2006
SPECIAL SESSION
JOINT LEGISLATIVE COMMITTEE

PUBLIC EMPLOYEE BENEFITS REFORM

FINAL REPORT

Co-Chairs:
Senator Nicholas P. Scutari · Assemblywoman Nellie Pou

Members:
Senators: Ronald L. Rice · William L. Gormley
Assemblymen: Thomas P. Giblin · Kevin J. O'Toole

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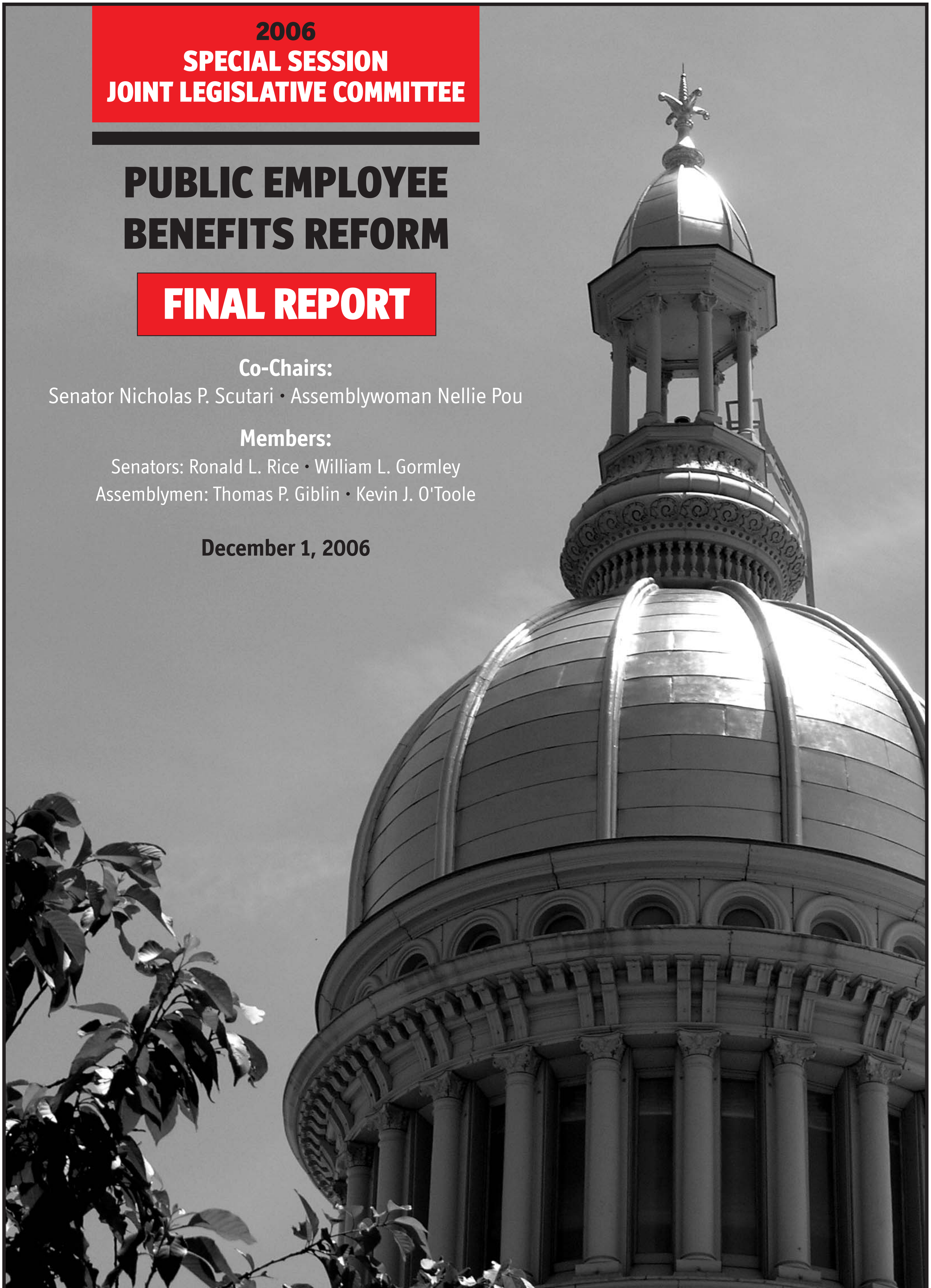

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I. Executive Summary

Pursuant to Assembly Concurrent Resolution No. 3, the Joint Legislative Committee on Public Employee Benefits Reform was charged with identifying proposals that will terminate abuses of the pension systems and control the cost of providing public employee retirement, health care and other benefits.

The Joint Legislative Committee on Public Employee Benefits Reform finds:

- New Jersey's retirement systems have an $18 billion unfunded liability.
- The four main contributors to this unfunded liability are:
    - State and local government employer pension "holidays" totaling $8 billion over seven years;
    - Negative investment returns resulting in a $20 billion loss;
    - Costly pension benefit enhancements and early retirement incentive programs; and
    - Continuous increases in both active and retiree enrollment.
- State Health Benefits Program expenditures total $3.6 billion annually.
    - These expenditures have risen by 150% over the past five years and will double by 2010;
    - State and local governments will soon have to recognize the long-term implications of these employee health care benefits on their financial statements, similar to the way pension obligations are presented;
    - The State's health care benefits unfunded liability is estimated to exceed $20 billion.
- Detrimentally altering the retirement benefits of active members of the retirement systems who have accrued at least five years of service credit, or of retired members, would be unconstitutional as an impairment of contract based on a legal opinion provided by the nonpartisan Office of Legislative Services and similar legal advice prepared by the Office of the Attorney General for the State Treasurer.

- For the benefit of taxpayers, government employees and retirees, and public employers, measures both to ensure that the retirement systems are financially sound and to control the rise in health care benefit costs must be implemented.
- Pension abuses and gimmicks must be terminated through a series of legislative and regulatory measures.
- Implementation of State Health Benefits Program cost-savings strategies will help curtail rising expenses.
- Pension and health care benefits are a significant and increasingly expensive obligation that State and local governments have to their current and former employees. These taxpayer financed benefits contribute to the cost of local property taxes borne by State residents and, therefore, short-term and long-term solutions are necessary.
- The Joint Committee's recommendations identify long term savings through wide-ranging reforms while maintaining the essential components of a competitive system of pensions and benefits, for the workers who deserve it.
- The reforms recommended by this Joint Committee are overdue. Whether some of these reforms are achieved through collective bargaining rather than through legislation is less significant than ensuring that they are, in fact, achieved. Collective bargaining notwithstanding, it is clear that the Legislature needs to attach permanency to a number of the recommended reforms.

The Joint Legislative Committee on Public Employee Benefits Reform recommends:

Pension Benefits

- *Recommendation 1*: Limit defined benefit pension plans to full-time career employees and establish new defined contribution program for all new part-time employees, elected officials and full-time appointed officials

- *Recommendation 2*: Increase retirement age to 62

- *Recommendation 3*: Reduce benefit formula for new members from N/55 to N/60

- *Recommendation 4*: Cap pensionable salary, which is now unlimited, to Social Security wage contribution limit - $97,500 for 2007

- *Recommendation 5*: Base "high salary" pension benefit calculations for new members on higher number of years

- *Recommendation 6*: Designate one job for one pension

- *Recommendation 7*: Repeal non-forfeitable right to pension benefits after five years of pension service

- *Recommendation 8*: Limit pension enrollment eligibility to $5,000 minimum salary

- *Recommendation 9*: Allow all non-vested employees to opt into defined contribution program

- *Recommendation 10*: Exclude all professional service contractors from membership in PERS

- *Recommendation 11*: Require Division of Pensions and Benefits to investigate compensation increases that exceed reasonably anticipated annual compensation increases

- *Recommendation 12*: Close Prosecutors Part of PERS

- *Recommendation 13*: Close Workers Compensation Judges Part of PERS

- *Recommendation 14*: Repeal special retirement benefit enhancement in PFRS

- *Recommendation 15*: Prohibit non-uniform public employees from enrolling in PFRS

- *Recommendation 16:* Require forfeiture of retirement system benefits for public officials convicted of crimes involving abuse of office

- *Recommendation 17*: Replace accidental and ordinary disability benefits with private disability insurance coverage

- *Recommendation 18*: Continue moratorium on benefit enhancements in State-administered retirement systems

- *Recommendation 19*: Continue moratorium on early retirement incentives, except in cases of regionalization and consolidation initiatives resulting in cost savings

- *Recommendation 20*: Eliminate use of excess valuation assets to reduce employers' normal contributions in State-administered retirement systems

- *Recommendation 21:* Use consistent and generally accepted actuarial standards for pension valuations

Health Benefits

- *Recommendation 22*: Require all active public employees to pay some portion of cost of health care insurance premiums

- *Recommendation 23*: Require future retirees to pay some portion of cost of health care insurance premiums

- *Recommendation 24*: Provide flexibility to local government employers participating in SHBP to negotiate different levels of cost sharing and plan selection with their current employees

- *Recommendation 25*: Require that SHBP benefits changes negotiated by State be applied to local governments

- *Recommendation 26*: Limit SHBP participation to those who work at least 35 hours per week

- *Recommendation 27*: Allow local employers participating in SHBP to provide monetary incentives to public employees who elect to waive SHBP coverage

- *Recommendation 28*: Prohibit out-of-State purchased pension service from being creditable towards post-retirement health care benefits

- *Recommendation 29*: Prohibit multiple health care coverage in SHBP

- *Recommendation 30*: Offer SHBP basic health care plan at low cost to public employees and determine cost to employee of SHBP plan according to sliding scale with regard to employee's compensation

- *Recommendation 31*: Mandate use of mail order for maintenance prescriptions and encourage generic drug utilization for SHBP participants

- *Recommendation 32*: Require SHBP bulk purchasing of pharmaceuticals

- *Recommendation 33*: Study use of pharmacy benefits manager

- *Recommendation 34*: Require Division of Pensions and Benefits screening of SHBP for ineligible participants

- *Recommendation 35*: Establish disease and chronic care management program for all SHBP participants

Other Benefits

- *Recommendation 36*: Limit sick leave compensation payable upon retirement to $15,000 for all local government and board of education employees

- *Recommendation 37*: Limit accumulation of vacation leave to one year for all local government and board of education employees

- *Recommendation 38*: Eliminate State's sick leave injury program

- *Recommendation 39*: Increase interest rate charged for pension loans in State-administered retirement systems

- *Recommendation 40*: Review number of State holidays for public employees

- *Recommendation 41:* Ban dual elective office holding

Senator Gormley and Assemblyman O'Toole wish to note that, while they agree with the thrust of this report, they would like to place on the record their firmly held opinion that effective reform requires stronger recommendations in several areas. They would like to acknowledge that the co-chairs have graciously agreed to include their reservations in the relevant parts of this report.

II. <u>Introduction</u>

On June 6, 2006, New Jersey Senate President Richard J. Codey and Assembly Speaker Joseph J. Roberts, Jr. announced "an unprecedented special legislative session" that would work throughout the summer and fall to enact reforms aimed at reducing New Jersey's property tax burden. The session began on July 28, when Governor Jon S. Corzine addressed a Joint Session of the Legislature, noting that New Jersey's property tax levy currently totals $20 billion and provides 46 percent of the State's tax revenues. Without changes to the present system, that amount will reach nearly $40 billion within a decade.

After the Governor's address, Assembly Concurrent Resolution No. 3 was passed by both Houses. It created four bicameral, bipartisan Joint Committees to review and formulate proposals to reform property taxes: (1) the Joint Legislative Committee on Public School Funding Reform, to address public school funding and expenses; (2) the Joint Legislative Committee on Government Consolidation and Shared Services, to address shared services and regionalized functions at all government levels; (3) the Joint Legislative Committee on Public Employee Benefits Reform, to control pension system abuses and the costs of public employee benefits; and (4) the Joint Legislative Committee on Constitutional Reform and Citizens Property Tax Constitutional Convention, to consider property tax reform through amendments to the State Constitution and other proposals.

The four Joint Committees followed an open and inclusive process. Throughout the State and at various hours, they held 32 public meetings, broadcast live and archived on the Internet, and nine public hearings. They solicited testimony in person and through teleconferencing from State and national experts, academics, practitioners, and officials; reviewed thousands of pages of background material; and received over 3,700 public emails. Both partisan and nonpartisan staff contributed research and policy analysis to the work of the Joint Committees and their members. The following is the report of the Joint Legislative Committee on Public Employee Benefits Reform.

III. **Background**

Joint Committee Members

As required by Assembly Concurrent Resolution No. 3, the Joint Committee consisted of six legislative members. Senators William L. Gormley, Ronald L. Rice and Nicholas P. Scutari were appointed by Senate President Codey, who also designated Senator Scutari as Co-Chairman. Assemblymen Thomas P. Giblin and Kevin J. O'Toole and Assemblywoman Nellie Pou were appointed by General Assembly Speaker Roberts, who also designated Assemblywoman Pou as Co-Chairwoman.

Joint Committee Charge

When the special session was announced, the Senate President and General Assembly Speaker noted the charge of the Joint Committee would be to use the Report of the Benefits Review Task Force as a starting point for suggesting changes to the current public employee pension and health benefit systems. The report, issued on December 1, 2005, was the product of a special committee of 10 public officials and private citizens created by Governor Codey, pursuant to Executive Order No. 39 of 2005. The Task Force offered more than 30 recommendations for structural changes that would make the systems equitable and save taxpayer money. Among the specific recommendations were ending pension boosting, tacking and other systemic abuses, including ending pensions for vendors and contractors; implementing strategic pension reforms, including adjustments to the defined benefit plans so that the retirement allowance calculation is based on the highest five or three years of salary, depending on the type of retirement, instead of the highest three years or one year of salary, as it is currently; and implementing strategic health care reforms, including requiring all public employees and retirees in the State Health Benefits Program (SHBP) to contribute to the cost of their health care benefits.

Materials Provided to Joint Committee

To facilitate and inform the Joint Committee's work, binders containing pertinent information were complied for each member by the staff of the Office of Legislative Services. Beginning with a copy of Assembly Concurrent Resolution No. 3, the binders included the Report of the Benefits Review Task Force, followed by documents that give a complete and current description of New Jersey's State government workforce. These initial sections are followed first by a section with detailed information about the State's pension systems for public employees and more general information about public pension systems in general, including in different states, and then a section with detailed information about State-provided health benefits for public employees and more general information about health benefits, including for public employees in other states. Media articles about public pensions and health benefits, legislation on those issues introduced in the 2006-2007 session of the Legislature, and media polling results on public employee salaries complete the materials in the binder.

