

Presentation  
To  
Joint Legislative Committee on Public Employee Benefits Reform

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## Table of Contents

<b>Introduction.....</b>	<b>3</b>
<b>Causes of Concern.....</b>	<b>4</b>
<b>History of the Retirement Systems and the Pension Problem .....</b>	<b>9</b>
<b>A Look at the Numbers.....</b>	<b>13</b>
<b>Benefits Review Task Force Recommendations.....</b>	<b>17</b>
<i>Use of Generally Accepted Budgetary and Actuarial Principles .....</i>	<i>17</i>
<i>Bonding Pension Liabilities .....</i>	<i>17</i>
<i>Unfunded Pension Liability.....</i>	<i>18</i>
<i>Pension Abuses, Part-Time Employment and Thresholds .....</i>	<i>18</i>
<i>Changing Salary Used to Determine Pension Benefit .....</i>	<i>22</i>
<i>No Pensions for Convicted Officials.....</i>	<i>23</i>
<i>Sick Leave Payouts .....</i>	<i>23</i>
<i>Retain Defined Benefit Retirement Systems .....</i>	<i>24</i>
<i>Eliminating Early Retirement Benefit in PERS and TPAF .....</i>	<i>24</i>
<i>Pension Loans .....</i>	<i>25</i>
<i>Moratorium on Early Retirement Incentive Programs .....</i>	<i>26</i>
<i>Health Benefits Recommendations.....</i>	<i>26</i>
<i>Pension and Health Benefits Review Commission .....</i>	<i>28</i>
<i>Recommendations for Benefit Increases .....</i>	<i>28</i>
<b>Some Final Comments .....</b>	<b>29</b>
<b>EXHIBITS .....</b>	<b>31</b>

## Introduction

Co-Chairs Senator Scutari and Assemblywoman Pou and members of the Joint Committee, I would thank you for the opportunity to make this presentation to the Joint Committee. I retired from state employment in July 2003 after 35 years of service. My first 16 years of employment were with the Legislature on the staff of the Division of Legislative Information and Research that was consolidated into the Office of Legislative Services during my tenure. My last 19 years were with the Division of Pensions and Benefits. I served in the positions of assistant director and deputy director, and as director of the Division for approximately three years from 1999 to 2002. Over time I served as the Treasurer's Representative on all of the Boards of Trustees of the State Retirement Systems and the State Health Benefits Commission. I was involved in most of the policy and legislative initiatives concerning the programs administered by the Division during my tenure.

I am not making this presentation because I have any concern over the benefits I am receiving. I am highly confident that there is more than sufficient protection against diminution of pension and health care benefits being received by retirees in the statutes and common or case law of the State. What prompted me to forward at this time were recent media and newspaper reports concerning the activities of the Joint Committee. The reports indicated that the Joint Committee was receiving presentations that the State and local governments were facing multi-billion dollar financial crises relative to public employee pensions and health benefits. Other reports indicated that local governments were advised by the State of dramatic increases in the contributions they were required to make to the State retirement systems for pensions for their employees. There were comments that something had to be done to restrain the rapidly rising costs of public employee pensions because they were placing an additional burden on already overburdened local property taxpayers. My first thought was to dismiss the reports and comments as coming from people who really did not understand the situation relative to the State retirement systems. But I thought it would be a good idea to investigate what was being presented to the Joint Committee and to find out what the committee members might be thinking about the situation.

At this point let me extend my commendation to the Legislature and its leaders for your great website. With all the information online concerning the meeting and hearings of all the joint committees, it was easy for someone like me who is now just a member of the public to investigate the proceedings of the Joint Committee on Public Employee Benefits Reform. Let me also commend the members of the Joint Committee. You are clearly conscientious people and have been working very hard to deal with the task that has been assigned to you. Quite frankly, I think you have been given an almost impossible task with a highly unrealistic timeframe in which to complete it.

### Causes of Concern

As I viewed and listened to your proceedings and read some of the transcripts, my concern over what appears to be transpiring increased dramatically. The focus of work and probable basis for recommendations of the Joint Committee seems to be the Report of the Benefits Review Task Force established by Former Acting Governor Codey. I read the report awhile ago. My reaction was that it was decent report. I agreed with some of its conclusions and disagreed with others. Some of the reports discussion and recommendations indicated to me a limited of understanding of the some of the retirement systems and that the some of the recommendations would have adverse consequences that had not been considered. After I read the report, my reaction was that there would probably little, if any, action on its recommendations. Apparently I was wrong.

Next I read Governor Corzine's address to the Joint Special Legislative Session at the beginning of the session that outlined his assessments of the problems that the session needed to address and the changes he felt needed to be made. His assessment was very dire and his charge to the Legislature was that dramatic changes of the type he outlined had to be made by January 1, 2007, or he would press for a Citizens Convention to be on the ballot. He stated there were five broad areas that needed to be addressed. Alarming, the first area he addressed was reform of pensions and benefits arrangements for public employees at every level of government. I felt it was alarming because the Joint Session was called to address property taxes and the first area the Governor identifies as a problem is public employee pensions and benefits. Next he mentioned the "\$1.3 billion cash payment we made to the pension funds this year was long overdue."

What he failed to mention was this amount was probably the normal annual contribution, not including any unfunded liability contribution, for the current year accrual of pension benefits for 255 thousand state employees and teachers. He also failed to mention that the contribution was returned to the State budget after many years on nonpayment of the contribution that is required by the state pension laws. Governor Corzine inherited the problem of nonpayment of pension contributions, and he and the current Legislature deserve praise for finally addressing the problem. However, in addressing the property tax problem, the payment needs to be placed in context and is not indicative in itself of a problem with public employee pensions.

The Governor then addressed “an \$18 billion unfunded pension liability that is one of the factors that limits our ability to provide meaningful local aid.” Here again there is no context for the Governor’s statement, only the mention of a very large number without any indication of how it happened. I am assuming that he was relying of the Benefits Review Task Force recommendation that this liability had to be addressed soon and that the use of State revenues to address the liability would limit the State’s ability to provide local aid. After discussing the growing unfunded liability and falling funded ratios, the Task Force’s report contains the following sentence:

*Experts have advised that the declines might not be significant, yet the Task Force is concerned with the long-term health of the funds for the reasons that follow.*

Presumably, the experts were actuaries, but the Task Force apparently did not believe the experts.

The Governor listed a number of changes that in “reality” must be considered based primarily on the Task Force report including two-tiered systems in all benefits for new and recently hired employees, broad changes to the retirement systems, including possible introduction of means-tested defined contribution plans, and increasing retirement ages for new hires. There was no clear statement of what the reality was and why these changes must be considered other than the previous mention of large numbers relative employee pension benefits and the Task Force report. The Governor stated that the Legislature could act immediately to eliminate the abuses that “allow professional service contractors, political appointees and people who barely work to enjoy the benefits

of a system intended for career employees.” He stated that eliminating “padding, boosting, and tacking – is a no brainer.” As I will discuss later in the presentation, the abuse problems identified by the Task Force and their solutions are not as simple as the Task Force indicated.

