/1/2003: \$17,500, \$8,750, \$13,125
- Tax year beginning after 1/1/2003: \$20,000, \$10,000, \$15,000. *P.L. 1999, Chapter 177*.

South Carolina increased the income tax deduction for individual taxpayers over the age of 65 from \$11,500 to \$15,000, and for married taxpayers filing jointly, if both of them are over the age of 65, to \$30,000, effective for tax year 1999. *Act 100, Part 2, Section 28*.

STUDIES

Florida legislature called for a study of DC and other alternative retirement plans.

Idaho legislature authorized a joint committee for an interim study of enhancements to pensions benefits and of defined contribution plans as an alternative to the existing defined benefit plan. *HCR 21*

Kansas' Joint Committee on Pensions, Investments and Benefits will review alternatives to the existing defined benefits retirement program in the 1999 legislative interim.

Massachusetts legislation authorizes a study of alternative retirement benefits for higher education employees, to be submitted to the General Court in January, 2000. *H4901, Conf § 272*

Nebraska's legislature authorized an interim study of the long-term funding of the five state- administered retirement systems. (*LR 119*)

North Carolina legislation calling for a study of the implications of creation of a DC plan did not come out of committee.

Oklahoma Senate special task force will review defined contribution plans.

Vermont legislature is reviewing pension system structures and alternative retirement plans in the 1999 legislative interim.

Virginia legislation calls for a study of the Virginia Retirement System's benefits and funding requirements apparently in connection with the possible creation of an alternative retirement plan.

News reports indicate that there will be interim studies of defined contribution retirement plans in **Georgia** and **South Carolina**.

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