Joint Committee Plan

To provide the public with as much access to the Joint Committee's deliberations as possible, the members adopted a committee work plan with several elements. It was agreed that meetings were to be held regularly, with some occurring in Trenton and some in different parts of the State. Public notice about the meetings would be given at least five days before their occurrence and the public would be invited to attend. Information about the meeting times, the documents in the binders and complete transcripts of the meetings were to be available on the Internet site set up for each special Joint Committee on the homepage of the New Jersey Legislature. Most of the Joint Committee's meetings were televised. In order for Joint Committee members to learn more about the State's pension systems and the health benefits, experts on those issues were asked to make public presentations. Among those testifying were public officials from the Division of Pensions and Benefits in the Department of the Treasury, including Mr. Frederick J. Beaver, Director of the Division, Mr. John D. Megariotis, the Division's Deputy Director of Finance and Ms. Florence Sheppard, the Division's Deputy Director of Benefit

Operations. Also providing information were Mr. William A. Reimert, an actuary with Milliman Global and Mr. Philip D. Murphy, chair of the Benefits Review Task Force. Many representatives from labor organizations, business, county and municipal organizations and members of the general public attended the meetings and offered information to the Joint Committee.

<u>Summary of Comments Received by Electronic Mail</u>

The Joint Committee received a total of 875 public emails over the course of its deliberations. The emails were helpful in highlighting areas of potential reform and offered a broad array of recommendations. While the recommendations represented a wide range of opinions and perspectives, several common messages emerged. One message heard by the Joint Committee was that New Jersey public sector pensions and benefits need to be brought in line with the private sector. Another message heard by the Joint Committee was that many current, career public sector employees believed changes to the pension and benefits system would violate the commitment the State made to them over the course of their careers and ignore the fact that they have paid their fair share of pension contributions into the system.

Emails were received and reviewed by the members of the Joint Committee on a daily basis and a number of the suggestions led to specific recommendations present in the final Joint Committee report. Examples of recommendations contained in the public emails to the Joint Committee that became part of the final report include:

- Increase the interest rate on pension loans
- Align the State retirement age with the Social Security retirement age
- No pension for politicians found guilty of a crime
- Eliminate pension boosting and tacking
- Public employees must contribute to the cost of medical insurance
- Make the State Health Benefits Program more flexible and offer a PPO
- State employees should not be allowed to collect more than one pension
- Cut back on State holidays
- Implement a two tier system for pensions

Many of these ideas were included in multiple emails and many of the emails offered a variety of solutions. One-hundred-forty-four (144) of the emails recommended some type of public pension reform, including the use of a 401(k) or making significant changes to the existing defined benefit pension plans. One-hundred-forty-two (142) of the emails recommended changes to the health benefits system, including reductions in benefits and increased cost sharing for public employees. Over 136 of the emails focused on ending abuse and gaming of the pension system. One-hundred-twenty-six (126) of the emails were written in support of maintaining the current level of public worker benefits. Finally, 123 emails recommended reducing government spending, reducing the size of the workforce, and running the State more like a business.

The emails submitted to the Joint Committee helped reinforce the importance of this Joint Committee's charge: to address abuses of the system and to control the costs of public employee retirement, health, and other benefits without unfairly diminishing protections afforded to the full-time, rank and file employees who have earned and contributed to their pensions. The public input and open communication was an important element to this process.

IV. Summary of Meetings

The Joint Legislative Committee on Public Employee Benefits Reform (Joint Committee) held a total of nine public meetings over three months. Seven of the meetings were held in the State House Annex in Trenton, one was held at Clifton High School, in Clifton, Passaic County and one was held at Gloucester County College, in Sewell, Gloucester County. The following is a summary of each meeting.

Overview of Pensions and Health Benefits

August 9, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

On August 9, the Joint Committee met in Committee Room 4 of the State House Annex to organize and receive a presentation by Frederick J. Beaver, Director of the Division of Pensions and Benefits. The meeting began with opening remarks by each Joint Committee member. Co-Chair Scutari spoke first; he discussed the current state of the pension system, and the task ahead of the Joint Committee. Co-Chair Pou then delivered her opening remarks, in which she defined the problems before the Joint Committee and the goals that the Joint Committee should seek to achieve. Senator Rice expressed his concerns regarding not blaming rank-and-file government workers for the issues before the Joint Committee, and commented that the Joint Committee should look to the health care industry in its examination of the rising costs of health care. Assemblyman Giblin discussed the issues facing the Joint Committee, and the scope of the reform measures the Joint Committee would recommend. Senator Gormley stated that the Joint Committee's process would be meaningless unless there were simultaneous contract negotiations held with public employees, and spoke about specific legislation that had been previously enacted regarding public employee pensions. Assemblyman O'Toole spoke about the experiences that shaped his thinking about public employee benefits, and mentioned some of the issues he felt the Joint Committee should explore in detail.

Following these opening comments, Co-Chair Scutari introduced Frederick J. Beaver, Director of the Division of Pensions and Benefits. Accompanying Mr. Beaver was Deputy Director of Finance, John D. Megariotis, and Deputy Director for Benefit Operations, Florence Sheppard.

The Joint Committee received a PowerPoint Presentation from Director Beaver, in which he provided the Joint Committee with the basic facts of the State-administered pension systems. Mr. Beaver stated that the State of New Jersey has the second largest public employee benefits program in the nation. The mission of the program is to attract and retain a skilled and competent workforce. The Division of Pensions and Benefits administers nine pension systems, three supplemental retirement savings plans, the State Health Benefits Program (SHBP), and various voluntary benefit plans. There are more than 740,000 active and retired participants in defined benefit plans, 16,000 participants in the defined contribution program, 802,000 covered lives in the SHBP, and over 122,000 participants in the various voluntary benefits plans. State benefits program costs are estimated to rise to $6.3 billion by fiscal year 2010.

Joint Committee members asked Mr. Beaver a number of questions to solicit additional information on the scope and cost of the current pension and health benefits systems. The topics discussed included:

- The pension loan program;
- How public employee salaries and benefits compare to those in the private sector;
- The different contribution rates for employees in different pension systems;
- Information on employees who hold multiple jobs;
- How New Jersey compares with other states' funding of pension systems;
- The new GASB accounting standards;
- Local employers reentering SHBP;
- The total unfunded liability of the systems;
- Changes in retirement calculations; and
- Other issues and recommendations that the Joint Committee may consider.

Legal Issues Related to Changes to Pension Benefits

August 23, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

The August 23 meeting of the Joint Committee was held in Committee Room 11 of the State House Annex. Each Co-Chair gave an opening statement, in which they stated that the purpose of the meeting was to receive a presentation from the Office of Legislative Services (OLS) on the legal parameters related to changes to pension benefits. Co-Chair Pou introduced Peter J. Kelly, Principal Counsel of OLS. Accompanying Mr. Kelly was Pamela H. Espenshade, Principal Counsel.

Mr. Kelly stated that OLS was asked to address the following question: whether the Legislature, by law, may reduce the retirement benefits that have been provided for public employees in the statutes establishing the various State-administered retirement systems. He stated that it was OLS's opinion that legislation that has the effect of detrimentally altering the retirement benefits of active members of State-administered retirement systems who have accrued at least five years of service credit, or of retired members, would be unconstitutional as violative of the federal and State constitutional proscription against impairment of the obligation of contracts. Mr. Kelly summarized OLS's reasoning as follows:

- In 1997 the New Jersey Legislature enacted a statute that confers on a public employee a non-forfeitable right to pension benefits established by law after the employee has served for five years;
- In enacting that law the Legislature intended to establish a contractual right;
- Both the federal and State constitutions prohibit the impairment of a contract; and therefore,
- Promised retirement benefits cannot be altered.

Mr. Kelly then discussed the context of New Jersey case law and case law in other jurisdictions with respect to this issue and described how the philosophy underlying public employee pensions has evolved. He described the 1997 enactment of N.J.S.A.43:3C-9.5 which established, for members of State-administered retirement systems, a non-forfeitable right to receive benefits.

Mr. Kelly described how a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State. He noted that when a state impairs a contract to which it is a party, the state's self interest is at stake and the courts will more closely scrutinize a legislative assessment of reasonableness and necessity. He described the standards of review that must be met, and concluded that when these standards are applied to legislation having the effect of reducing pension benefits to which, by law, non-forfeitable rights have attached, it is apparent that the state would be impermissibly impairing the obligation of a contract to which it is a party.

Mr. Kelly noted, however, that in many states that recognize contractual or vested rights of a public employee in a state or local pension system, those rights are subject to a reserved legislative power to make reasonable modifications in the plan, or to modify benefits, if there is a simultaneous, offsetting new benefit of equal or greater value. Thus, such a substitution of one benefit for another may be permissible without impairing the obligation of a contract as long as the change is reasonable and any disadvantage to the members is accompanied by offsetting and counterbalancing advantages.

Mr. Kelly stated that OLS believes that when a member has served and retired, all of the conditions precedent to the receipt of a pension have been fulfilled and the member's benefits may not be changed to his or her detriment. Additionally, increases in benefits can become a contractual right. Although it appears that the retirement benefits for members with fewer than five years of service could be detrimentally altered, implementation of any change may have to be limited to prospective application. That is because it would be inequitable to rescind credit earned for the period prior to completing five years of service.

Following Mr. Kelly's presentation, the Joint Committee members asked several questions of Mr. Kelly and Ms. Espenshade. The topics of discussion included:

- Whether other states have similar laws regarding non-forfeitable rights;
- What impact repealing the 1997 law would have;
- What level of benefits is guaranteed to public employees;
- Under what circumstances the contractual right to a pension could be impaired;
- Whether the State can change benefit levels for employees with less than five years of service credit;
- Distinctions between rights guaranteed to active and retired employees;
- The funding of the pension systems;
- Issues regarding individuals holding multiple public jobs; and
- The counterbalancing of pension and health benefits.

The Joint Committee members then discussed the future meetings of the Joint Committee, and whether the Joint Committee should continue to focus on the pension systems, or shift its focus to health benefits.

State of the State Pension Systems

August 24, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

The Joint Committee met on August 24 in Committee Room 11 of the State House Annex. Co-Chair Scutari and Co-Chair Pou made their opening remarks, and Co-Chair Scutari introduced Frederick J. Beaver, Director of the Division of Pensions and Benefits. Mr. Beaver began by addressing several of the Joint Committee's concerns from the previous day's meeting, including how public employee pension systems are different than private sector systems and the auditing process. Mr. Beaver then gave a PowerPoint presentation to the Joint Committee in which he discussed actuarial methodology and the budget implications associated with the pension systems, the history of the pension systems, the current status of the various plans, and the Benefits Review Task Force.

Mr. Beaver began by discussing the nature of a defined benefit plan, and the risks associated with such a plan. He discussed how experience determines the key drivers for funding defined benefit plans, such as life expectancy, the size of the workforce, the length of career service, salary growth, and inflation. He noted that gains and losses are recognized over a rolling five years to limit volatility. He stated that actuarial value of the assets versus the actuarial liabilities determines both funding status and the need for employer contributions. Funding of a defined benefit plan requires dynamic change over time. As an example, he noted that currently the systems have an unfunded accrued liability of about $18 billion, which is amortized over a 30-year period. He stated that the cost of pension and other employee benefit programs is increasing at a rapid pace, and the challenge is finding adequate funding to meet an ever growing demand among competing interests.

Mr. Beaver then discussed the funding of all the pension systems, including the asset to liability ratio for each system, and where New Jersey ranks with the funding of its systems nationally. He described the recent history of pension funding in New Jersey, including the issuance of pension obligation bonds, the authorized temporary changes in the actuarial method, the authorized use of surplus assets to offset employer contributions, the reduced employee contributions for PERS and TPAF, and the backloaded debt service. He noted that surpluses grew in the late 1990's due to proceeds from the bond sale. Investment returns declined beginning in fiscal year 2001, and benefits were enhanced for PERS and TPAF in fiscal year 2002, and PFRS in fiscal year 2000, adding over $5 billion in liabilities to the systems. There were limited or no employer contributions to the systems for seven years; by fiscal year 2004 the pension contribution "holiday" came to an end, and the phase-in of contributions was adopted. Mr. Beaver stated that New Jersey's liabilities are growing faster than its assets. To address these issues, Mr. Beaver suggested that the employers must make or increase the employer pension contribution, work to improve investment performance, and better match growth in assets and liabilities.

The recommendations of the Task Force report were then discussed, with Mr. Beaver delineating which were long and short term goals, as well as other recommendations. The members of the Joint Committee asked Mr. Beaver questions on several topics, including:

- The unfunded accrued liability of the pension system;
- Changing the retirement age;
- The standard for full-time employment as it relates to enrollment in a pension system;
- The impact to PERS if employees with less than five years service credit and new employees were placed in a 401(k) plan;
- Remittance of local employee and employer contributions;
- Qualifications for being in the SHBP;
- The pension loan program;
- The rate of return on the pension fund;
- Disability retirement;
- Employees who hold multiple public jobs;

- The issue of "tacking" several public jobs;
- Being able to opt out of a pension system;
- The purchasing of service credit;
- Longevity concerns;
- The funding ratios for each pension plan; and
- Recommendations to simplify the pension system.

Defined Benefit and Defined Contribution Pension Plans

August 31, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

On August 31, the Joint Committee met in Committee Room 11 of the State House Annex. Co-Chair Pou began the meeting by mentioning a legal opinion that was released by the Attorney General on August 25 that concurred with the OLS opinion presented to the Joint Committee on August 23. Based on these two opinions, Co-Chair Pou stated that it is not likely that the Joint Committee would be able to negatively affect the pensions of current public employees. However, she stated that the Joint Committee would still have the ability to make significant changes to the pension systems that would foster long-term cost savings through real reform. She stated that the purpose of the day's meeting was to look at different options for public employee pension systems, including both defined benefit and defined contribution plans. The Joint Committee would also focus on two-tier retirement plans for the State public employee workforce. She noted that transitions to two-tier benefits plans were currently being implemented in this State at New Jersey Transit, which the Joint Committee would hear testimony from later that day. Co-Chair Scutari opened the meeting by stating that he was interested in exploring hybrid plans that retain the defined benefit element of the current system, while including a defined contribution component. He noted that they can serve to reduce the employer's overall liability while, at the same time, providing guaranteed retirement income to employees.

Co-Chair Scutari then introduced Frederick J. Beaver, Director of the Division of Pensions and Benefits. Accompanying Mr. Beaver was Deputy Director of Finance, John D. Megariotis, and Deputy Director for Benefit Operations, Florence Sheppard. Mr. Beaver delivered a PowerPoint presentation on the Alternate Benefit Program (ABP) to the Joint Committee. Mr. Beaver spoke about the following with respect to the ABP: the history of the program, the current membership and costs, who is eligible to participate, the employer and employee contribution rates, vesting, long-term disability, life insurance, and pension loans. Joint Committee members were then given the opportunity to ask several questions of Mr. Beaver and his staff, including questions about:

- Administrative costs of ABP as compared to the defined benefit plans;
- The implications of switching employees with less than five years of service credit and new employees into a defined contribution plan;
- Employer contributions to a defined contribution plan;
- The increase in benefits costs;
- Examples of what an employee who entered the workforce would achieve after 25 years under PERS and ABP; and
- Potential cost savings that may result from shifting from a defined benefit plan to a defined contribution plan.