The duty of the Joint Committee is to review and formulate proposals that address abuses and control the costs of public employee benefits using the Task Force. The Task Force report, the Governor’s charge to the Special Session and the duty of the Commission all seem to assume that the problems with public employee benefits are obvious and the solutions as outlined by the Task Force report are the obvious source of the solutions. With respect to public employee pensions I have yet to see a clear statement of the problem other than obvious abuses that have been around for decades and that periodically were the subject of newspaper articles. The only reason these problems were never addressed was that there never was any political will to do so and there cost impact on the retirement system were not great. I have not seen or heard in your proceedings any documentation that the costs of public employee pensions are an increasing problem in the State budget, other than the fact that the costs are large and that they have to be put back in the budget.

I finished my investigation by listening to the Joint Committee’s meeting with Philip D. Murphy, Chairman of the Benefits Review Task Force. The picture that emerged from my review of the Joint Committee’s proceedings seemed to be that most of the Joint Committee members believe, as apparently does Mr. Murphy, that the State is faced with looming financial crises relative to both the State pension system and the health benefits programs in the magnitude of tens of billions of dollars that require immediate substantial reductions in the benefits to certain public employees to avoid disastrous consequences if the changes are not made. With all due deference to anyone involved in this process who holds this view, I respectfully submit that it just is not so.

To be sure, there are problems in both the pension and health benefits areas. They are separate and distinct problems. The problem with public employee and retiree health benefits is by far the more serious problem. The problem in the pension area, a significant unfunded liability in all of the State retirement systems that is much more manageable. Unfunded liabilities are not unusual for defined benefit retirement systems.

All of the State retirement systems had unfunded liabilities for much of their history. The statutes governing the retirement systems have long had provisions for managing unfunded liabilities. The problem confronting the State is a budgetary problem that is the product of 13 years of budget mismanagement. Everyone has acknowledged that the problem has been caused by what are being called pension holidays. However, I am not sure if pension holidays are being considered in the proper context.

There is nothing wrong, and in fact, it is entirely appropriate not to make a contribution to a pension system that is fully funded. Private sector employers are prohibited from making contributions to pension plans that are fully funded by federal law. The issue is what should be done with the money freed up in an annual budget because a pension contribution does not have to be made. I am not a budget person so I can not tell what budget experts would advise, but common sense would suggest that the money should not be used to fund recurring expenditures because there is no guarantee that the money will be available in succeeding years. It should probably be used to fund some temporary purpose or capital item or perhaps to pay off some of the State's debt. If it were used to bring down State debt, it would have a multiplier effect in subsequent years in reduction of debt service. The money was not used in any of these ways. It was used to balance the State's operating budget, the State's recurring expenditures. State officials advised local government officials that the reduced or eliminated pension contributions were property tax relief. The budget problems were compounded by increasing State debt to balance the operating budget. This practice was recently prohibited by the State Supreme Court. The ability to use excess assets in the State retirement systems for pension holidays is no longer available because there are no excess assets. The State retirement systems have substantial unfunded liabilities that need to be addressed in accordance with the procedures in the State pension laws for funding these liabilities.

Now the State is faced with the problem of restoring to the budget not only the normal pension contributions to fund the annual pension benefits that accrue each year in an amount of approximately one billion dollars, but also contributions for the unfunded liabilities in the State retirement systems of approximately  $\frac{3}{4}$  of a billion dollars. Historically there was and there should be a contribution in the budget for annual pension benefits just as there is an appropriation for employee salaries. Ideally it should be a

manageable percentage of employee salaries. Public employees did not cause the budget problem and the costs their retirement benefits have not been rising faster than public employee salaries or the State and local government budgets. Yet public employees are being asked to bear a significant reduction in their pension benefits to help fix the problem. The rhetoric involved is very respectful. Public employees are assured they are not being blamed for the problem and that they are entitled to a reasonable pension. The history of pension holidays and bad budget practices is acknowledged. There are statements that many parties share the blame for the problem and it is not helpful to engage in finger-pointing. It is claimed that the task now is for all of the parties or “stakeholders” to come to the table prepared to offer some blood to fix the problem.

It is this scenario of the “public employee benefit problem” that really disturbs me. Neither public employees nor the cost of their pension benefits have caused the State’s budget problem. In my opinion, it is highly inequitable to ask public employees to bear significant reductions in their pension benefits to fix the State budget problem that neither they nor their pension systems caused.

The cost of public employee health benefits is another matter. It is a serious problem that has to be addressed and public employees should prepare themselves to contribute to the solution of this problem. The cost of public employee health benefits is significant percentage of the State budget and the budgets of local governments. It is being funded on a pay-as-you basis and the cost is increasing much more rapidly than public employee salaries and the budgets themselves. It has to be brought under control soon lest it threaten the State’s ability to fund other services. Recent changes in the accounting rules for financial statements of governmental entities will require disclosure of the State liability for post-retirement medical (PRM) benefits. It has been indicated that the initial number for this liability will be \$20 billion. It is important to note that this number is for disclosure purposes and it does not have to be funded. It does indicate the gravity of the rapidly rising costs of public employee health benefits. The disclosure number will grow rapidly not only from of the annual increase in health care costs but also from the increase in the retiree population at a higher rate with the retirements of baby boomers. It is hard to underestimate the size of the problem of the problem with public employee health care benefits. The National Association on Health Care has indicated that employer health insurance premiums increased by 9.2% in 2005. At this

rate premiums will double in 8 years. The actuarial report for TPAF for 2005 indicates medical cost trend rates for estimating retiree health benefit costs of 11% to 14%. At an annual rate increase of 13%, the costs would double in 6 years.

In 1997, the law was changed to provide for negotiation of the premiums for health care benefits for state employees. The State negotiated cost sharing for state retirees. No provisions for retiree cost sharing were enacted for teachers and other education employees. The number of education retirees receiving state paid PRM benefits is more than double the number of state employee retirees, 58,334 versus 26,521. The PRM contribution for 2007 for education retirees is almost three times contribution for state retirees, \$714 million versus \$261 million.

## History of the Retirement Systems and the Pension Problem

First, I would like to briefly discuss the history of the State retirement systems, especially the recent history that has led to the “pension problem.” New Jersey has been in the forefront of states in providing pension benefits to its public employees. The two largest systems were established right after World War I, TPAF in 1919 and SERS (the predecessor of PERS) in 1921. An interesting aspect of the law that established TPAF was a statement of public policy in the preamble of the law that public funds should be used to fund public employee pensions and that public retirement systems should be “established on a scientific basis” to “protect the well-being” of their members. The scientific basis reference is to actuarial methods for determining and funding long-term obligations that were being developed at that time. A 1920 law authorized municipalities to establish local pension systems for their police and firemen in accordance with the provisions of the state law. These local systems were not generally successful. They were closed to new members, and a new state retirement system for police and firemen, PFRS, was established in 1944. The members of the local systems remained in the systems until 1952 when they were consolidated into a new state system, CPFPPF. The current retirement systems for state policemen and judges were established in 1965 and 1973, respectively. All the systems were funded on an actuarial basis. There were benefit enhancements over time. Exhibit I provides a list of benefit enhancement from the late 1950s to date for PERS, TPAF and PFRS. An alternate retirement system was established for the faculty and professional staff at the state colleges and universities

1969. Known as the Alternate Benefit Plan, it's the State's only defined contribution plan. It was requested by the higher education community because many colleges and universities throughout the country provided pension benefits for their faculties through a defined contribution plan administered by the Teachers' Insurance and Annuity Association and the College Retirement Equity Fund, TIAA/CREF.