The Joint Committee then invited Mr. William A. Reimert, Actuary, Milliman Global, to deliver a PowerPoint presentation. Mr. Reimert introduced himself as an actuary with the firm of Milliman, which is retained by the Division of Pensions and Benefits as actuaries to the Teachers' Pension and Annuity Fund (TPAF). Mr. Reimert began by giving background information on PERS and TPAF, the two largest systems, based on the last valuations done for both systems in July 2005. Mr. Reimert then discussed some underlying issues involved with his analysis. He noted that if PERS and/or TPAF were closed to new members, the amortization of the unfunded accrued liabilities will need to be accelerated in order to accumulate sufficient assets to pay benefits when they are due. He also stated that establishing a new defined contribution plan may increase the required employer contributions over the near term (a decade or more) relative to the current defined benefit plans, even though it may reduce employer contributions over the longer term. Mr. Reimert then discussed some of the options for changing the pension systems that were before the Joint Committee. He stated that some of the options available to the Joint Committee include: modifying the current features in the defined benefit plans for new hires, closing the current defined benefit plans and creating a defined contribution plan for new hires, and offering current members the option of moving to a new plan. Mr. Reimert then described the major differences between defined benefit and defined contribution plans to the Joint Committee. Joint Committee members asked several questions of Mr. Reimert. Topics that were discussed included:

- Other systems that New Jersey could compare itself to;
- Cost savings if the State shifted to a defined contribution plan;
- Potential changes to the defined benefit plans;
- The possibility of creating different plans based on levels of compensation;
- Differences between private and public sector plans;
- How pension funds are being invested;
- Whether the State would have to accelerate payments to the defined benefit plans if the plans were closed;
- Whether the "n/55" calculation for retirement benefits is appropriate;
- The calculation of service credit for part-time employees; and
- The accuracy of the data presented.

Following Mr. Reimert's presentation, the Joint Committee invited H. Charles Wedel, Chief Financial Officer and Treasurer, New Jersey Transit Corporation, to deliver a PowerPoint presentation to the Joint Committee. Mr. Wedel explained that, historically, New Jersey Transit's non-agreement employees and bus union employees had been in defined benefit pension plans that are similar to PERS. Beginning in fiscal year 2007, New Jersey Transit implemented a new defined contribution plan, a 401(a), for new non-agreement employees. This plan, with a fixed company contribution, is in lieu of the traditional defined benefit pension plan. Current non-agreement employees will also be offered the option of switching from the current defined benefit plan to the new 401(a) plan. In addition to the 401(a) plan, new non-agreement employees will still have the option of contributing to a traditional 401(k) plan, which would supplement their primary 401(a) plan. Mr. Wedel explained that the benefit of the new plan was not cost-savings but the predictability of pension cost. The members of the Joint Committee asked Mr. Wedel several questions on topics including:

- The employer contribution to the plan;
- Benefits enhancements in the defined benefit plan;
- The unfunded liability in the defined benefit plan;

- Current employees opting into the 401(a) plan; and
- Risks in defined contribution plans.

The State Health Benefits Program

September 13, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

The September 13 meeting of the Joint Committee took place in Committee Room 11 of the State House Annex. The purpose of the meeting was to provide Joint Committee members with an overview of the State Health Benefits Program (SHBP).

Frederick J. Beaver, Director of the Division of Pensions and Benefits, accompanied by Deputy Director of Finance, John D. Megariotis, and Deputy Director for Benefit Operations, Florence Sheppard, presented the Joint Committee with a PowerPoint presentation on the SHBP. Mr. Beaver began by describing the structure and membership of the SHBP. He then discussed the increase in participation over time and the costs for active and retired employees. He noted that coverage for retirees now costs more than coverage for active employees, and discussed who pays for retiree coverage. He gave an example of the rate structure for NJ PLUS. He then spoke about what is driving the cost of health care, and the ways SHBP manages health care costs. Mr. Beaver discussed several plan modification proposals, and then described the recommendations in the 2005 Task Force Report. Joint Committee members then asked Mr. Beaver questions regarding:

- The prescription drug program;
- The Chapter 330 program;
- The differences in retiree health coverage between teachers and State employees;
- What parts of health benefits coverage are governed by statute, the State Health Benefits Commission, or contract negotiations;
- Costs of the SHBP;
- How the rates are structured for different groups of employees;
- Potential areas for cost savings;
- Offering an incentive to opt out of dual health benefits coverage;

- Replacing the Traditional Plan and NJ PLUS with a preferred provider organization (PPO);
- Post-retirement medical benefits liability;
- The expected rate of retirements over time;
- Increased in health care costs;
- Ways to structure a health benefits plan;
- The premiums paid by employees;
- Local employers who leave SHBP;
- Termination of coverage;
- Coverage for dependents under age 30;
- Administrative fees; and
- Out of state retirees.

Testimony from the Public on Pensions and Health Benefits

September 19, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

The September 19 Joint Committee meeting was held in the Clifton High School Auditorium, Clifton, Passaic County. Co-Chair Pou opened the meeting by describing the work of the Joint Committee thus far, and then testimony from members of the public was taken. Forty individuals testified and written comments were also accepted. Some of the individuals who testified represented local governments, school boards, education associations, public employee unions, law enforcement, State colleges and universities, and various interest groups. Several private citizens also testified.

The Joint Committee heard testimony on a variety of issues. The concerns most often mentioned were: opposition to a two-tiered benefits system; reasons why a defined benefit plan should be maintained; decreased participation by school districts in the State Health Benefits Program (SHBP); adding incentives for school employees to waive coverage under SHBP; the importance of health benefits to retired public employees; how part-time employees should receive service credit; and the importance of pension and health benefits in retaining employees in the public sector. The overall theme was that the State should not join the private sector in a "race to the bottom" in offering benefits.

Another prevalent concern was the belief that the "pension holiday" and system abusers were to blame for the current funding situation, not rank and file workers.

Other topics mentioned included: the mandating of local enhanced benefits, professional service contractors' eligibility for pensions, early retirement initiatives, the uniqueness of the Police and Firemen's Retirement System (PFRS), the changes in pension and health benefits coverage over time, New Jersey residents who are uninsured, differences between private and public sector benefits, projected costs for SHBP over the next few years, municipalities' skipped pension payments, allowing local governments and school boards to pool employees for increased bargaining power when purchasing benefits, whether benefits should be provided to elected officials, and suggestions for cutting costs in health benefits.

Reducing and Containing Costs Related to Pension, Health, and Other Employee Benefits

October 12, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

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The Joint Committee met on October 12 in Committee Room 11 of the State House Annex. The purpose of the meeting was to hear testimony from invited constituency groups on measures to reduce and contain costs related to State and local pension, health, and other employee benefits. The Joint Committee received testimony from representatives of twelve organizations.

The Joint Committee first heard from representatives of different public employee unions, beginning with Richard R. Dorow, Executive Director, New Jersey Association of School Business Officials. Mr. Dorow presented six areas of concern to the Joint Committee: TPAF employee contributions, alternative investments of the pension fund, the inflexibility of SHBP, the $1,500 threshold for enrollment in the pension fund, pension abuse, and certain professionals who are enrolled in pension plans and receive health benefits.

Following Mr. Dorow, the second speaker was Joyce Powell, President, New Jersey Education Association. Ms. Powell stated NJEA's position that pension and medical benefits should not be tiered or reduced. Ms. Powell then offered several suggestions for the Joint Committee to consider: bulk purchasing of drugs, ending abuses to the pension system, implementing positive incentives for people to stay on the job longer, and maintaining the integrity of the SHBP.

The third speaker was Robert Master, Legislative and Political Director, District 1, Communications Workers of America. Mr. Master spoke about the history of the collective bargaining process. He discussed the genesis of the NJ PLUS plan, and stated that it costs the State 25% less than the average cost of health plans in the private sector.

He also noted that the contract that was negotiated in 2003 saved the State an estimated $400 million. Mr. Master concluded by saying that collective bargaining has worked before, both for State workers and for the citizens of New Jersey, and it can work again.

Following Mr. Master was Rob Nixon, speaking on behalf of the New Jersey State Policemen's Benevolent Association and the New Jersey State Firemen's Mutual Benevolent Association. Mr. Nixon began by discussing the pension and benefits offered to police and firefighters. He then discussed several areas in which the Joint Committee could focus, including the inflexibility of SHBP, the lack of choice in SHBP, and dual health benefits coverage. He ended by emphasizing that police officers and firefighters are public employees who are compensated and provided benefits not necessarily for what they do, but for what they may be asked to do.

The fifth speaker was Peter Guzzo, representing the American Association of University Professors, the New Jersey American Federation of Teachers, Health Professionals and Allied Employees, the New Jersey State Fraternal Order of Police, and the Professional Firefighters Association. Mr. Guzzo began by reminding the Joint Committee that public employees have continued to pay their fair share into the pension systems. He asked that if a system is devised to address the holding of multiple jobs that the Joint Committee consider that part time and adjunct faculty at State colleges and universities teach classes at four or five different colleges and universities, and that their needs should be considered.

Joint Committee members then asked questions of the speakers on topics including contributions into the pension system from police and firefighters; reasons why police and firefighters' benefits are not suited to a tiered system; qualifications for being part of PFRS; distinctions between college faculty who are in PERS and ABP; school related staff who are in PERS; contracting out of school services; and the Prosecutors Part in PERS.

Co-Chair Scutari then asked Frederick J. Beaver, Director of the Division of Pensions and Benefits, to further discuss the Prosecutors Part in PERS. Mr. Beaver stated that the benefits under the Prosecutors Part are similar to those under PFRS. Co-Chair Pou asked Mr. Beaver which individuals in the Attorney General's office are covered under the Prosecutors Part. Mr. Beaver described the distinctions between which individuals are in the Prosecutors Part and which are not.

Senator Gormley asked questions regarding the capping of sick leave payouts at $15,000. Mr. Nixon, Ms. Powell, and Mr. Dorow stated that the issue should be dealt with in the collective bargaining process.

Following the testimony from the labor organizations, the Joint Committee invited individuals representing the business community to testify. Kathleen A. Davis, Executive Vice President and Chief Operating Officer, Chamber of Commerce, Southern New Jersey, discussed a survey that provided a comparative analysis of private and public employee benefits. The survey found that State government employees are paid comparable or greater salaries than their counterparts in the private sector; have more paid time off; pay less for their health benefits; have better benefits plans; and that most private sector companies are moving toward 401(k) retirement plans and away from defined benefit pension plans.

Following Ms. Davis was Christine Stearns, Esq., Vice President Health, Legal Affairs, and Small Business Issues, New Jersey Business and Industry Association. Ms. Stearns began by stating that escalating government spending is bankrupting businesses and putting them in a very difficult position. She noted that compensation for public employees, in wages and benefits, exceed those being offered in the private sector. She stated that the health benefits package offered in the public sector should reflect those being offered in the private sector, and cost sharing should be instituted. She recommended looking at the deductibles and co-pays under SHBP, and considering moving to a PPO plan. She stated that management of SHBP should be given the ability to respond quickly to changes in the health care environment, and that a higher quality of care should be encouraged. With respect to pensions, she recommended that the State move all employees with less than five years of service credit, and all new employees, into a defined contribution plan.

Lynne Strickland, Executive Director, Garden State Coalition of Schools spoke next. Ms. Strickland spoke about the high costs and inflexibility in the SHBP. She suggested implementing opt-out provisions for employees that already have coverage via a spouse's policy, and instituting a waiver incentive. Other options she provided include allowing districts to negotiate with individual bargaining units regarding their plan options, and allowing districts to offer a variety of health insurance options. She then gave several examples of how much money individual districts have saved after leaving the SHBP.

Next to testify was Barbara Horl who is a lobbyist for the New Jersey School Boards Association. Ms. Horl advocated making the SHBP more flexible, specifically highlighting the uniformity rule as too restrictive on local governments. Additionally, she noted that levels of deductibles and co-pays are set by statute and therefore not negotiable, and incentives for non-enrollment may not be negotiated. She advocated giving school districts the ability to negotiate tiered benefits and the right to offer waivers for duplicate coverage.

John G. Donnadio, Esq., Legislative Director, New Jersey Association of Counties, testified next. He provided the Joint Committee with specific examples of how counties have taken the initiative to save taxpayer dollars and still provide comprehensive health care coverage for public employees. Mr. Donnadio gave examples of cost savings in Sussex, Somerset, and Monmouth counties. He also stated that, as far as he knew, every county has a cap on sick leave payouts.

Following Mr. Donnadio was L. Mason Neely, Co-Chair, Pension and Health Study Committee, New Jersey State League of Municipalities. Mr. Neely raised several issues, including the cost to municipalities for PFRS pensions, State mandates, arbitration, pension maximization, pension loans, thresholds for enrollment, early retirement incentives, disability retirement, and opt-out provisions.

The Joint Committee members then discussed several topics with the speakers, including increased flexibility in SHBP, and school districts that have left SHBP reentering the plan.

Testimony from the Public on Pensions and Health Benefits

October 18, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

On October 18, the Joint Committee met at Gloucester County College in Sewell, Gloucester County. The Joint Committee received testimony from eighteen members of the public, and written testimony was also accepted. Those testifying represented various interests including local governments, public employee unions, advocacy groups, and education associations. Several private citizens also testified.

The Joint Committee heard testimony on a variety of issues, including: the importance of public employee pensions and benefits; legislative mandates; putting property tax relief from the State into a dedicated account; pensions for part-time municipal attorneys and other part-time employees; wages paid to public sector employees compared to the private sector; the collective bargaining process; giving employees a choice between defined benefit and defined contribution plans; ethics in State government; the cost of health insurance; benefits as a recruitment and retention tool; and the effects of the uninsured population on society.

During the meeting, the Communications Workers of America (CWA) Local 1033 delivered a PowerPoint presentation entitled "Comparative Benefits for Public Workers: Unlocking the Truth through Indexing," in which the CWA stated that it sought to do the following: index the benefits provided to New Jersey State workers with public worker benefits in other states; present data to show that the State of New Jersey does not have a "Cadillac" plan; refute the anti-state worker "bashing" program that is "generated by members of this Legislature and funneled through the media;" provide facts to the members of this Joint Committee to establish a basis to objectively evaluate the true worth of the benefits received by public workers; and establish the basis for enhancing public worker benefits through the collective bargaining process.

Governor's Benefits Review Task Force Recommendations

October 25, 2006 Meeting of the
Joint Legislative Committee on Public Employee Benefits Reform

The Joint Committee's October 25 meeting was held in Committee Room 4 of the State House Annex. Co-Chair Scutari opened the meeting and then invited Philip D. Murphy, Chair of the Governor's Benefits Review Task Force, and Principal, Murphy Endeavors, LLC, to testify before the Joint Committee. Mr. Murphy began by giving the Joint Committee background information on the Governor's Benefits Review Task Force and the pension and health benefits issue in the State. Mr. Murphy then outlined the Task Force's recommendations, including the State's obligation in financing pensions; addressing pension abuses; keeping a defined benefit plan; raising the retirement age to 60; basing the calculation of a pension on a broader number of years; changing the threshold to enter the pension system to $5,000; and imposing a moratorium on early retirement programs and benefit enhancements. With regard to the one-job, one-pension issue, Mr. Murphy stated "I think the spirit of our recommendation is, the pension ought to be for a legitimate, single, full-time occupation." He also stated that while he was generally not in favor of a two-tier pension system, given the current situation, the worst possible option would be to do nothing. Mr. Murphy also suggested the sale of a State asset to cover part of the unfunded liability.

On the issue of health care, he stated that all public employees should contribute something to their premium; NJ PLUS and the Traditional Plan should be merged into a new PPO; health care benefits negotiated on the State level should be applied to the local governments; greater health care options should be provided; and changes should be made to the prescription drug program. He also suggested that there be independent experts to inform the Legislature and Executive branch about costs related to changes in benefits.

The Joint Committee asked several questions of Mr. Murphy, including topics such as: whether the Task Force considered who its solutions could constitutionally apply to; why the Task Force was not in favor of a two-tier system; the threshold for enrollment in the pension systems; the amount of years to vest in the pension system; cost-sharing of health benefits costs; health care premiums; sick-leave payouts; phasing in certain reforms; the unfunded accrued liability in the pension systems; changing the retirement age; having a separate plan for elected and appointed officials; the number of years' salary a pension should be based on; individuals holding multiple public jobs; costs for the prescription drug program; providing a basic health care program; and other recommendations Mr. Murphy had made.

V. **Overview**

Pension Benefits

Unfunded Liability At $18 Billion

Early in the history of New Jersey's State-administered retirement systems, the State Legislature recognized the need to place these systems' plans on a sound financial footing by requiring the application of generally accepted actuarial principles to pre-fund public employee pensions. Through adherence to sound pension funding principles, in accordance with the Governmental Accounting Standards Board (GASB), New Jersey's retirement plans became one of the top retirement systems in the nation. From fiscal year 1995 through fiscal year 2000, valuation assets rose from $42.3 billion to $74 billion while the systems' accrued liability rose at a slower pace, from $45.2 billion to $66.5 billion. By fiscal year 2000, valuation assets had exceeded the accrued liability by $7.6 billion and the GASB funded ratio (Valuation Assets divided by Accrued Liability) peaked at 111.4%.

In fiscal year 2001, valuation assets rose by approximately $9.4 billion, to $83.4 billion, but during this same fiscal year, accrued liability jumped nearly $10 billion, to $76.4 billion. Since that date, valuation assets have stagnated in the $83 billion range, but the accrued liability has continued to rise steadily, to $101.5 billion in fiscal year 2005. According to reports filed in accordance with GASB 25 and 27 regarding the Schedule of Funding Progress by the actuaries of the various State-administered retirement systems, the unfunded liability of the these systems totaled nearly $18 billion as of June 30, 2005 with a GASB funded ratio of 82.3%. The unfunded liability represents the excess of the actuarial accrued liability over the actuarial value of assets.

The four main factors contributing to the unfunded liability are: State and local government employer pension "holidays" in which governments neglected to contribute substantially or in some cases at all to the pension systems; negative investment returns resulting in a loss of $20 billion in plan assets; pension benefit enhancements and early retirement incentive programs; and increases in both active and retiree membership.

1. Pension Holidays

The State and local government employers pay annually a normal contribution to the retirement system. This contribution is determined each year on the basis of the annual valuation and represents the value of the benefits to be earned in the year following the valuation date. However, due to the enactment of a law in 1997, from fiscal year 1997 to fiscal year 2003, employers did not have to make contributions to the pension funds. A subsequent law has led to resumption of contributions, but on a phased-in approach.

The fiscal year 2007 Appropriations Act made an important first step toward stabilizing the pension system and having the State meet its financial obligations when the Legislature appropriated more than $1.1 billion to fund the various systems.

P.L.1997, c.115 changed the manner by which the State financed its pension obligations. This law allowed the issuance of $2.75 billion in pension obligation bonds to finance the plans' unfunded liability. Additionally, the law allowed the use of excess valuation assets of the retirement system to offset employers' annual normal contributions to the pension system. This change in funding policy resulted in either full or partial reductions in the State's and local government employers' otherwise required normal contributions to the retirement plan for fiscal year 1997 through fiscal year 2003.

With excess valuation assets no longer available for use by the State and local government employers to eliminate or reduce their normal contribution and the unfunded liability amortized over a 30-year period now part of the annual required contribution, the State changed funding policy under the provisions of P.L.2003, c.108. This law enabled local government employers to "phase-in" as of fiscal year 2004 their total contributions due in increments of 20% a year. They will reach 100% in 2008 for the Police and Firemen's Retirement System (PFRS) and in 2009 for the Public Employees' Retirement System (PERS). The phase-in further increases the unfunded liability of the systems.

Frederick J. Beaver, Director of the Division of Pensions and Benefits, estimated that pension contributions that were avoided, or were not made to the system during this period of time, totaled approximately $8 billion.

2. Negative Investment Returns

From the end of fiscal year 1995 through fiscal year 2000, the market value of the plans' assets rose from $40.6 billion to a peak of $85.9 billion. Since that date, the market value declined to a low of $64.2 billion in fiscal year 2003, before beginning to rise. Because these losses are being phased-in to the systems over a period of five years, the actuarial valuation of assets have not fully recorded these investment losses. These lower rates of return are a major contributor to the development of the now $18 billion unfunded liability.

3. Benefit Enhancements and Early Retirement Incentive Programs

Enactment of legislation that provided pension benefit enhancements increased pension liabilities considerably. The most costly enhancement to the pension system was provided by P.L.2001, c.133 which increased the Public Employees' Retirement System (PERS) and the Teachers' Pension and Annuity Fund (TPAF) pensions by 9.09%. Known as n/55, this law increased pension liabilities by over $4.2 billion, a portion of which represent the cost of providing the n/55 benefit to retirees, to past service for current employees, and to the cost for future service for current employees.

P.L.2001, c.366 created the Prosecutors Part in PERS to provide enhanced pension benefits for county prosecutors and certain other criminal justice personnel. The State is liable for the cost of this legislation, which for fiscal year 2007 amounted to more than $2.7 million. P.L.2001, c.259 created a special Workers Compensation Judges Part in PERS and will cost the State nearly $500,000 this year alone.

P.L.1999, c.428 enhanced the retirement and survivor's benefits of the Police and Firemen's Retirement System (PFRS) by providing a "20 and out" and "50% surviving spouse pension" similar to that provided to the State Police for members of the PFRS.

This law increased pension liabilities by over $500 million. P.L.2001, c.4 increased the special retirement pension from 60% to 65% of final salary for certain retired public safety officers. Since fiscal year 2000, the total liabilities of the PFRS – Local have risen from $14.9 billion to nearly $21.4 billion in fiscal year 2005, in part due to benefit enhancements.

The Division of Pensions and Benefits also found that P.L.2002, c.23, which provided retirement incentives (ERIs) to State employees and State college and university employees increased pension system liabilities by $645.4 million. Cumulative savings to the State for the four years since the ERI program total approximately $314 million, the Department of Personnel reported.

Cumulatively, since 1999, these enhancements increased State and local pension liabilities by over $6.8 billion.

4. Membership

Active membership in the retirement systems totaled 543,400 in fiscal year 2005, up 10,935 members from the number of active members in fiscal year 2004. The number of retirees and their beneficiaries totaled 219,860 in fiscal year 2005, an increase of 7,840 from the prior year. These retirees and beneficiaries received monthly pensions cumulatively in excess of $5.7 billion annually. They are living longer and collecting pensions for a longer period of time compared to retirees from a generation past. For example, the State Police Retirement System now has eight retirees for every ten people working. In several years, there will be one retiree for every active member.

The State-Administered Retirement Systems

New Jersey has six major State-administered retirement systems. Along with the required contributions of the public employees, these systems are funded by contributions from the State and more than 1,500 other public employers, which include all New Jersey counties, municipalities and boards of education. Five of those systems, the Public Employees' Retirement System (PERS), the Teachers' Pension and Annuity Fund

(TPAF), the Police and Firemen's Retirement System (PFRS), the State Police Retirement System (SPRS) and the Judicial Retirement System (JRS), are defined benefit pension plans. The Alternate Benefit Program (ABP) for faculty at New Jersey public institutions of higher education is a defined contribution pension plan.

A defined benefit pension plan is a pension plan which provides a certain benefit determined by a stated formula for the life of the beneficiary, often with cost-of-living increases. The formula is usually related to an employee's length of service and salary. Public employee defined benefit plans usually require an employee contribution of a certain percentage of compensation through payroll deduction. The employee contribution rates in New Jersey's defined benefit plans range from 3% to 8½%. The actuarial valuation, together with the plan's benefit provisions and the investment performance of plan funds, determines the employer's periodic contribution. Defined contribution plans look like bank accounts because the contributions from the employee and the employer are deposited in the employee's individual account, which then accumulates interest and investment earnings. In the case of ABP, employees contribute 5% of compensation; the employer contributes 8%. Unlike a defined benefit plan, a defined contribution plan does not guarantee a stated retirement allowance regardless of the employee's salary or years of service. The benefit is a function of the amounts of employee and employer contributions, wage history, and investment earnings. The participant usually is responsible for the investment choices.

Of the five defined benefit plans, PERS and TPAF share a common benefit structure. A PERS member is a person employed in a PERS-covered position with a public employer; a TPAF member is a teacher in a TPAF-covered position. The 322,000 active PERS members and 154,000 active TPAF members make an employee contribution of 5% of compensation. PERS and TPAF members accrue service credit for the time during which the member works. A PERS member may be employed in two or more PERS-covered positions in a calendar year, but no more than one year is credited for all the employment in a year and the compensation for that period is the sum of the compensation from all positions. A PERS or TPAF member becomes "vested" upon accruing 10 years of service credit. Once vested, a PERS or TPAF member is eligible for a pension funded by both the employee's contributions and employer contributions. The State pays the TPAF employer contributions for boards of education.

Currently, there are 121,000 retired PERS members and 65,400 retired TPAF members. A PERS or TPAF member with 25 or more years of creditable service before reaching the normal retirement age of 60 may elect "early retirement" and receive 1/55 of final compensation for each year of service credited, reduced, however, by 1/4 of 1% for each month that the member lacks of being age 55. A PERS or TPAF member with any number of years of service who has attained 60 years of age may retire on a service pension and receive 1/55 of final compensation for each year of service credited. Final compensation means the average of the three years of highest compensation. The PERS and TPAF systems also provide veterans retirement benefits, ordinary and accidental disability retirement benefits, death benefits for survivors of an active or retired member, and optional life insurance. PERS provides special benefits to legislators, workers compensation judges and prosecutors, which along with veterans benefits, are calculated based on a single year of compensation.

PFRS, SPRS and JRS differ from PERS and TPAF, in part, because the members are subject to a mandatory retirement age. PFRS and SPRS have similar structures and benefits. The 45,000 active PFRS members are employed full-time as a police officer or firefighter; the 2,950 active SPRS members are officers or troopers of the State Police. A PFRS member contributes 8½% of compensation; a SPRS member contributes 7½%. Members of PFRS may retire at any age but may not continue employment beyond age 65. Members of SPRS may retire at any age but may not continue employment beyond age 55. Basic PFRS and SPRS retirement benefits are 50% of final compensation with 20 or more years of service, 65% of final compensation with 25 years of service plus 1% for each year beyond 25 but not to exceed 30 years. For PFRS and SPRS, final compensation means the compensation received in the 12 months preceding retirement. Currently, there are about 29,000 PFRS retirees and 2,300 SPRS retirees. The PFRS and

SPRS systems provide ordinary and accidental disability retirement benefits, pension and death benefits for survivors of an active or retired member, and optional life insurance.

The smallest State-administered retirement system is JRS, whose members are judges in the Judicial Branch upon whom the New Jersey Constitution imposes a mandatory retirement age of 70 years. JRS benefits vary among members depending upon years of service as a judge and other service as a public employee. Its members contribute 3% of compensation. The basic benefit for judicial service alone is 75% of annual salary received at time of retirement, if the JRS member has served at least 10 years as a judge and attained the age of 70, served at least 15 years as a judge and attained the age of 65, or served at least 20 years as a judge and attained the age of 60. The JRS provides disability retirement benefits, pension and death benefits for survivors of an active or retired member, and optional life insurance.

The initial provisions of the five State-administered defined benefits retirement systems were established in statute in 1944, 1954, 1965, 1967 and 1973 for PFRS, PERS, SPRS, TPAF, and JRS, respectively. Any changes to these systems over time were made by law. In the last decade, for example, some basic benefit enhancements were made to three of the systems. P.L.1999, c.428 provided that the calculation of benefits for PFRS members would be based upon the final year of compensation as opposed to the average of compensation for the three final years. It also added the retirement benefit of 50% of final compensation with 20 years of service and the survivors' pension upon the death of an active PFRS member in ordinary circumstances. P.L.2001, c.133 and P.L.2001, c.353 changed from 1/60 to 1/55 the fraction used in the calculation of PERS and TPAF retirement allowances for both active and retired members, a 9% increase in benefits.

Legal Issues

For additional guidance in its deliberations, the Joint Committee received two letters on the legal issues related to changes to pension benefits. In a legal opinion, Peter J. Kelly, Principal Counsel of the Office of Legislative Services (OLS) opined that "legislation that has the effect of detrimentally altering the retirement benefits of active members of

State-administered retirement systems who have accrued at least five years of service credit, or of retired members, would be unconstitutional as violative of the federal and State constitutional proscription against impairment of the obligation of contract." The OLS opinion reviewed pertinent case law and the New Jersey statute, N.J.S.A. 43:C-9.5, which provides that a retirement system member with five years of service credit has "a non-forfeitable right to benefits based on the laws governing the retirement system on the date the member completes five years of service." The opinion advised that "a substitution of one benefit for another may be permissible without impairing the obligation of contract as long as the change is reasonable and any disadvantage to the member is accompanied by offsetting and counterbalancing advantages, apparently under the theory that when there is no net loss in overall benefits the contractual relationship is not substantially impaired." In a legal opinion for New Jersey's Treasurer, Bradley Abelow, the Office of the Attorney General advised that "N.J.S.A.43:3C-9.5 created legally enforceable rights in vested members of the state pension systems to the benefits programs of those systems" and subsequently under "the State and Federal Constitutions, the Legislature may not enact laws which substantially impair those rights, except in the narrow circumstances recognized by state and federal courts."