The funding of the systems proceeded apace with contributions for the annual benefit accruals and the unfunded liability. State officials began to express concern over the cost of pension benefits. The primary cause for concern was cost-of-living-adjustments (COLA) that the State had begun to provide to all retirees under the state retirement systems on a pay-as-you-go basis. Inflation throughout the 1970s was very high. Governor Kean established a Pension Study Commission early in his first term to address the problem. The Commission recommended a number of changes, but the primary recommendation was the establishment of an incentive savings plan (a defined contribution plan) for new employees and employees under 40. No action was taken on the report. Fortunately, inflation came down and eventually the Federal Reserve Board began to manage it. The funding of the state retirement systems continued to improve. Governor Kean signed legislation in 1987 to provide post-retirement medical (PRM) benefits for retired teachers under TPAF on the same basis used for state employees, namely, 25 years of service or retirement on disability. This law and a similar law for PERS provided for prefunding of COLA and PRM benefits under PERS and TPAF on a phased-in basis over a long period of time.

By 1991, the state retirement systems were close to being fully funded. Ironically, at what should have been one of the best times for the retirement systems as full funding was near, the long slide into probably their worst of times began. At that time, pension assets were valued at book value. Despite the tax increases enacted in Governor Florio's first year in office, the State budget was still experiencing the effects of a recession. In 1992, Governor Florio initiated the first scheme to use pension assets to help balance the State budget. It was known as Pension Revaluation. As its name suggests, the primary change under this initiative was a change in the method of valuing pension assets from book to market. The change seemed to be appropriate because private sector plans used market value. The problem was how the additional pension assets were used. There was a \$5 billion difference between the two values at the time.

The change in the valuation method resulted in full funding of the liability for basic benefits and retiree COLA and resulted in surplus assets that could be used for contribution reductions. The legislation also made some changes in the actuarial funding method and governance of the systems. Employee representatives objected to using all the additional funds for reductions of pension contributions. A compromise was reached under which 40% of the additional assets (\$2 billion) remained in the retirement systems to improve the phased-in funding for COLA and PRM benefits. The other 60% (\$3 billion) was used to reduce employer pension contributions. The impact of initiative was immediate and dramatic. State pension contributions were reduced by \$733 and \$552 in 1992 and 1993, respectively. Local employer contributions fell by \$233 in 1993. The State budget was still in trouble in 1993 and the sharp increases in funding for COLA and PRM were eliminated.

The first major initiative of the Whitman Administration was another pension initiative. It was called "Pension Reform." This initiative made numerous changes in the actuarial funding method and assumptions and abandoned prefunding of PRM benefits. It generated pension contribution savings for the State of \$4.1 billion over 5 fiscal years from 1994 to 1998. Savings for local governments over the same period were \$750 million. The State took \$545 million of local savings as offsets for State aid. Journalists noted that the pension contribution savings were approximately the same as the reduction in income tax revenues resulting from tax cuts in the first 2 ½ years of the Administration. CWA and NJEA sued the State over the initiative.

Once again, despite the massive savings in pension contributions, the State Budget was again in trouble in 1997. There was an estimated \$600 million gap in the budget. After the two pension initiatives, it was difficult to conceive that there could be another pension initiative. But there was. This initiative was known as the "Pension Security Proposal." This initiative was more creative than the previous initiatives and is too complicated to explain in detail. The gist of the initiative was to increase the pension assets by resetting their value to full market value (generally referred to as "marking to market") and issuing state appropriation bonds to fund the \$3.2 billion dollar unfunded liability in the retirement systems. The initiative generated \$600 million in pension contribution savings needed to balance the budget. Employee representatives were split over the initiative. Most eventually supported it after changes to limit the period for full

pension contribution offsets by the State and to provide for reductions in employee contributions to PERS and TPAF from excess assets. Interestingly, the period for full pension contribution offsets extended to 2002 when the second term of Governor Whitman would be over. The State received a concession from CWA and NJEA. The lawsuit they initiated over the Pension Reform initiative was dropped. The apparent victory for the pension systems and the employee representatives, i.e., the deposit of \$2.75 in state bond proceeds in the pension funds, was a pyrrhic one. The \$600 contribution savings it provided was an immediate give back in pensions funds and the contribution reductions in succeeding years surely exceeded the remaining proceeds of the bond issue. Now the State general fund is responsible for paying the annual debt service for the pension bonds.

The last pension initiative occurred in 1991 and its purpose was not pension contribution offsets but enhancement of pension benefits for PERS and TPAF. Pension contribution offsets were already institutionalized in the pension statutes as long as there were excess assets. PERS and TPAF employees had received contribution reductions of up to 2% of pay after the bond deal. This initiative required that the value of the pension assets be marked to market. The benefit enhancement was an increase in the annual accrual rate for pensions under PERS and TPAF from n/60 to n/55. The accrual rate was near the bottom of all states and had been n/60 since 1955 or earlier. The increase amounted to approximately a 9% increase in the benefits. The initial intent was to raise only the service retirement rate. When the proposal was unveiled and was applicable only to service retirees, veteran and disability retirees complained because they would not receive a pension increase. Their benefit rates were substantially higher or required less years of service. Nonetheless, all the benefit rates, including the veteran rate (50%), ordinary disability rate (40% with 10 or more years of service), and the accidental disability rate (66 2/3%), were increased by 9%. Two additional benefits enhancements were provided for two small groups of PERS members, prosecutors and worker's compensation judges. Separate parts were established under PERS to provide benefits at the level of PFRS for prosecutors and at the level of JRS for the worker's compensation judges. The benefit increases for these enhancements were substantially greater than the 9% increase in the PERS service benefit. There was an enhancement in 2003 affecting PFRS. It provides for a prospective increase in the PFRS special retirement benefit, from

65% to 70% at 25 years of service and 70% to 75% at 30 years, once the retirement system's funding level exceeds 104%.

## **A Look at the Numbers**

To determine if a pension cost problem exists, it is important to look at both current numbers and historical cost trends. To review current numbers, attached are Exhibits 2 and 3 that provide selected data from the 2005 actuarial reports of the five active systems that cover state and local employees. The data includes assets and liabilities, active members and retirees, covered compensation and annual benefits, and annual contributions and contribution rates. Exhibit 2 covers state employees. Exhibit 3 covers local employees.

The historical information that should be reviewed would be figures on revenues and expenditures in the state budget from the year before the tax increases in the Florio Administration (1989 or 1990) through the current state budget for 2007. The information should show the history of revenues and expenditures by type, including employee salaries and pension and health benefits shown separately. You may already have this information. The Legislative Budget Office might already have the information, or it could surely provide it. The pension information in Exhibits 2 and 3 for the same time period should also be reviewed. The Division of Pensions could provide it, if it has not done so already. The contribution information should show the full required contributions and the contributions actually made. The annual rate of return on pension assets and the annual rate of inflation should be included. This information would clearly indicate the problem and might suggest some of the reasons for it.