Report of Benefits Review Task Force

The Joint Committee was charged to examine the recommendations for change to the public employee benefits contained in the December 1, 2005 report of Governor Codey's Benefits Review Task Force. These recommendations were discussed also by the chairman of that body, Philip D. Murphy, during his testimony before the Joint Committee on October 25, 2006. Relating to the fiscal health of the retirement systems, the Task Force recommended full payment of annual pension obligations by the State and local government employers, the use of generally accepted actuarial standards, abstention from pension bonds, and reduction of the current funding deficiency across the pension systems. With regard to the overall structure of the systems, the Task Force recommended maintaining the current defined contribution structure, increasing the compensation enrollment threshold for PERS to $5,000, an extension of salary history used in pension calculation from the current three years to five years and from a single year to the average of three years, and an extension of the age at which a PERS or TPAF member could retire without any reduction in benefit from the current age of 55 years, with 25 years of service, to age 60.

In addition, the Task Force examined the phenomenon known as "abuses" of PERS, some of whose members may be employed in multiple part-time positions (tacking) or may over time have a service history of modest compensation followed by a dramatic increase in compensation resulting in a significant increase in ultimate pension benefit (boosting). The Task Force report recommended a restriction on end-of-career salary hikes, requiring PERS members to designate a single position for establishing pension credit, a ban on PERS membership for persons who are employees as well as contractors for professional services, a defined contribution plan for elected officials and appointees, forfeiture of pensions by convicted officials, and a limit on the amount employers other than the State may pay for unused sick leave (currently a calculation often set by collective negotiations and for which there is no established prefunding).

Frederick J. Beaver, Director of the Division of Pensions and Benefits, reviewed the Task Force's proposals for the Joint Committee at its August 24, 2006 meeting. He pointed out that some of the changes recommended have a low value fiscally but may be important to the integrity of the system; other changes would have a fiscal impact on the system. On the integrity side, the director highlighted the Task Force recommendation to make full actuarially sound pension payments as being a step toward alleviating the current $18 billion deficit, as well as the need to maintain good actuarial assumptions and not change them to achieve some budgetary objectives. He also supported efforts to end boosting and tacking, making persons with services contracts ineligible for pension system membership, a defined contribution system for elected and appointed officials and restricting manipulation of end-of-career salary. On the broader side, the director suggested either stopping the practice of pension loans or raising the interest rate, having a pension credit purchase include the attendant cost of post-retirement health benefits, and a moratorium on early retirement incentives and benefits enhancements. He thought that the Joint Committee could consider a two-tier system and an alternative pension plan for part-time employees. He urged examination of the normal retirement age of 60 which gives a benefit with any number of years of service, in contrast to the early retirement provision which assures that the employee has at least 25 years of service at age 55. He suggested that the optional life insurance benefit be offered separately from the pension systems, with more flexibility to meet needs of employees as they evolve over time. The director also pointed to the generous disability benefits in PERS and TPAF and said that there would be savings if there was a separate long-term disability program for the non-uniform services.

State Health Benefits Program

The New Jersey State Health Benefits Program (SHBP) covers about 804,000 lives (employees, retirees and dependents) at a cost of $3.6 billion. Groups that participate in the SHBP include the State (including colleges and universities), local boards of education and local governmental units. The State SHBP has 115,000 active participants and 34,000 retirees. The local employer group has 127,000 active group members and 88,000 retirees.

The cost to the State of providing these health benefits has been rising over time. For example, in fiscal year 2004, the cost of providing health benefits to active State (including college and university) employees totaled $912 million. This amount rose to over $1 billion in fiscal year 2006. State funded retiree costs have risen from $742 million in fiscal year 2004 to $961 million in fiscal year 2006. For fiscal year 2007, retiree health care costs are projected at $1.1 billion. The vast majority of retiree health care costs is attributable to P.L.1987, c.384, which granted fully paid health benefits coverage to eligible retired school board employees. For fiscal year 2007, Teachers' Pension and Annuity Fund (TPAF) and other board of education retirees will cost the State nearly $735 million, up from $490 million in fiscal year 2004. Major cost drivers include the utilization and improvements in technology, along with more expensive prescription drugs and a growing retiree population.

Unfunded Retiree Health Care Liability

The effect of rising health care costs on state budgets has been a challenge for the better part of the last two decades. The Government Accounting Standards Board (GASB), concerned about health care inflation and the degree to which states' financial statements do not capture its long-term implications, issued GASB Statement 45 to require that government financial statements treat these post-retirement medical benefits in the same way pension obligations are presented. New Jersey's unfunded liability to provide these medical benefits for retirees is estimated to exceed $20 billion. However, it should be noted that that unofficial estimate was written five years ago and may be dated. Mercer

Consulting estimates that governments that have not set aside money for these obligations could face liabilities 40 – 60 times the current annual cost of retirees' health care, suggesting a potential $40 billion to $60 billion unfunded liability for New Jersey.

SHBP Plans

In 1961, the New Jersey Legislature passed the State Employees Health Benefits Act, N.J.S.A.52:14-17.25 et seq., to provide health insurance coverage for full-time State employees and appointed or elected officers. In 1964, the program was expanded to allow other public employers (counties, municipalities, school districts and authorities) to participate. The act was renamed the New Jersey State Health Benefits Program Act in 1972.

Administered by the Division of Pensions and Benefits in the Department of the Treasury, the State Health Benefits Program (SHBP) is a multiple option program offering health benefits coverage through the indemnity Traditional Plan or one of the managed care options, which include NJ PLUS and several health maintenance organizations (HMOs). SHBP also offers dental coverage and prescription drug benefits. Currently, 934 public employers participate in the SHBP and the program covers about 804,000 individuals, almost 10% of the population of New Jersey. SHBP is an employer health benefits program, not a health benefits program for the public. As is the case with health insurance programs of private sector employers with a large number of employees, the SHBP health plans are self-insured. The State and participating public employers other than the State pay the actual expenses of those plans plus administrative fees, and they assume the ultimate financial risk. "Premium" rates are established annually by the State Health Benefits Commission in order to fund the program's projected expenditures through appropriation for the State's expenses as an employer and through assessment of the participating employers other than the State.

The Traditional Plan, a fee-for-service or indemnity plan, administered by Horizon Blue Cross Blue Shield of New Jersey, reimburses an enrollee for the cost of hospitalization, doctor bills, surgery and other medical services and supplies in the amounts of reasonable and customary allowances. It does not cover preventive or well care and there are no restrictions in choosing a physician. The enrollee is required to satisfy certain deductible and coinsurance requirements. NJ PLUS, a point-of-service plan (POS) administered by Horizon Blue Cross Blue Shield of New Jersey, provides coverage which includes well care and preventive services and requires that the enrollee choose a Personal Care Physician (PCP) within a network of participating doctors. PCP and in-network specialist services are covered after a $10 copayment. Unauthorized out-of-network services are reimbursed at 70% after satisfaction of a $100 deductible. The SHBP's participating HMOs for 2006 are Aetna Health, CIGNA HealthCare, Health Net, Oxford Health Plan, and AmeriHealth. An HMO provides complete coverage, including well and preventive care for medical services provided by affiliated physicians and hospitals. Employees who enroll in an HMO pay a minimum copayment of $10 for a routine office visit and must use the doctors and hospitals that are part of the particular HMO for all services except emergencies. If an employee uses a doctor or hospital outside the HMO without a referral or under emergency conditions, the HMO does not pay for the services.

Current law provides that State employees and the employees of an independent State authority, board, commission, corporation, agency or organization may be required to contribute toward the cost of SHBP health benefits coverage according to the terms of a binding collective negotiations agreement. The amount of an employee's premium sharing depends upon union affiliation and plan option. In 2006, for example, some union-affiliated State employees, required by contract to contribute toward the cost of their SHBP benefits, pay 25% of coverage cost if electing the Traditional Plan or pay 5% of coverage cost if electing an HMO. The State pays the remaining cost. The State pays the entire cost of coverage for the employees electing NJ PLUS. Non-aligned State employees (those whose positions are not eligible for union representation) contribute in the same manner, consistent with the terms of one of the union contracts binding on the State, as designated by the State Health Benefits Commission pursuant to the law.

Under current law, public employers other than the State participating in SHBP pay the cost of an employee's coverage and have the option of assuming the cost of dependent coverage. Most of these public employers, however, have agreed to assume the cost of SHBP coverage for their employees' dependents. A local employer must offer all SHBP plan options to its employees and any premium sharing must be uniform across all employee groups. Municipalities, municipal authorities and county colleges are allowed to offer up to 50% of the premium amount to an employee who has other health care coverage in exchange for that employee waiving SHBP coverage (opting out). Counties, municipalities, school districts and independent authorities that choose not to participate in SHBP may contract independently with one or more health insurance providers, self-insure or participate in a joint health insurance fund. These employers, pursuant to relevant union contracts, may or may not offer more than one plan option, and may or may not require employee premium sharing.

The State is responsible for payment of the full or partial cost of post-retirement medical benefits under SHBP for certain retirees and their dependents, but not their survivors. State employees who do not choose deferred retirement and employees of boards of education and of county colleges, even if their employer does not participate in SHBP, are eligible for fully or partially State-paid SHBP coverage if they retire with an allowance based upon 25 or more years of service or retire on a disability pension. These retirees and their spouses are required to enroll in Medicare Part A (hospital) and Medicare Part B (medical) when they are eligible therefor. The Traditional Plan, NJ PLUS and the participating HMOs automatically coordinate benefits with Medicare, which becomes the primary insurer for retirees after age 65. Retirees covered by SHBP do not participate in Medicare Part D. State-paid SHBP coverage in retirement ceases upon the death of a retiree. Surviving spouses, however, as well as employees covered by the SHBP at the time of retirement with fewer than 25 years of service, may choose to continue SHBP coverage for themselves and their dependents at their own expense.

State employees who accrued 25 years of service on or before July 1, 1997, and all eligible school board and county college employees, receive fully paid SHBP coverage in the Traditional Plan as well as in all the SHBP managed care plans and full reimbursement of the prevailing cost of Medicare Part B. State employees who attain 25 years of service credit or retire on disability after July 1, 1997, may be required to share in paying the cost of SHBP coverage and Medicare Part B according to the terms specified in the union contract applicable to them at the time they attain 25 years of service credit, or retire for disability. For certain police officers and firefighters and their dependents, but not survivors, who retire with 25 or more years of service credit, or on disability, and who do not receive any employer payment toward post-retirement health benefits, regardless of whether their former employers make any payment toward such benefits for other retirees, the State pays 80% of the least expensive cost of coverage among the SHBP plans. The retiree pays the remainder of the cost of whatever plan is chosen and pays for Medicare Part B.

Under current law, participating public employers other than the State may choose to offer SHBP benefits in retirement to employees not electing deferred retirement, and their dependents as well as survivors. The local public employer may choose to cover employees who (1) retire on a disability pension; or (2) retire with 25 or more years of service credit in a retirement system which includes a period of service of up to 25 years with and determined by that employer; or (3) retire at age 65 or older with 25 or more years of service credit which includes a period of service of up to 25 years with and determined by that employer; or (4) retire at age 62 years or older with at least 15 years of service with that employer. The employer payment obligations for such benefits may be determined by a binding collective negotiations agreement with respect to aligned employees and in the sole discretion of the employer with respect to non-aligned employees. Employers other than the State may also choose to reimburse retirees for the cost of Medicare Part B. SHBP coverage for its retirees ceases if an employer withdraws from SHBP.

The Employee Prescription Drug Plan is administered by Horizon Blue Cross Blue Shield through Caremark, which is a pharmacy benefits management company. After a copayment of $10 for name brand drugs or $3 for generic drugs, the State Prescription Drug Program for active State employees covers the cost of a 30-day supply at a retail pharmacy. A 90-day supply for any drug obtained through mail order requires a copayment of $15 for name brand drugs or $5 for generic drugs. Three copayments may be paid for a 90-day supply at a retail pharmacy. SHBP participating employers other than the State may offer prescription drug benefits at an additional cost in the SHBP plan options or through a free-standing prescription card. HMOs provide prescription drug coverage to their enrollees.

Caremark also administers the separate SHBP Retiree Prescription Drug Plan for retirees under the Traditional Plan and NJ PLUS. It requires a certain copayment for up to a 30-day supply at a retail pharmacy or up to a 90-day supply through mail order (a 90-day supply at a retail pharmacy requires three copayments). The amount of a copayment varies depending upon which of three prescription drug categories applies and the method of purchase. Generic drugs (FDA approved equivalents to brand name drugs) have a copayment of $8 for either up to a 30-day supply at a retail pharmacy or up to a 90-day supply via mail order. Preferred brand drugs (more cost effective alternatives within a therapeutic class of brand name drugs with comparable therapeutic efficacy - includes over 80% of all brand name drugs) copayments are $16 for retail pharmacy and $25 for mail order. All other brand name drugs are in the third category that requires a copayment of $33 at a retail pharmacy and $41 through mail order. Out-of-pocket prescription drug copayments per person are capped at a maximum of $1,000 annually.

Report of Benefits Review Task Force

The report of Governor Codey's Benefits Review Task Force recommended that all employees and retirees in SHBP contribute toward the cost of their health care benefits. It suggested that cost sharing could be based on personal need and cost, with the State and other employers contributing a fixed dollar amount toward the employee's choice of plan. Development of a safety-net base plan and the creation of a Preferred Provider Organization (PPO) to replace the Traditional Plan would be part of that arrangement. To reduce the cost of prescription drugs, the Task Force suggested that SHBP contract directly with a Pharmacy Benefit Manager, increase the copayment differential between generic and brand name drugs to increase greater utilization of generics, and require mandatory mail-order for maintenance prescriptions.

For local participating employers, the Task Force recommended that the SHBP become more flexible, that it allow an employer to offer some but not all SHBP plans and eliminate the requirement for uniform benefits for all employees. Local employers could then negotiate different agreements with their employee groups to increase cost savings. The Task Force also urged that SHBP apply changes in benefits resulting from the State's collective bargaining agreements to participating local employers, which include increasing managed care office visit and prescription co-pays and eliminating SHBP coverage as both employee and dependent. The State Health Benefits Commission has moved to implement those changes.

Frederick J. Beaver, Director of the Division of Pensions and Benefits, discussed the Task Force's proposals at the August 24, 2006 meeting of the Joint Committee. He spoke of the possibility of replacing the Traditional Plan and NJ PLUS with a PPO to increase competition in the bidding process for the SHBP administration contract to help control future costs. The director acknowledged that local employers leave SHBP seeking more flexibility and that their ability to reenter SHBP without any limitation is problematic.

Other Benefits

Local Government and School District Payments for Accumulated Unused Sick Leave

The International Foundation of Employee Benefit Plans (IFEBP), which is the largest educational association serving the employee benefits and compensation industry, defines "sick leave" to mean "plans that provide employees protection against short-term disability and typically specify a maximum number of benefit days per year or per disability that an employee may take at full pay before insured short-term or long-term disability benefits are initiated." The purpose of sick leave is to protect employees from loss of income during short periods of temporary illness or disability. Sick leave is not part of a general compensation plan. Many school districts and municipal governments throughout the State grant and allow employees to accumulate significant amounts of sick, vacation, and other forms of paid leave and receive cash compensation for unused leave annually during employment and retirement. There have been recent reports in the media indicating that one municipality in 2004 gave the prior outgoing police chief a severance package that was valued at nearly $153,300, including more than $56,600 for unused sick leave and $62,000 for unused vacation time. In another town, the board of education bought out the last year of its long-serving superintendent's contract for more than $500,000, paying for 511 and a half accumulated sick and vacation days.

Recently, the State Commission of Investigation (SCI) issued a report on questionable and hidden pay and perks for top school officials entitled "Taxpayers Beware: What You Don't Know Can Cost You. An Inquiry Into Questionable and Hidden Compensation for Public School Administrators." The SCI found "significant weaknesses in the statutory and regulatory structure governing public employee benefits in New Jersey that enables public employees below the State level of government to obtain lucrative packages involving sick and vacation leave." This investigation revealed the widespread practice of allowing administrators to receive cash payment for substantial amounts of accumulated sick and vacation leave at retirement or upon departure. A previous SCI report issued in 1998 found similar situations with regard to local government employees. That report examined certain aspects of public employee pension and benefit programs and found abuse, manipulation and excessive expenditures that cost New Jersey taxpayers substantial sums of money every year. Questionable practices were detected in every region of the State, among municipalities, school districts, community colleges and independent authorities. The SCI found that it is common at various levels of government in New Jersey to provide public employees, both before and after retirement, with certain fringe benefits at taxpayer expense that can only be characterized as unreasonably generous. Much of the excess revolves around excessive allowances for sick leave and vacation time.

A cap of $15,000 is currently applicable to the unused sick leave of State employees who retire from a State-administered retirement system. Pursuant to N.J.S.A.11A:6-19, this supplemental compensation is paid at a rate of one-half of the eligible employee's daily rate of pay for each day of accumulated sick leave based upon the compensation received during the last year of employment prior to the effective date of retirement. This cap has been in effect since 1986. Unlike many municipal, school board and college employees, no State employee can collect more than $15,000 for unused sick leave, regardless of how much he or she has accumulated during the employee's career, and such lump-sum payments can be collected only at retirement.

Although numerous bills have been introduced over the years to impose a cap on payments for accumulated unused sick leave for local government and school district employees, none have been enacted.

This issue was raised at the meetings of the Joint Committee. Persons testifying affiliated with public employee unions were generally opposed to a State mandated limit on sick leave benefit payouts at $15,000, arguing that such fringe benefits should be negotiated between the employer and employee.

State Sick Leave Injury Program

New Jersey is one of only five states that provide a sick leave benefit at full wages in addition to workers' compensation to State employees injured at the workplace.

N.J.S.A.11A:6-8 provides for the program, which has been in effect since 1986. Regulations promulgated by the Merit System Board in the Department of Personnel regulate the use of the program by providing full wages for up to one year.

As opposed to workers' compensation, which pays injured employees a temporary benefit not to exceed 70% of the Statewide average weekly wage, the sick leave injury program is a salary continuation program that provides full pay to employees, although sick leave injury program payments are reduced by amounts received by the employee for workers' compensation.

The purpose of the sick leave injury program, defined in N.J.A.C. 4A:6-1.6 et seq., is to provide a continuation of pay for up to one year for State employees who are injured or become ill from work-related causes. Employees continue to pay income taxes and both employee and employer continue to pay Social Security and other payroll taxes. After a year on sick leave injury, employees are moved to the State's workers' compensation program until final disposition of their case.

Governor Corzine proposed in his fiscal year 2007 budget to eliminate the sick leave injury program for State employees. Elimination of this program would save an estimated $3 million annually. This estimate was prepared by the State Auditor who found in a March 2003 report that elimination of the sick leave injury program and utilizing, in lieu thereof, the workers' compensation program would save the State money and that injured State employees making $50,000 or less would take home about the same amount because taxes and deductions are not be taken from the workers' compensation benefit.

Report of Benefits Review Task Force

The Benefits Review Task Force recommended that State law limit unused sick day payouts at all levels of government, not just for State employees.

VI. Recommendations

With this final report, the Joint Legislative Committee on Public Employee Benefits Reform has attempted to identify methods of reforming the State-administered pension systems and the public employee benefits system. The recommendations put forth by this Joint Committee are in part the product of State and local governments' failure and neglect over a ten year period to meet their pension obligations as employers. They are also the result of legislative actions over the same period that enhanced employee benefits in ways that added billions in future unfunded liabilities to the pension systems. They are the product of a stock market plunge that exposed the weaknesses in the State's investment policies and that further increased the gap between pension assets and liabilities.

Newspaper articles have highlighted high-profile abuses of the public pension systems. There have been accounts of end-of-career salary boosts resulting in overly generous and largely unearned pensions. There have been numerous examples of individuals holding multiple jobs, allowing these individuals to "tack" together a hefty salary base on which to collect an equally hefty pension. Many of these multiple job holders are not public employees but rather under contract with a municipality, undermining the integrity of a pension system designed specifically for career public employees.

Many of the recommendations included in the Benefits Review Task Force's report called for significant modifications to the benefits package of public employees. A number of the reforms should apply immediately. Reforms that would result in an unconstitutional reduction in benefits to existing employees should be applied prospectively.

The Joint Committee considered the establishment of a defined contribution plan for all new employees but learned that such a plan would cost the State more in the short term. Ultimately, the Joint Committee concluded that the full-time, career employees of the future are entitled to a defined benefit plan but that significant reforms are necessary to ensure the continued health of the pension systems.

To address the abuses of the systems, and as a corollary to the principle that pensions are meant to be replacement income for full-time career employees, the Joint Committee concluded that future part-time employees would not be eligible for a defined benefit pension. Instead, the committee determined that such employees should participate in a defined contribution plan. The Joint Committee reached the same conclusion with regard to elected and appointed officials who also would be eligible to participate in a defined contribution plan. These proposed reforms would go a long way toward addressing the above-noted pension system abuses. For example, the assignment of all part-time employees to a defined contribution plan would eliminate the opportunity for "tacking." Also, the inability to string together consecutive years at $1,500 per year would remove the opportunity for boosting.

The Joint Committee's investigation of health benefits issues revealed a system plagued by the skyrocketing costs of health care that have dramatically increased the cost of health benefits for both current and retired public employees. The investigation also found that New Jersey public employees contribute less toward their health benefit costs than public employees in other states. The Joint Committee recommends that all employees share in the cost of their health benefits at some level and that local governments be accorded increased flexibility when negotiating cost sharing with local employees.

The reforms recommended by this Joint Committee are overdue. Whether some of these reforms are achieved through collective bargaining rather than through legislation is less significant than ensuring that they are, in fact, achieved. Collective bargaining notwithstanding, it is clear that the Legislature needs to attach permanency to a number of the recommended reforms.

The following section provides detailed descriptions of the Joint Committee's recommendations.

Pension Benefits

RECOMMENDATION 1: LIMIT DEFINED BENEFIT PENSION PLANS TO FULL-TIME CAREER EMPLOYEES AND ESTABLISH NEW DEFINED CONTRIBUTION PROGRAM FOR ALL NEW PART-TIME EMPLOYEES, ELECTED OFFICIALS AND FULL-TIME APPOINTED OFFICIALS

- **DISCUSSION**

In defined contribution pension plans, the employer's benefit promise is in the form of an actual periodic contribution placed into an employee's individual account. The contribution can be based upon various factors such as a percentage of an employee's pay or the employee's age and service, or it can be an amount designed to accumulate to a targeted benefit. Defined contribution plans look like bank accounts because the contribution from the employer is deposited in the employee's account, which then accumulates interest and investment earnings. A defined contribution plan may allow or require employees to make additional contributions of their own to their accounts. Some initial waiting period for the vesting of employer contributions may exist at the beginning of employment.

A defined contribution plan does not guarantee a stated retirement allowance regardless of the employee's salary or years of service, unlike a defined benefit plan. The benefit is a function of the amounts of employer and employee contributions, wage history, and investment earnings. The participant usually is responsible for the investment choices.

A defined contribution pension plan has a stable and predictable employer contribution rate; actuarial estimates and investment income are not a budgetary concern. A defined contribution plan shifts the investment risk from the employer to the employee. Defined contribution plans, however, could impose fiscal discipline on employers because employer contributions must be made according to a strict payment schedule and contributions for new benefits cannot be postponed through amortization.

The State Division of Pensions and Benefits currently administers one defined contribution program for public employees. Established in 1969 to provide for the uniform administration of several alternate benefit programs for certain members of the faculty and staff of State institutions of higher education, the Alternate Benefit Program (ABP) is a tax-sheltered, defined contribution program for faculty and certain administrators of New Jersey public institutions of higher education. As of 2005, there were 16,920 program participants.

Pursuant to N.J.S.A.18A:66-169 et seq., the ABP provides retirement benefits, group life insurance and disability benefits. Full-time faculty, officers, visiting professors and certain professional administrative staff required to possess a college degree or its equivalent participate in the ABP. ABP members contribute 5% of base salary. This contribution is tax deferred under the 414(h) provisions of the Internal Revenue Code. Members are also permitted to make voluntary federal-tax deferred contributions under the Internal Revenue Code section 403(b). The State pays an employer contribution of 8% of base salary.

The following are examples of some of the key differences between the ABP, a defined contribution program, and the Public Employees' Retirement System (PERS), N.J.S.A.43:15A-1 et seq., a defined benefit plan.

The PERS employee contribution is set by law at 5% of base salary; a public employee with a base annual salary of $1,500 or more is required to become a member of the PERS. Enrollment in the PERS is mandatory for elected officials who are veterans and for members of the Legislature and is optional for other elected officials. The PERS employer contributions are actuarially determined each year to ensure adequate funding of the future liability of the system. In ABP, the employee contributes 5% of actual base contractual salary paid as long as the employee earns 50% or more of the base salary each year. The ABP employer contributes a fixed 8% of base salary as set by statute.

Vesting in PERS is set at 10 years of service credit, making the employee eligible for a retirement benefit, if certain requirements are met. In ABP, a member is vested after one year of participation, and under certain circumstances is vested immediately.

In PERS, retirement is permitted at age 60 with any number of years of service credit or after the completion of 25 or more years of service credit. There is no minimum age or service requirement in ABP, except what is provided in federal tax laws; benefits are determined by the retirement age of the annuitant in relation to the funds accumulated and the distribution option selected.

As provided by law, PERS retirees are eligible for an annual cost of living adjustment beginning in the 25th month of retirement. Under ABP, there are no specific cost of living provisions.

The Benefits Review Task Force found that elected officials and political appointees should be eligible for a defined contribution program similar to the ABP. Those who had previously vested in a defined benefit plan would not be prohibited from continuing to participate in such a plan. The report stated that the defined contribution plan is a more portable benefit and more appropriate for individuals such as appointees and elected officials who may remain in public employment for a short period. The report went on to state that the recommendation would reduce if not eliminate "the opportunity for political games with individual pensions."

The Joint Committee received testimony on August 31, 2006 on the Alternate Benefit Program from Frederick J. Beaver, Director of the Division of Pensions and Benefits, and from William A. Reimert, a consulting actuary, on the differences between defined benefit and defined contribution plans.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to limit eligibility for defined benefit pension plans to full-time career employees. The Joint Committee also recommends the establishment of a new defined contribution program for all new part-time employees, new elected officials and new full-time appointed officials.

This legislation should apply to persons who are, after the effective date of the new law, elected to public office, appointed to certain full-time State or local public positions, or retained as part-time State or local public employees. The Joint Committee recommends that:

- only persons earning $5,000 in base annual salary be permitted to participate in the defined contribution program;
- each employer and employee be required to contribute a percentage of the employee's base salary to the program, to be determined pursuant to an analysis by the Division of Pensions and Benefits but ensuring that the employer's cost not exceed what the employee would have cost the employer under the defined benefit program;
- non-vested members of any other State-administered retirement system be permitted to transfer to this new defined contribution program;
- strict oversight of defined contribution program managers be provided; and
- a review panel be created to make decisions on a person's eligibility to enroll in the program.

The Joint Committee finds that the defined benefits program is the most appropriate one for full-time career employees. Therefore, it is reasonable to enroll, on a prospective basis, part-time employees in a new defined contribution program. It will need a strong oversight board with fiduciary responsibilities to protect the investments of employees and retirees in the program. The Joint Committee recommends that such a board be comprised of appointed experts in the fields of finance and accounting, investment advisors and representatives of all levels of government in the State. It could offer financial security for employees and the program's assets by insuring that all investment decisions are made transparently and that managers of the fund do not invest too heavily in one stock or one type of security. Also, the Joint Committee recommends that an appeals process be established to determine eligibility for the defined contribution program versus eligibility for the defined benefit program. Inevitably, questions will arise as to whether a particular position with particular conditions of employment and duties should be covered by an existent defined benefit program or by the defined contribution program recommended by this section. Such an appeals process would give a public employee ample opportunity to appeal his or her placement in a defined contribution program, while simultaneously maintaining the integrity of the defined benefit programs.

This recommendation will reduce abuses related to pension tacking and boosting and increase the money saved by all units of government. Furthermore, the recommendation is consistent with the Report of the Benefits Review Task Force regarding enrolling elected and appointed public officials in a defined contribution program.

Assemblyman O'Toole and Senator Gormley believe the Joint Committee should have recommended a higher compensation threshold for membership in a public retirement system, not less than $10,000.

<u>RECOMMENDATION 2</u>: INCREASE RETIREMENT AGE TO 62

- **DISCUSSION**

Members of the Public Employees' Retirement System (PERS) and the Teachers' Pension and Annuity Fund (TPAF) have three retirement options. First, employees in these systems may retire when they reach the service retirement age or they can take early retirement after 25 years of service. Service retirement age for members of these two systems is 60 (N.J.S.A.43:15A-47 for PERS; N.J.S.A.18A:66-43 for TPAF). An employee may retire at age 60 regardless of the number of years of service. The service retirement formula used to calculate the member's annual retirement allowance is the same as the standard formula.