The information in Exhibit 2 is for state employees and teachers. The State pays the employer contributions for teachers. As a point of information, the State also pays the employer social security contributions on teachers' regular salaries. I do not have the amount of this contribution, but multiplying the covered compensation under TPAF by the social security rate of 7.65% yields an estimate of \$647 million. The far right column provides information on the ABP, the state's only defined contribution system, for comparison purposes. The asset and liabilities section shows the unfunded liability on actuarial and market value of bases. The actuarial value unfunded liability is \$12 billion

and the market value unfunded liability is \$19 billion. The total membership of the systems is 255 thousand and the number of retirees and beneficiaries is 101 thousand. There are 85 thousand retirees entitled to state paid PRM. The annual compensation of the membership upon which contributions are based is \$13.6 billion. The annual amount of retirement allowances is \$2.9 billion, and death benefit payments are \$66 million.

The contribution amounts listed are the full required contributions. I do not know how much of the required contributions were actually made. I used the full required contributions and the contribution rates they provide (the contribution divided by the covered compensation) to provide a measure of the annual costs of the retirement systems as a percentage of payroll for the purpose of comparisons among systems. A good measure for comparison of the systems is the normal contribution rate. It provides the annual cost as a percentage of payroll for the benefits accrued for the year of the report. Looking at the normal contribution rates for the systems, you will note that PERS is the lowest at 5.67%. If the current PERS state employees were in the ABP, the annual cost would be substantially higher, \$346 million versus \$210. The cost would be comparable teachers and substantially lower for the police and fire and judges systems.

The purpose of the last six rows on the bottom is to illustrate that the State is not faced with an imminent problem relative to the unfunded liability. Notwithstanding the liability, these pension funds (for state employees and teachers) still have \$43 billion of market assets in the bank. If there were no more contributions to the systems and assuming that benefits payments and the assets grow at the same rate, the current level of benefits could be paid for the number of years indicated on the third row from the bottom, varying from 11 to 18 years. Including the annual employee contributions in the calculations, benefit payments could be made for the years indicated in the second row from the bottom, varying from 12 to 31 years. If the State paid the normal contributions, the benefits could be paid for the years indicated in the bottom row, varying from 31 to 37 years. (There is no entry for State PFRS because the indicated contribution distorts the result.) Exhibit 3 provides the same information for local employers under PERS and PFRS. If investment returns on pension assets were included, the number of years the benefits could be paid would increase substantially. If the unfunded liability is addressed, the funding of the retirement systems will back on the sound actuarial basis that characterized the funding until 1992 and that ensure funding in perpetuity.

Since my view is that the primary problem facing the State is restoring the required pension contributions back into the State budget, I believe it can be accomplished on a phased-in basis over a reasonable period of time without posing a significant threat to the financial health of the pension systems. The first target should be the normal contribution. The Governor indicated in his message to the Joint Session that the State made a contribution of \$1.3 billion. The State apparently made the normal contribution for the current fiscal year. I highlighted the unfunded liability payments because some or all of these payments could be skipped for a while if the budget situation required it. Consideration could be given to phasing in these contributions.

In another one of your meetings, concern was expressed over the size of unfunded liability and the potential for growth of the liability. To help myself get a feel of how much the unfunded liability might grow in the next 10 years, I developed a very simple spreadsheet projection of the unfunded liability that is shown in Exhibit 4. I do not particularly care for estimates of financial numbers beyond short term estimates, a couple of years, because I do not believe estimates for longer periods are reliable. They are attempts to predict the future and give the prediction the illusion of accuracy by expressing it with numbers. However, human nature being what it is, we just can not seem to avoid the tendency of ask what will it be in 10 years or 20 years. The projections are pure speculation. It takes the two numbers that in the aggregate provide the unfunded liability, the assets and the liabilities. The assets shown are the market value assets and the unfunded liability and the funded percentage are derived from the two numbers. The only real numbers in the projections are the initial asset and liability numbers under 2005, and the initial growth rates for the assets and liabilities in the two top rows under 2006. The only experience data I had for actual growth rates for the numbers was for the 2004 and 2005. Exhibit 5 shows the growth rates for the three major systems, PERS, TPAF and PFRS. I used the average of the growth rates of the three systems for the growth rates for 2006. The asset growth rate between 2004 and 2005 seems like an anomaly and is probably attributable to lack of pension contributions. For the rest of the projections, I used higher growth rates for the numbers around the regular interest assumption for the systems, 8.25%.

Exhibit 4 lists five different scenarios for growth in assets, liabilities, liability, and funded status. I want to make it clear that this is a very simple projection and is designed to provide indications of possible outcomes for the unfunded liability and funded status. This is not an actuarial projection. The actuaries could provide you with more sophisticated projections if you felt they are necessary, but the cost could be significant. I provide the projections merely to try to illustrate that it is highly unlikely the financial status of the systems will be seriously degraded over the next 10 years. I actually believe that investment returns on the assets will be favorable over the next few years and will help to manage the unfunded liability even if the full required contributions are not made.

The first scenario in Exhibit 4 assumes that both the assets and liabilities grow at the interest assumption for the systems. The unfunded liability more than doubles over the ten-year period, but the funded percentage remains the same. This is simply a function of the math. Both the numerator and the denominator are increased by the same percentage. All the numbers grew substantially, but the funded percentage remained the same. The next projection is more optimistic. The assets grow at the regular interest rate, but the liabilities grow at 7.5%,  $\frac{3}{4}$ % lower than the assets. The unfunded liability grows substantially but the funded status improves slightly. The next scenario is more pessimistic. The assets grow at 7.5 % and the liabilities grow at 8.25%. The unfunded liability is the highest under this scenario and the funded status decreases significantly, but only 6% over 10 years. The last two scenarios are even more optimistic. Both assume that the liabilities will grow at 7.5 % and the assets grow at  $\frac{1}{2}$ % and 1% greater than the interest assumption. Under both scenarios, the unfunded liability grows more slowly and begins to stabilize and the funded status increases. The actual liability numbers will probably not vary greatly because they are generated by the actuarial valuation systems based on assumptions that are changed only every three years. They are affected by the experience of the covered population, but that too is unlikely to vary greatly in the short term. The asset figures will be more volatile because they are based on market value that will vary based on market performance.

In listening or viewing some of your proceedings, some committee members seemed uncomfortable with the size of the unfunded liability numbers. All of the numbers are in the billions. The market assets are \$42 billion, covered compensation

\$13.6 billion, annual benefit payments \$3 billion, and normal contribution \$1 billion. An investment return on the assets of 8.25% would be \$3.5 billion.

## **Benefits Review Task Force Recommendations**

### ***Use of Generally Accepted Budgetary and Actuarial Principles***

Since the recommendations of the Benefits Review Task Force are the primary basis for your deliberations, I would now like to offer my comments on the recommendations. I whole heartedly agree with the recommendations against pension holidays and actuarial gimmicks, and that consistent and generally accepted actuarial standards be used for pension funding. The pension holidays and actuarial gimmicks made the real harm possible, i.e., using the money freed up by lack of pension contributions in the regular operating budget. There is nothing wrong with not making a contribution to a fully funded pension system. The actuaries generally advise that if market value is used to value pension assets, the full funding target should not be 100%, but 120% to 130%. This leaves room for significant swings in the market value of the assets in market downturns. The drop in market value of pension assets from 2000 through 2003 was approximately 25%. However, there is an even greater need to require the use of good budget practices by the Executive and Legislative Branches. The problem faced by the current Administration and Legislature is budget mismanagement beginning in 1992 that continued through successive Administrations and Legislatures, up to but NOT including the current Administration and Legislature. In view of the failure of the political process to adhere to good budget and actuarial practices for the past 13 years, it is probably time to add appropriate provisions to the State Constitution to specify permissible and impermissible practices budget practices and to require use of generally accepted actuarial principles and methodologies for determining and funding pension liabilities. There is already a constitutional provision on the State budget.

### ***Bonding Pension Liabilities***

I agree that pension bonding of the type used by the State to over fund the systems to permit pension holidays should definitely not be done. However, local governments that adopted the early retirement incentives are authorized to fund the liability with bonds. It they can obtain interest rates for the bonds that are lower that the interest rate

used by the retirement systems, currently 8.25%, then bonding the liability might be advisable.

### ***Unfunded Pension Liability***

I disagree with the recommendation that the unfunded liability be immediately addressed. I would agree if the State budget were not in such a bad condition. I feel it is possible and advisable to hold off addressing the unfunded liability for a year or two, and then to start phasing the contribution back into the budget. I am hoping that the investment returns will improve substantially now that the investment market seems to be moving upward. Hopefully the recent decision to further diversify the investment of pension assets to include higher risk investments will pay off with significantly higher returns. This should be watched very carefully to ensure the significantly greater costs incurred with these investments and the use of outside managers are justified by higher investment returns.

### ***Pension Abuses, Part-Time Employment and Thresholds***

All of the recommendations concerning abuses and gaming-the-system need further study and consideration. The recommendations of the Task Force indicate a lack of understanding of the problems that lead to abuses and gaming, and that unintended hardships could result to certain members of the system from the recommendations. Multiple positions are a problem primarily in PERS. Part-time employment affects both PERS and TPAF, but it is much more prevalent in PERS. There are many legitimate situations of multiple part-time positions. A lobbyist for the unions at the colleges and universities mentioned the situation of adjunct faculty at the colleges and universities. The colleges and universities, especially the community colleges, use adjunct staff to save money. They are paid low salaries and receive no health benefits. They tried for years to be allowed to participate in the State Health Benefits Program (SHBP). I believe that legislation was enacted recently to permit part-time workers to participate in the SHBP and bear all of the premium cost. The State also uses part-time workers and intermittent workers for processing tax returns and unemployment claims. Because of the large number of small municipalities, there are a lot of part-time positions. They include positions such as municipal court judges and prosecutors, a variety of other legal positions for a myriad of local boards and commissions, tax assessors and collectors,

municipal engineers, and code enforcement officials. These positions present an opportunity for abuse, but it would be inequitable to these employees and harmful to municipalities to require that they designate only one job for pension purposes. More work needs to be done to identify the problem positions and to develop reasonable solutions for pension benefits for these positions.

The threshold for participation in the pension systems also affects primarily PERS. It is not an issue in TPAF and PFRS. PERS is the catchall system covering state employees and local employees not eligible for other systems. The low threshold creates a problem I refer to as “cheap credit.” Assemblyman O’Toole has mentioned this problem several times during the proceedings. The low threshold is attractive to people with political jobs. When there is a change of administration at the State level, especially when there is a change of the party in control, there are usually a number of people looking for paid positions on boards and commissions with sufficient compensation to meet the threshold to continue their PERS membership until they reach vesting or obtain another full time job. Raising the threshold might limit the potential for this to happen, but it might stimulate an increase in the compensation for boards and commission to match the new threshold. My inclination relative to the threshold issue is to limit the system to full-time employees, but this would hurt the legitimate part-time employees. I am not concerned over the claim that the threshold should be kept low so as not to punish poor people who might be in very low paying jobs. What people in low paying jobs need are better paying jobs. If they are working in very low paying jobs, I think they would rather not have money taken out of their low pay for pension benefits. A related problem is the requirement of mandatory participation in PERS if the membership and threshold requirements are met. Some people in low paying jobs would prefer not to participate in a retirement system. Voluntary participation could add to the problem of pension boosting.

Attempts to address the boosting problem are always met with concerns over “legitimate” salary increases near retirement. I believe that all unusual salary increases near retirement are suspect. My response to anyone who claims that an unusual salary increase near retirement that significantly increases a retirement benefit is legitimate would be that control of pension costs and the necessity for predictable experience for actuarial funding of long-term pension obligations requires that salaries near retirement

that will affect pension benefits be controlled. I would further congratulate the individual on the good fortune of receiving the increase in compensation near retirement and suggest that the additional compensation not usable for pension calculations be put in a deferred compensation plan or IRA so that it could be available in retirement

I am not sure what the recommendation for no pensions for professional service contractors and vendors means. Persons who are contractors and vendors for governmental entities are not entitled to enroll in the state retirement system. They are restricted to public employees. If the concern is that persons who are actually contractors or vendors are being considered as employees, this should be considered with the whole area of multiple enrollments, part-time employees and the threshold level.

There are problems of boosting in PFRS and TPAF that have not been identified and discussed by the Task Force. When I was with the Division of Pensions and Benefits, I served as the Treasurer's representative on the Boards of Trustees of the systems through much of my tenure. There was a constant battle over ten years or more on the PFRS Board over attempts by police and fire local unions to include compensation not included in the base compensation for most of their members' careers in base compensation near the time of retirement. The salary used to determine pension benefits is the base salary and does not include overtime or extra compensation for such things as uniform allowances or longevity. The practice had developed in local police and fire contracts to negotiate for several types of extra compensation that would be not included in base compensation. Both local employers and employees benefited from the practice because both avoided pension contributions on the compensation. The PFRS Board, thanks to the efforts of certain member representatives, brought the practice under control and regularly reviewed local contracts to prohibit this practice. I assume the practice is still under control, but I do not know if it is. There is also a minor boosting problem in the State Police Retirement System (SPRS). Members do not pay pension contributions on their maintenance allowance but the amount of the allowance is included their compensation for determining retirement benefits.

There is a more limited problem relative to the TPAF. In some local teacher contracts, there is some optional work that would entitle a teacher to extra compensation, such as, teaching an extra course or assuming an extra curricular duty. The Board

generally approved these items for use in determining retirement benefits if they were specifically included in the teacher's contract. This situation technically may fall within the law and regulations, but the result is significant boosts in retirement benefits, especially if the teacher is a veteran.

This whole area needs more study. Providing part-time credit has been mentioned, but this complicates the administration of the system. It can be done. Other states do it. The pension computer programs would have to be modified to do it. Senator Scutari has mentioned the possibility of using "the whole body of work" in determining pension benefits. When I was with the Division of Pensions and Benefits I thought about this problem and wondered if would be possible to relate the benefit provided to the contributions paid. Contributions are related to salary and for most employees a regular schedule of salary increases is the norm with contributions comprising a reasonable percentage of the pension benefit at retirement. I had someone do a considerable amount of work on trying to identify a reasonable ratio between a pension benefit and the contributions that could be used as a limit for pension benefits. In other words, if the ratio of contributions to a pension benefit is below a standard ratio, the benefit would be reduced to where it matched the standard ratio. The work we did was inconclusive and there was no real interest outside the Division in addressing the problem. I do not know if this could provide a solution. It should be reviewed by the Division of Pensions and Benefits and the actuaries to see if it feasible and what problems it might create.