(Years of Service/55) x Final Average Salary = Retirement Allowance

The second option is early retirement. Early retirement is available to members of the PERS and TPAF who have attained 25 years of service (N.J.S.A.43:15A-41 for PERS; N.J.S.A.18A:66-37 for TPAF). Under early retirement, a member with 25 years of service may retire without a pension reduction or penalty as early as age 55. The annual retirement allowance is calculated using the same formula used to calculate service retirement. When a member with 25 years of service retires before reaching age 55, a penalty in the form of a reduction of ¼ of 1% per each month below age 55 – or 3% per each year – is applied to the member's retirement allowance. For example,

If the retirement age below 55 is...	The retirement penalty equals...	And the pension reduction factor would be...
54	.03	.97
53	.06	.94
52	.09	.91
51	.12	.88
50	.15	.85

Lastly, members in both PERS and TPAF may also retire under deferred retirement. Pursuant to N.J.S.A.43:15A-38 for PERS and N.J.S.A.18A:66-36 for TPAF, a member of the retirement system is vested in the system upon completion of 10 years of service in the covered employment. Vested status means that a member is guaranteed a pension benefit when the member reaches age 60. If a member decides to leave the covered employment and therefore leave the system after having attained vested status but before having 25 years of service, the member may retire when reaching age 60. The formula for calculating the annual retirement allowance for a deferred retirement is the service retirement formula above.

In its 2005 report, the Benefits Review Task Force recommended an increase in the early retirement age from 55 to 60 years of age. The Task Force noted that most private employers use age 65 for normal retirement eligibility, and that thirteen states have adopted a retirement age that is greater than 55 for full retirement benefits. Under the Task Force's recommendation, the 3% pension reduction penalty currently applicable for each year the retiring member is below age 55 would apply for each year below age 60.

- **RECOMMENDED ACTION**

The Joint Committee recommends increasing the retirement age from 60 to 62 in the PERS and TPAF for new members. The Joint Committee also recommends increasing the early retirement age from 55 to 62 so that age 62 will become the standard unreduced retirement age. These changes should be accomplished through legislation, and would only apply to employees hired after the date of enactment. The revised early retirement adjustments are recommended to be made as follows:

If the retirement age below 62 is...	The retirement penalty equals...	And the pension reduction factor would be...
61	.03	.97
60	.06	.94
59	.09	.91
58	.12	.88
57	.15	.85

The Joint Committee determined that setting retirement age at 62 is appropriate for several reasons. First, the Joint Committee notes that age 62 is the earliest age that a member can begin to collect federal Social Security retirement benefits; following the increase, the State retirement age will be consistent with the federal retirement age. Second, increasing the retirement age to 62 is more reflective of current life expectancy patterns and actual average retirement age than the current retirement age. Finally, raising the retirement age to 62 brings State practice closer in line with the private sector.

<u>RECOMMENDATION 3</u>: REDUCE BENEFIT FORMULA FOR NEW MEMBERS FROM N/55 TO N/60

- **DISCUSSION**

Under the provisions of P.L.2001, c.133 et seq. and P.L.2001, c.353 et seq., the formula for service, deferred and early retirement under the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS) was changed to a method of calculating the final pension benefit using n/55 of final compensation for each year of service. Known as n/55, this law increased pension liabilities by over $4.2 billion, a portion of which represents the cost of providing the n/55 benefit to retirees, to past service for current employees, and to future service for current employees.

The Benefits Review Task Force debated the issue and recommended adhering to the n/55 retirement calculation. There were concerns about whether there could be a change in law because of State and federal laws regarding retiree and vested employee rights. The report concluded that the 2001 change in the law was not appropriate and that there are better ways to preserve and strengthen the pension funds.

In his testimony before the Joint Committee on October 25, Philip D. Murphy, Chairman of the Benefits Review Task Force, stated that:

> The one area that we said if we had a "do-over" it would be the "n/55" from "n/60." And people disagree with that, and they certainly have a right to disagree with that. But I would argue, the process failed us. Whether we disagree on the substance is separate from whether or not the process was a good process. And that is a multibillion dollar tail that will live with us as long as that's in place. And we accept, in this report -- that we believe, based on the advice we got – is that it will stay in place. But it's a good example -- it's probably the best example I can think -- of where the process failed us . . . . We have to have a much more professional, systematic, clear, open-daylight, fully transparent process; and one that we're not sort of nickel and dimed to death without, in some cases, knowing what we're doing, collectively.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to reduce the TPAF and PERS benefit formula for new members from n/55 to n/60. The legislation should apply prospectively to new employees who become members of the retirement systems after the enactment of the legislation. It should be noted that the n/55 benefit enhancement applied only to PERS and TPAF; therefore, the recommendation to return to n/60 would only apply to those retirement systems. The other public retirement systems use other methodologies to calculate retirement benefits.

The Joint Committee notes that its recommendation is consistent with other recommendations aimed at reducing the long-term costs of the defined benefit retirement systems to ensure their fiscal stability and the fiscal stability of the State and local public employers funding those costs. The reduction from n/55 to n/60 would result in prospective, full-time employees receiving a retirement allowance that is 8% less than the retirement allowance accorded to existing full-time employees.

RECOMMENDATION 4: CAP PENSIONABLE SALARY, WHICH IS NOW UNLIMITED, TO SOCIAL SECURITY WAGE CONTRIBUTION LIMIT - $97,500 FOR 2007

- **DISCUSSION**

Currently, the five State-administered defined benefit pension plans have no restriction on the amount of compensation that is subject to pension contributions and creditable for retirement benefits other than a definition of base salary which excludes salary items that are defined as extra compensation and which is contained in the regulations for each plan.

The State's defined benefit pension plans provide a certain benefit determined by a stated formula applied to an employee's length of service and salary. A benefit is calculated by multiplying a compensation amount by a percentage figure, which product is multiplied by the numbers of years of service. The underlying assumption is that over time the employee and employers have been contributing to the pension system appropriately and based upon the employee's amount of compensation each year.

If an employee experiences a significant increase in compensation toward the end of a career of public service, the compensation amount used to calculate the benefit will not be reflected in the employee and employer contribution history over the entire length of that public service. The boost in compensation creates an unfunded liability in the pension system.

The Public Employees' Retirement System (PERS) is most vulnerable to this type of unfunded liability because its members may have a varied service history. A cap on the maximum compensation base for calculation of contributions and benefits could control the relationship between employee and employer contributions and pension system obligations.

- **RECOMMENDED ACTION**

The Joint Committee recommends a cap on pensionable salary at the Social Security maximum wage contribution limit under the Federal Insurance Contributions Act (FICA).

The Social Security maximum wage contribution limit is $94,200 for 2006 and $97,500 for 2007. This cap would adjust as the federal cap is adjusted. Employees with annual compensation in excess of the Social Security maximum would be eligible for membership in the defined contribution program in Recommendation 1 of this report with regard to only that excess compensation. However, the employer match rate for the amount earned in excess of the cap would be less than the rate provided for salary earned below the cap.

The legislation should apply prospectively to all new employees who become members of the State-administered retirement systems, except the Judicial Retirement System (JRS), after the enactment of legislation. This recommendation should also apply to members of the new defined contribution pension program in recommendation 1 of this report.

The Joint Committee notes that, at present, approximately 97% of the current members of the PERS, TPAF, PFRS and SPRS have salaries below the $97,500 FICA threshold. Therefore, the vast majority of full-time, career public employees would be unaffected by this proposal. Employees earning in excess of the Social Security wage contribution limit would continue to earn pensionable credit up to the cap in a defined benefit plan and would earn pension credit in a defined contribution program on amounts above the cap. Furthermore, the cap would apply cumulatively to persons holding multiple jobs, such that a person holding multiple part-time jobs would only be eligible to earn a defined contribution match up to the cap. The Joint Committee believes that this proposal should help control escalating retirement system costs, will put an end to excessive "tacking," and will ensure the integrity of the pension systems while affecting a relatively small number of employees.

The Joint Committee concluded that there are valid reasons not to make changes in the pension coverage provided to members of the JRS. Unlike the members of the other retirement systems, judges usually become members of the JRS later in life, often after a career as an attorney in private practice. Their time in public service tends to be shorter than most public employees. In private practice, their salaries tend to be higher than when they are judges. As a judge, however, their salaries and pensions tend to be higher than the average public employee. This differential is essential to enable the State to stay competitive with the private sector when recruiting outstanding jurists. It should also be noted that the JRS is the smallest State-administered retirement system. As of June 30, 2005, active membership in the system totaled 427, with 432 retirees and beneficiaries. Thus, changing the pension benefits of JRS members would affect the ability of the State to attract and retain excellent jurists, and the amount of money the State may save would be small compared with the potential negative impact such reforms might have on the quality of New Jersey's judicial system.

<u>RECOMMENDATION 5</u>: BASE "HIGH SALARY" PENSION BENEFIT CALCULATIONS FOR NEW MEMBERS ON HIGHER NUMBER OF YEARS

- **DISCUSSION**

Many of the benefits received by public employees in this State are based on a formula that takes into account the compensation received by a member for one year, or for an established number of years. This formula is used to calculate both retirement benefits for the member and, in some cases, pension benefits for surviving family members and death benefit payments to beneficiaries. Under the Public Employees' Retirement System (PERS), N.J.S.A.43:15A-1 et seq., and the Teachers' Pension and Annuity Fund (TPAF), N.J.S.A.18A:66-1 et seq., the annual retirement benefit for members is calculated using the average of the three years of highest compensation, times the fraction represented by a numerator that is the number of years of service of the individual over a denominator of 55. For veteran members in those two systems and members of the Police and Firemen's Retirement System (PFRS), N.J.S.A.43:16A-1 et seq., and the State Police Retirement System (SPRS), N.J.S.A.53:5A-3 et seq., the annual pension benefit is based on the single highest year of compensation.

Changing the year or number of years of compensation as part of the retirement and benefit formula was discussed in the Report of the Benefits Review Task Force, issued on December 1, 2005. The report noted that "basing the annual pension on the highest three years and especially the highest year of salary is inconsistent with national trends among state plans." The Task Force found that the practice "encourages 'boosting' and other manipulation at the end of a public employee's career by requiring a minimal time commitment and does not reflect a replacement level of the salary a worker received throughout their time in government."

Several members of the public suggested that the retirement and benefits formula should be based on a greater number of years than three, and also strongly denounced "boosting" or serving just three years in a position to increase a final pension benefit.

The Task Force recommended increasing the number of years used to calculate retirement and other benefits for members of PERS and TPAF from the average of the three years of highest compensation to the average of the five years of highest compensation. For veteran members of those two systems and individuals in PFRS and SPRS, the Task Force recommended changing the formula from the single year of highest compensation to an average of the three years of highest compensation. The impact on members of such a change would vary, depending on the member's compensation history. But the fiscal impact on the State and its localities would be significant because it would enable each to realize significant savings from the benefits paid to public employees.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to change the pension benefit calculation from the three highest paid years to the five highest paid years or from the single highest paid year to the three highest paid years, as appropriate. The legislation should apply to new employees who become members of the State-administered retirement systems, except the Judicial Retirement System (JRS), after the enactment of legislation.

The Joint Committee notes that its recommendation is consistent with other recommendations aimed at reducing the long-term costs of the defined benefit retirement systems to ensure their fiscal stability and the fiscal stability of the State and local public employers funding those costs. This recommendation essentially implements the Benefits Review Task Force recommendation prospectively, to apply to new employees who become members of the retirement systems after the enactment of legislation.

As noted earlier, the Joint Committee concluded that there are valid reasons not to make changes in the pension coverage provided to members of the JRS. Unlike the members of the other retirement systems, judges usually become members of the JRS later in life, often after a career as an attorney in private practice. Their time in public service tends to be shorter than most public employees. In private practice, their salaries tend to be higher than when they are judges. As a judge, however, their salaries and pensions tend to be higher than the average public employee. This differential is essential to enable the State to stay competitive with the private sector when recruiting outstanding jurists. It should also be noted that the JRS is the smallest State-administered retirement system. As of June 30, 2005, active membership in the system totaled 427, with 432 retirees and beneficiaries. Thus, changing the pension benefits of JRS members would affect the ability of the State to attract and retain excellent jurists, and the amount of money the State may save would be small compared with the potential negative impact such reforms might have on the quality of New Jersey's judicial system.

RECOMMENDATION 6: DESIGNATE ONE JOB FOR ONE PENSION

- **DISCUSSION**

Under N.J.S.A.43:15A-1 et seq., enrollment in the Public Employees' Retirement System (PERS) is mandatory for the majority of public employees. Nothing in the PERS statutes limits the number of PERS covered positions that an individual may hold. In fact, a number of factors, including the low enrollment threshold and the requirement for mandatory enrollment, make it possible for an individual to be employed in more than one PERS eligible position. Under N.J.S.A.18A:66-1 et seq., enrollment in the Teachers' Pension and Annuity Fund (TPAF) is mandatory for teachers, and the same situation exists concerning covered positions.

Employees holding more than one PERS covered employment position, or more than one TPAF position, are required to make employee contributions based on each of the salaries the employee earns in those positions. Those contributions are deposited into a single retirement system account created for the member regardless of the number of positions a member might hold or the number of employers as he might have. Generally, each PERS and TPAF member contributes 5% of base salary into the retirement system. For the purpose of calculating pension benefits, all of the base salaries earned by a member holding multiple positions are consolidated for each year and used as a total in the calculation of final average salary.

The Benefits Review Task Force recommended in its 2005 report that multiple memberships in PERS be eliminated, and that employees be required to select only one eligible position for pension credit. It was determined by that Task Force that the aggregation of salaries currently allowed for members holding multiple covered positions results in high costs to the retirement system.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to require the designation of one position per employee for both the PERS or TPAF. The legislation should apply to new full-time employees who become members of PERS or TPAF after the bill's enactment and who must select one job for defined benefit credit.

The Joint Committee notes that, although a person holding multiple positions does contribute to the retirement system for each position, the potential for abuse and the difficulty in preventing it make the one-position requirement a necessary reform. This proposal will supplement the proposals to enroll new part-time public employees in a new defined contribution program and to restrict PERS and TPAF membership to full-time public employees to ensure the elimination of future abuse of the pension systems.

Senator Gormley and Assemblyman O'Toole believe the Joint Committee should have recommended that this principle be applied more strongly, by adopting it not only for future employees but also with regard to current employees in defined benefit retirement systems.