One way to get a handle on the extent of the problem of boosting would be to do a statistical analysis of the salaries in the final five years of employment and the salary used to determine retirement benefits for each of the retirement systems for all retirees in a current year. Data on the total contributions and the accumulated interest on the employee contributions should be included. Both the Division and the actuaries should have the data, and either could do the analysis. A standard statistical analysis could be done on the data. Mean or median salary increases (whichever is deemed appropriate) for each of the five years could be developed. Standard deviations could be developed and outliers could be identified. A salary scale based on system experience could be developed for the last five years of employment. Salary increases greater than the system salary scale for the last five years of employment could be excluded from pension benefit calculations. If the analysis indicates that this approach is appropriate, it could become

part of the three-year experience studies. The same data could also be used to determine if it is feasible to develop a reasonable minimum ratio between contributions and pension benefits. If either a final five-year salary scale or minimum ratio for pension contributions proves to be a viable solution, other solutions could be unnecessary.

The procedure outlined by the Benefits Task Force for review of the five-year salary history of all retiring employees to see if there is evidence of boosting is already being done by the Division and has been done for many years. The investigation can slow down significantly the processing of a retirement. The items the Task Force considered as acceptable salary increases, legitimate promotions, negotiated contracts and part-time to full-time employment, would be significant loopholes that could lead to significant boosting. The final recommendation relative to these reviews was that in any case (it is not clear if this would include cases where the Division found the increases to be acceptable), a pension based upon the salaries above the systems actuarially based salary increase percentage would not be paid unless the employer pays the unfunded liability. This was tried in the 1980's based on the some general language in the statutes that pensions could only be paid if assets were available and it was struck down in court. Paying the higher pension benefits if the employers pay the unfunded liability is not a good idea because it would have local employers participating in the boosting at the expense of local taxpayers, even though it would not harm the retirement systems. It would not be appropriate to charge a new employer for unfunded liability if the employee took the job near the time of retirement.

### ***Changing Salary Used to Determine Pension Benefits***

I am opposed to changing the basis for determining the final salary used to determine pension benefits from a three-year to a five-year average. Salary is the most significant factor in determining a pension. The accrual rate in PERS and TPAF is 1.82% a year. Salaries generally increase by between 5 and 10% or more in the early years of employment and at or near the rate of inflation near retirement. In standard financial planning, a person would estimate what his or her salary would be at or near retirement and then plan to have a sufficient benefit from pension from employment, social security and savings, usually between 70 to 80% of the salary, so the person's income in retirement would provide a standard of living comparable to that enjoyed before retirement. Changing the average from three to five years moves the benefit salary

further from the salary at retirement, and significantly reduces the retirement benefit. Assuming salary increases for the five years before retirement at the rate of 4%, a three year average would be close to the salary in the second year before the year of retirement. The pension would be based on a salary approximately 4% below the final year salary. Moving to a five year average would move the benefit salary to the salary in the third year before retirement and thus the benefit would be approximately 8% lower. TPAF and PERS have the lowest benefit levels and PERS has the most lower income people. Furthermore, I think it is highly unlikely that the final year salary provision for veterans and police and fire members will be changed.

### ***No Pensions for Convicted Officials***

With respect to the recommendation of no pensions for convicted public officials, there are laws already on the books that address this situation in the appropriate manner. There is a significant body of case law on the subject. Each of the pension boards has procedures for handling these cases. I have participated in many cases involving public employees convicted of crimes and have voted for total or partial forfeiture of pension benefits based on the facts in each case and the relationship of the violations to the public employment. The boards of trustees take their responsibilities in this area very seriously and they do a good job administering it. The current laws works well and there is no need to change to a more draconian approach of total pension forfeiture for public employees convicted of crimes. Pension forfeitures for criminal convictions are generally prohibited in the private sector.

### ***Sick Leave Payouts***

I agree with the recommendation that limitations on sick leave payouts should be extended to all levels of government. This is not a pension problem but it occurs at retirement and there is an appearance that it is a retirement benefit. It is a problem in all areas of local employment, police and fire, regular municipal and educational. Some of the major cases that are reported in the newspapers involve high level police and fire and education officials. Sick leave payout occurs relative to most police and fire retirements. There is a common practice relative to accrued sick and vacation leave and police and fire retirements that is know as terminal leave. It is often addressed in police and fire collective bargaining agreements and attempts have been made to fold compensation for accrued leave in final salary for pension purposes. Under terminal leave, a prospective

police or fire retiree would run out accrued leave by taking the leave right before retirement. There is generally no problem with vacation because the amount is not usually high. Sick leave is another matter. The amount of accrued sick leave could be substantial and there is an issue of whether leave intended for sickness should be turned into leave not caused by sickness at the time of retirement. In the education area, the problem is with high level officials like superintendents of schools. Much of the problem in these cases is what should be permissible compensation for these education officials. I have seen superintendent contracts where the required employee pension contributions were paid by the board of education and other types of additional compensation were provided. If salary increases near retirement are significant, the Division usually investigates the situation to ensure that the salary reported for pension purposes is limited to base salary. The whole area needs review to determine what the real problems are and what the limits should be.

For state employees, the \$15,000 limit should be raised and indexed. The \$15,000 limit is not indexed and has not been changed for a long time. The current value of the sick leave payment is probably half of the original value due to inflation.

### ***Retain Defined Benefit Retirement Systems***

I agree with the recommendation that the current defined benefit systems should be retained. They have provided good pension benefits for public employees and could have provided great benefits to the State and local employers from excess assets if they had been used wisely. If excess assets had not been taken out of the system, it is likely that there would have been substantial assets to fund the COLA and PRM benefits. If the excess assets had been used more wisely in the budget, the funds freed up from pension contributions could have been used for many beneficial purposes without distorting the budget structure.

### ***Eliminating Early Retirement Benefit in PERS and TPAF***

I strongly disagree with the recommendation that the early retirement benefit of retirement after 25 years at age 55 under PERS and TPAF be removed. As I have stated repeatedly in this presentation, PERS and TPAF have the lowest benefits levels that are reflected in their normal costs. The normal costs are reasonable with the PERS being the lowest at 5.67% and 5.02%, for the State and local employers, respectively. The police

systems have early retirement built into the retirement formula. Members can begin to retire at 20 years of service regardless of age on a benefit of 50% of final year salary. A PERS employee can not retire at 20 years of service until age 60, and the benefit would be 36% of final average salary. Both PERS and PRFS members can retire with 25 years of service, but PRFS members can retire at any age on a benefit of 65% of final year salary. A PERS can also retire at any time with 25 years of service but the benefit would be reduced by 3% a year for every year the age was below 55. The retirement benefit would be 45% of final average salary. The disparity in benefits between PERS and PRFS is already substantial. Eliminating the PERS early retirement benefit will make the disparity greater. The discrimination is so palpable it is difficult to understand how it can be considered for members of the retirement system with the lowest benefit levels and the greatest number of low income employees.

### ***Pension Loans***

I strongly disagree with the analysis that pension loans cost the systems a significant amount and the recommendation that they be eliminated. The loan program seems to be a favorite “whipping benefit” when people talk about the state retirement systems. Neither the nature of the benefit nor its financial cost to the retirement systems is well understood nor are they properly characterized. The loan provisions have been in the retirement systems so long, I believe that the interest rate of 4% was probably the interest rate used by the systems when the loans were first authorized. The method used by the Benefits Task Force to illustrate the cost to the retirement systems of the loan program was inappropriate. It compared the loan rate to the interest assumption used by the retirement system. The pension loans are fixed income investments that have no risk whatsoever. They are immune from bankruptcy. Pension loan repayments must be suspended during bankruptcy, but they must be settled at the time of retirement either in a lump sum or through scheduled repayment in retirement. (I do not know if this is still the law, but it was at the time I left the Division.) There is even authorization for repayment out of death benefits if a members or retiree dies with an unpaid loan balance. The repayments are made out regular salary checks during employment or from pension checks for retirees.

A more appropriate comparison of the loan rate as a potential lost investment opportunity is the rate for fixed income investments by the Division of Investment. I do

not know what the current fixed income return for pensions investments is (there is no indication on the Division of Investment website), but I suspect it is in the range of 4% to 6%, and the actual returns will vary from year to year based on market conditions. The pension loans always return 4%. Administration of the loan program by the Division of Pensions and Benefits is so efficient that a loan can be obtained in one week. I remember when it used to take two months. A recent change in payback requirements because of federal law has probably reduced the loan volume. Previously, a member could take two loans a year and receive a new five-year repayment schedule for the new balance (no more than half the contributions). Now additional loans have to be repaid with the repayment period of the original loan. The loan program is a minor benefit of the retirement systems that has a minimal cost impact on the systems. Loans are provided under ABP, the defined contribution program for higher education faculty and professional staff, by the companies that manage the investments for the participants.

If there is concern over loan programs under the retirement systems, the subsidized mortgage loan program under PFRS should probably be investigated. The law governing this program provides that 10% of the investment assets of the retirement system, currently \$1.96 billion, be used to provide the subsidized mortgage loans for PFRS members. PFRS members also have the regular loan program. I am not questioning this benefit for PFRS members, but I am suggesting that if loan programs under the retirement system are of concern, equity requires that the PFRS mortgage loan program also be considered.

### ***Moratorium on Early Retirement Incentive Programs***

I wholeheartedly agree with the recommendation for a moratorium on early retirement incentive programs. The cost savings from the programs are illusory. They may provide some short term savings for a few years, but the savings will disappear at that point (unless there is a significant, continuing reduction in the workforce). The payoff of the liability will go on for a long time.

### ***Health Benefits Recommendations***

I only have a few comments of the health benefits recommendations. I was not as involved with the program during much of my tenure as I was with the pension program. I was always involved with the legal, legislative and regulatory aspects of the program

because this was my responsibility before I became Director. As Director, I was directly involved and learned a lot about the program. I have been away from the program for four years and I do not feel competent to comment on the health benefits recommendations other than what I stated above and my comments that follow. The Division of Pensions and Benefits has an excellent health benefits staff and consultants. They should be able to provide you with whatever information and advice that you might want.

With respect to collective bargaining over health benefits, I support the current statutory provision that authorize the State and other employers participating in SHBP to negotiate the premium obligations for the program. I would continue the practice of not negotiating aspects of plan design, but conferring with employee representatives over plan design issues. Cost sharing of premiums for education retirees and local police and fire members not eligible retiree health benefits from their employers should be enacted soon. It is almost 10 years since cost sharing was adopted for state employees. There is some cost sharing in the police and fire program in that the State only pays for the lowest cost plan. If retirees choose a higher cost plan, they must pay the cost difference. The benefits for these public employees are statutory and can be changed by a change in statute. Discussions should be held teacher and police and fire representatives before any change is made to give them the opportunity to have input relative to the change.

With respect to the recommendation that all current and retired employees should contribute for health care, I agree with the recommendation relative to active employees. For state retirees, I believe that the State is prohibited by statute from changing the payment obligation for retirees entitled to State payment for health benefits either in full or in accordance with the collective bargaining agreement that was applicable to the retiree at the time of retirement. The statute constitutes a contract between the State and the retired state employees that is entitled to the protections against violation of contracts under both the State and Federal Constitutions. The language in the pertinent statute, P.L. 1996, c. 8, s. 6 – NJSA 52:14-17.28b, establishes the contractual nature of the State's promise and obligation to pay for retiree health benefits more clearly and definitively that the statute providing a non-forfeitable right to pension benefits.

The only other comment I would like to make concerns the proposal to change NJ PLUS, a POS or point-of-service plan, to a PPO, a preferred provider organization. I am currently in the NJ PLUS. If the PPO plan provides similar in-network and out-of-network services without referrals, it sounds like it could be as good as or better than the POS. Having the same or similar out-of-network services as NJ PLUS is important.

### ***Pension and Health Benefits Review Commission***

The recommendations on the Commission for strengthening the PHBRC seem impractical. If there is a real desire for an independent watchdog, the responsibilities should be turned over to some independent third party or to consultants. Some states have actuarial audits done on their systems. This area needs more work.

### ***Recommendations for Benefit Increases***

It was interesting that not all of the Commissions recommendations were for benefits reductions. The Commission recommended that the systems offer a life-long survivors benefit to the spouse of a member who dies in active service. At present, a statutory survivor benefits is only payable to a spouse or children of a member who suffers an accidental death on the job. For members whose death is not job related, the benefit payable is the active death benefit or insurance benefit and return of contributions plus accumulated interest. The insurance benefit is substantial, 3 or 3 ½ times final salary. The insurance benefit is payable to named beneficiaries that do not have to include the spouse. Providing a pension benefit in addition would be an additional cost. This proposal needs more investigation.

Changing vesting from 10 to 5 years is not a major change. It does not involve a significant expense. It could help to solve the problem of people seeking part-time employment to continue membership until vesting. Employee representatives sought 5-year vesting in the legislation that provided the non-forfeitable right to no reduction in benefits after five years of service. The State refused to agree to it. Now that section has the confusing wording that vested members have non-forfeitable rights after five years of service. The change would clarify that statutory provision because both the vesting and non-forfeitable right time periods would be the same.

The proposals to retain the defined benefit systems and not to repeal the n/55 benefit increase in PERS and TPAF are both positive recommendations. The defined benefit systems have been very good for public employees in New Jersey. The benefit increase in PERS and TPAF was the first benefit increase in a long time and raised New Jersey from the bottom of all states for pension accrual rates.

### Some Final Comments

Despite the negative tone of some of my comments, I believe that something good can come out of this process of reviewing public employee pension benefits. The last review was done in the early eighties. Based on the Benefit Task Force's report and the Governor's charge to the Joint Session, there may be political will to change long-standing problems. However, the promise of this process will be for naught if there is a rush to make substantial changes in the state pension plans without a clear indication of what the problem is with the plans, other than the well known abuses. The only apparent problem is that pension contributions have to be put back in the State and local budgets after years of pension holidays and the size of the required contributions is large. There seems to be only two choices. The pension costs are rising faster than employee compensation and the budget can not sustain that trend. For PERS and TPAF, I doubt that this is the case. I do know what the trend might be for the police and fire and judicial systems. If the pension costs are not rising faster than compensation, the only other choice is that the pension costs are too high compared to something else, benefits in other states or the private sector. It would be distressing if this is the reason for the reductions in benefits. It is a story we see regularly in the media. Employees in once major businesses are taking big salary and benefit cuts, or losing their jobs. Middle class income is either flat or rising slightly but benefit costs are increasing as many employers reduce payments for benefits. The situation is generating numerous articles and books on the plight of the middle class. Whatever the reason, it would be helpful if it were clearly stated and illustrated. This would go a long way to relieving the crisis atmosphere that surrounds the process and a feeling that the decision has already been made that dramatic changes have to be made in the public employee pension benefits.

Nothing that might be proposed is going to have any significant impact on the State budget or the property tax problem in the short term. If budget relief is still necessary, the unfunded accrued liability payments could be skipped for a year or two. With respect to health benefits, cost sharing mechanisms are already in place for state employees through collective bargaining. Cost sharing provisions for teacher and certain local police and fire personnel need to be established, preferably with consultation with the affected parties.

What I hope the Joint Committee will do is develop a detailed outline based on the Benefits Review Task Force and your own activities over the last four months of what you believe should be done relative to public employees pension benefits. I would further hope that you would stop there and not try to develop legislation to implement your proposals. There is too much more that needs to be done to turn the proposals that have been discussed into a good revision of the state retirement systems. The two oldest plans, TPAF and PERS have been around for over 80 years, PFRS for over 60 years, and the two smaller systems for decades. There is no need to rush a revision of these long standing systems into a short period of time. Once the Joint Committee makes its report, presumably it will be reviewed by Legislative leaders and policy decisions concerning the final outline of the revised pension plans will be made. At this point, I would hope that the process of actually preparing the revisions agreed upon would be turned over to an expert working group, composed of inside experts and outside experts as needed. This group could do any further research or investigation that may be required, check out ramifications of proposals that might not have been anticipated, and prepare all the legislation and any other materials that may be necessary for full development of the revised plans. Revising the state retirement systems is major undertaking and it should not be rushed. Consideration should be given to allowing the representatives of the public employees to have knowledge of and possible input into the process. There are a number of good people representing public employees with extensive knowledge of employee benefits who could be of assistance in the process. This could help reduce the potential for opposition to revision when it is presented to the Legislature.

Thank you for the opportunity to make this presentation. You have done good work to date and still have a difficult job ahead of you. Good luck with your work.

## **EXHIBITS**

- EXHIBIT 1 MAJOR BENEFIT ENHANCEMENTS IN PERS, TPAF AND PFRS FROM 1958 TO DATE**
- EXHIBIT 2 SELECTED DATA FROM 2005 ACTAUARIAL VALUATION REPORTS FOR STATE PERS AND PRFS, TPAF, SPRS AND JRS AND ABP**
- EXHIBIT 3 SELECTED DATA FROM 2005 ACTAUARIAL VALUATION REPORTS FOR LOCAL PFRS AND PERS**
- EXHIBIT 4 10-YEAR PROJECTION OF UNFUNDED LIABILITY AND FUNDED PERCENTAGE**
- EXHIBIT 5 PERCENTAGE INCREASE IN MARKET VALUE ASSETS AND PENSIONS LIABILITIES FOR TPAF, PERS AND PFRS**

## **EXHIBIT 1**

### **MAJOR BENEFIT ENHANCEMENTS IN PERS, TPAF AND PFRS FROM 1958 TO DATE**

#### **ALL SYSTEMS**

- 1958 – Ad hoc percentage increases in retirement allowances for persons who retired from state retirement systems through 1951 starting in 1959.
- 1969 – Annual COLA provided for retirees from state retirement systems beginning in 1970.
- 1971 – Major benefit enhancements including: change in final average salary from 5 to 3 years; change in annual reduction for retirement with 25 years of service below age 60 from 6% to 3%; payment of group life insurance benefit in addition to annual pensions in cases of accidental death (job related).
- 1971- Annual COLA extended to survivors.

#### **PERS**

- 1966 – Relationship to Social Security changed from integration to coordination (offset in retirement benefit for initial Social Security benefit eliminated, but offset in employee contributions related to Social Security contributions retained); minimum ordinary disability percentage increased from 28 1/3% to 40%; vesting period reduced from 20 years to 15 years; participation in PERS required for all public employees not required to participate in another contributory plan.
- 1973 – Age for early retirement with unreduced benefit reduced from 60 to 55.
- 1990 – Actuarial reserve funding provided for COLA and PRM benefits on a phased-in basis.
- 2001 – Increase in the percentage rates for all retirement benefits of 9%.
- 2001 – Special parts established to provide PFRS level of benefits for prosecutors with separate accounts and benefit rates for prosecutor and non-prosecutor service, and JRS level of benefits for workers' compensation judges.
- 2003 – All prior service PERS of county prosecutors included in Prosecutor Part at no additional cost to the members.

## **TPAF, PERS (EDUCATION EMPLOYEES) AND ABP**

1966 - Relationship to Social Security changed from integration to coordination (offset in retirement benefit for initial Social Security benefit eliminated, but offset in employee contributions related to Social Security contributions retained); minimum ordinary disability percentage increased from 28 1/3% to 40%; vesting period reduced from 20 years to 15 years.

1973 – Age for early retirement with unreduced benefit reduced from 60 to 55.

1987 – PRM for qualified retirees (retirement with 25 years of service or on disability) paid by retirement system (State pays the employer contributions to the system); actuarial reserve funding provided for COLA and PRM benefits on a phased-in basis.

1992 – (PERS and ABP) State payment of PRM benefits for qualified educational retirees (support staff) under PERS and from community colleges.

2001 – Increase in the percentage rates for all retirement benefits of 9%.

## **PFRS**

1966 – Accrual rate for service retirement increased from 1.67% (1/60) to 2% (1/50) for first 25 years of service and 1% thereafter; percentage rate for ordinary disability increased from 25% to 40%.

1969 – Special retirement benefit approved that provided for retirement at age 51 with 25 years of service on an unreduced benefit.

1973 – Age limit for retirement on an unreduced benefit with 25 years of service eliminated.

1979 – Special retirement percentage increased from 50% to 60%.

1982 – Salary used for special retirement benefit changed from final three-year average to final year.

1985 – Widow/widower's pension percentage rate increased from 25% to 35%.

1989 – Special retirement benefit rate increased from 60% to 65%; actuarial reserve funding for COLA; State contribution of 1.8% of system covered compensation to fund increased cost of special retirement benefit.

1991 – Widow/widower's pension percentage rate increased from 35% to 50%; State payment for increased cost of benefit.

- 1999 – Rates for service retirement (2% a year up to age 30 and 1% thereafter based on final three-year average salary) changed to special retirement rates based on final year salary; changed compensation basis from final three-year average to final year salary for ordinary disability and deferred retirements and for pensions for surviving spouses and children; increased the ordinary disability percentage rate for members forced to retire by employers between 20 and 25 years of service from 40% to 50% at 20 years and increasing at 3% a year for each additional year of service up to 25 years; provided for pension (instead of a return of contributions) for a widow/widower and children of members who dies in active service (not job related) in addition to 3 ½ times compensation death or insurance benefit; reduced the service requirement for ordinary disability retirement from 5 to 4 years; changed the length of marriage requirement for survivor benefits from one year to marriage at time of death.
- 2003 – Prospective increase in special retirement percentage rates from 65% to 70% with 25 years of service and from 70% to 75% with 30 years of service when the funded level for the retirement system is 104%.