<u>RECOMMENDATION 7</u>: REPEAL NON-FORFEITABLE RIGHT TO PENSION BENEFITS AFTER FIVE YEARS OF PENSION SERVICE

- **DISCUSSION**

In 1997, the New Jersey Legislature enacted N.J.S.A.43:3C-9.5 which established, for members of State-administered retirement systems, a non-forfeitable right to receive benefits, as follows:

> a. For purposes of this section, a "non-forfeitable right to receive benefits" means that the benefits program, for any employee for whom the right has attached, cannot be reduced. The provisions of this section shall not apply to post-retirement medical benefits which are provided pursuant to law.
>
> b. Vested members of the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pension Fund, the Police and Firemen's Retirement System, and the State Police Retirement System, upon the attainment of five years of service credit in the retirement system or fund or on the date of enactment of this bill, whichever is later, shall have a non-forfeitable right to receive benefits as provided under the laws governing the retirement system or fund upon the attainment of five years of service credit in the retirement system or fund or on the effective date of this act, whichever is later.
>
> c. ....
>
> d. This act shall not be construed to preclude forfeiture, suspension or reduction in benefits for dishonorable service.
>
> e. Except as expressly provided herein and only to the extent so expressly provided, nothing in this act shall be deemed to (1) limit the right of the State to alter, modify or amend such retirement systems and funds, or (2) create in any member a right in the corpus or management of a retirement system or pension fund.

In a legal opinion to the Joint Committee, Peter J. Kelly, Principal Counsel, the Office of Legislative Services (OLS), explained that "legislation that has the effect of detrimentally altering the retirement benefits of active members of State-administered retirement systems who have accrued at least five years of service credit, or of retired members, would be unconstitutional as violative of the federal and State constitutional proscription against impairment of the obligation of contract." He advised that "a substitution of one benefit for another may be permissible without impairing the obligation of contract as long as the change is reasonable and any disadvantage to the member is accompanied by offsetting and counterbalancing advantages, apparently under the theory that when there is no net loss in overall benefits the contractual relationship is not substantially impaired." Similarly, in a legal opinion for New Jersey's Treasurer, Bradley Abelow, the Office of the Attorney General advised that "N.J.S.A.43:3C-9.5 created legally enforceable rights in vested members of the state pension systems to the benefits programs of those systems" and consequently under "the State and Federal Constitutions, the Legislature may not enact laws which substantially impair those rights, except in the narrow circumstances recognized by state and federal courts."

Mr. Kelly's opinion explained, "The enactment of N.J.S.A.43:3C-9.5 also served to provide notice to persons beginning public employment after the law's effective date that their pension rights will not become unalterable until they accrue five years of service. Although it appears that the retirement benefits for members with fewer than five years of service could be detrimentally altered, implementation of any change may have to be limited to prospective application, the rescission of any credit earned for the period prior to completing five years of service being problematic."

Repeal of N.J.S.A.43:3C-9.5 should be prospective only, that is, it should apply to those employed after the repeal. The OLS legal opinion pointed out that because the statute "created a contractual right for the members to whom it is applicable, any subsequent amendment or repeal thereof would not extinguish the rights conferred on those members."

- **RECOMMENDED ACTION**

The Joint Committee recommends the repeal on a prospective basis for new employees of N.J.S.A.43:3C-9.5, which provides members of the State-administered retirement systems with a non-forfeitable right to receive in retirement the benefits provided by statute at the time a member of a retirement system attains five years of service credit.

The Joint Committee supports the repeal of the statute providing a non-forfeitable right to certain pension benefits after just five years of public service so that such a right would not attach for new public employees because the Legislature should not be permanently and inextricably bound by an action of a prior session of the Legislature.

<u>RECOMMENDATION 8</u>: LIMIT PENSION ENROLLMENT ELIGIBILITY TO $5,000 MINIMUM SALARY

- **DISCUSSION**

The enrollment compensation threshold for the Public Employees' Retirement System (PERS), N.J.S.A.43:15A-1 et seq., is $1,500. Membership in the retirement system is generally required as a condition of employment for most employees of the State, or any county or municipality, school district or public agency. The threshold for the Teachers' Pension and Annuity Fund (TPAF), N.J.S.A.18A:66-1 et seq., is $500. Persons appointed to positions requiring certification by the Department of Education as members of a regular teaching or professional staff of a public school system in New Jersey are required to enroll as a condition of employment. Department of Education employees holding unclassified professional and certificated titles are also eligible for membership.

The PERS amount was last increased from $500 in 1986, and the TPAF amount has not been increased since the fund's inception in the 1950's.

The Report of the Benefits Review Task Force recommended increasing this threshold to $5,000. The report states that the pension systems are meant for individuals who are career employees of the State or local governments. The threshold has enabled many individuals who do not meet this criteria to earn years of credit in the pension system "that they do not deserve." This has facilitated, according to the report, pension abuses that occur when a member participates at a minimum level for many years and obtains a high paying position only as the member nears retirement, or when the member who had a full career takes in a low paying job prior to retirement in order to extend years of service that are used to calculate the pension.

The report indicated that there are 8,500 public employees in the retirement system earning under $5,000, most of whom work at the local level.

The committee received testimony from speakers who urged that part-time employees should receive pension credit on an hourly basis if performing services for less than 1,000 hours per year. Another speaker suggested 1,820 hours per year as the threshold over which an employee would receive credit for a full year of service, and under which the employee would receive pro-rated service credit. It was noted during various meetings that this low salary enrollment threshold in PERS provides opportunity for abuse.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to limit eligibility for membership to $5,000 minimum salary. The legislation should apply to new employees who become members of the PERS and TPAF retirement systems after the enactment of legislation. This proposal should be enacted only in the event that the proposal to enroll new part-time public employees in a new defined contribution program, and to restrict PERS and TPAF membership to full-time public employees, is not enacted.

The Joint Committee supports raising the compensation threshold for PERS and TPAF membership as a means to ensure a pension benefit to public employees with some significant compensation and to eliminate pension costs to local employers for employees earning small amounts annually.

Assemblyman O'Toole and Senator Gormley believe the Joint Committee should have recommended a higher compensation threshold for membership in a public retirement system, not less than $10,000.

<u>RECOMMENDATION 9</u>: ALLOW ALL NON-VESTED EMPLOYEES TO OPT INTO DEFINED CONTRIBUTION PROGRAM

- **DISCUSSION**

At present, public employees earning more than a minimal threshold amount are required to be enrolled in a retirement system. Membership in the Public Employees Retirement System (PERS), however, is optional for elected officials, other than veterans and legislators. N.J.S.A.43:15A-7; 43:15A-75; 43:15A-135. Allowing all members of defined benefit State-administered retirement systems who have not yet vested to choose a new defined contribution plan in lieu of membership in the retirement system may be more appropriate for certain public employees and elected officials given the nature and length of their public service and their personal circumstances.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to give all non-vested employees the option of entering into the defined contribution program. This legislation should apply to all current and future public employees.

The Joint Committee recommends that members of all retirement systems be permitted to transfer to a defined contribution program if such a program better serves their retirement goals. Such a program would reduce public employee costs while giving these employees the flexibility to choose a plan that is most consistent with their personal situation and financial goals. It would also help to reduce the burden on taxpayers of providing public employee retirement benefits.

<u>RECOMMENDATION 10</u>: EXCLUDE ALL PROFESSIONAL SERVICE CONTRACTORS FROM MEMBERSHIP IN PERS

- **DISCUSSION**

There is no provision in State law that expressly prevents a person from being both an employee of, and a contractor for, a unit of local government or a board of education.

The Benefits Review Task Force recommended that "professional services vendors, such as municipal attorneys, tax assessors, etc., who are retained under public contracts approved by an appointing agency should not be eligible for a pension. In our opinion, these employees simply do not meet the original purpose of the public retirement plan and should not be eligible to participate in any pension plan."

In testimony before the Joint Committee on August 24, 2006, Mr. Frederick Beaver, Director of the Division of Pensions and Benefits, testified that situations where, for instance, an attorney is employed by a municipality and earning pension credit while having the municipality's work performed by his law firm was "somewhat abusive of the system."

It should be noted that both the Internal Revenue Service and the New Jersey Department of Labor have rules that govern the distinction between an employee and an independent contractor. The purpose of this recommendation is to ensure that all public employers adhere to these rules.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to exclude all professional service contractors from membership in PERS. This legislation should terminate immediately the membership of all existing contractors and prohibit future contractors from enrolling in PERS.

This recommendation of the Joint Committee is consistent with the principle that only employees of a public entity, be it State or local, are entitled to a pension benefit. The Benefits Review Task Force found this as a major abuse of the system.

<u>RECOMMENDATION 11</u>: REQUIRE DIVISION OF PENSIONS AND BENEFITS TO INVESTIGATE COMPENSATION INCREASES THAT EXCEED REASONABLY ANTICIPATED ANNUAL COMPENSATION INCREASES

- **DISCUSSION**

Currently, the Division of Pensions and Benefits reviews increases when the salary of a member of a State-administered retirement system is increased by more than the actuarially assumed average plan experience. The average is currently on 5.95% for Police and Firemen's Retirement System (PFRS) and 5.45% for all other systems, and is adjusted periodically based on system experience.

The systems' boards of trustees may question compensation whenever there is evidence that there may be extra compensation included in the base salary. Under the current law and regulation, base salary can not include extra compensation. Certain items have been identified as extra compensation including, but not limited to, overtime, lump-sum payments for longevity, and clothing allowances. Essentially, creditable compensation includes pay for performance of duties; pay received in a regular paycheck (not lump-sum); pay not specifically listed as extra compensation or as not being creditable; pay received in a similar manner as everyone else in a similar situation; and pay included in base salary from the first day it is paid. If the board determines that a violation occurred, it will take action to remedy the situation, including refunding the employee's extra contribution and recalculating the retirement benefit.

In addition, the Benefits Review Task Force recommended ending pension boosting by restricting end of career salary hikes. The report stated that the ability to dramatically increase salaries, particularly at the end of a career, must be restricted. Restrictions are a matter of fairness to all employers and taxpayers who pay the cost for the pension system deficits caused by the boosting of salaries. While long-term employees should be fairly compensated for their expertise and experience, excessive increases should not be permitted to have an adverse impact on the retirement systems.

The concern is that the funding generated by the employer and employee contributions over the course of the employee's career is insufficient to cover the costs associated with the retirement benefit. The insufficient contributions result in an underfunding of the pension system.

The Task Force gave examples of boosting and suggested actions to limit boosting. The suggestions included: examining at least 5 years of salary history; if a member's salary is increased by more than the average plan experience, the increase will be reviewed; during the review process, the employer is required to provide documentation justifying the salary increase(s), including whether given on an individual basis or to other employees as well; and the higher pension will be permitted only if the employer pays any unfunded liability that results from the higher salary, if not paid, the amount of the pension will be based upon the lower salary.

Frederick J. Beaver, Director of the Division of Pensions and Benefits, reviewed the Task Force's proposals for the Joint Committee at its August 24, 2006 meeting. He also supported efforts to end boosting.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to require the Division of Pensions and Benefits to curtail boosting abuses by investigating compensation increases that exceed reasonably anticipated annual compensation increases to curb boosting. Boosting (or padding) occurs when an employee obtains a salary that is much higher in their final year(s) of service in order to increase their pension benefit. This includes when someone who works part-time for much of their career moves to a full-time position for the necessary period of time to increase their benefit. This legislation would apply to all employees of State and local employers who seek to retire after the enactment of the legislation.

The Joint Committee supports the current regulation of the Division of Pensions and Benefits and recommends that it be enacted into law to aid in enforcement and ensure that unreasonable end-of-career compensation increases, which drive up retirement system costs, are stopped.

Assemblyman O'Toole and Senator Gormley believe that merely codifying the current procedures designed to discourage "boosting" would not make any substantive change in policy, as these are the same provisions that have become recognized as ineffective. They believe that the Joint Committee should have recommended some means of strengthening these provisions, perhaps by requiring the employer to pay for any unfunded liability created by a late-career salary boost. This would serve as a disincentive for employers to engage in the practice.

<u>RECOMMENDATION 12</u>: CLOSE PROSECUTORS PART OF PERS

- **DISCUSSION**

N.J.S.A.43:15A-155 et seq., established a special Prosecutors Part within the Public Employees' Retirement System (PERS) effective January 7, 2002. The Prosecutors Part provides enhanced pension benefits for county prosecutors, first assistant prosecutors and assistant prosecutors; the Director of the Division of Criminal Justice in the Department of Law and Public Safety; assistant directors, deputy directors, assistant attorney generals and deputy attorney generals in that department and assigned to that division; and criminal investigators in the Division of Criminal Justice in the Department of Law and Public Safety who are not eligible for enrollment in the Police and Firemen's Retirement System (PFRS).

Prosecutors Part members contribute 7.5% of their salary as their pension contribution. A Prosecutors Part account will vest when the prosecutor has 10 years of creditable Prosecutors Part service. If the prosecutor also has regular PERS service, the right to receive a regular PERS benefit will vest when the prosecutor has 10 years of regular PERS service. Prosecutors Part and regular PERS service vest separately unless all of the service will be used to qualify for a regular PERS retirement benefit.

Final compensation under the Prosecutors Part is based on the last 12 months of salary as a prosecutor. The benefits available under the Prosecutors Part are generally similar to those offered under PFRS. The types of retirements available under the Prosecutors Part include:

- Service Retirement - available at age 55 (except that members in a Prosecutors Part position on January 7, 2002 are exempted from the age 55 requirement if they have 20 or more years of service) with any number of years of Prosecutors Part service. A Prosecutors Part Service Retirement is calculated using the highest of:

    - 50% of Final Compensation if the prosecutor has 20 or more years of service;
    - 2% x Final Compensation for each year of service credit plus 1% for each year over 30; or
    - 1/60 x years of service x Final Compensation.

- Special Retirement - available at any age with 25 or more years of Prosecutors Part service. A Prosecutors Part Special Retirement is calculated using 65% of Final Compensation plus 1% of Final Compensation for each additional year over 25 years up to 30 years of service.

- Deferred Retirement - available at age 55 with ten or more years of Prosecutors Part service. A Prosecutors Part Deferred Retirement is calculated using 2% of Final Compensation for each year of service credit up to 25 years of service.

The Prosecutors Part is one of four special benefit parts under the PERS; the other three are Law Enforcement Officers (LEOs), Legislative Retirement System and Workers Compensation Judges Part.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to close the PERS Prosecutors Part. This legislation should apply prospectively to new members.

The Joint Committee recommends an end to special benefits within the Public Employees' Retirement System for selected groups of public employees and officials. This proposal, coupled with the one to close the Workers Compensation Judges Part and the one to require members of the Legislature to enroll in a new defined contribution program, would eliminate prospectively special benefit categories in the PERS (except for a very few remaining law enforcement officers). After the enactment of the recommended legislation, prosecutors, who would have enrolled in the Prosecutors Part, will be members of the PERS and will receive the same benefits that all other PERS members receive. This recommendation would standardize pension benefits for public employees with similar job functions.

<u>RECOMMENDATION 13</u>: CLOSE WORKERS COMPENSATION JUDGES PART OF PERS

- **DISCUSSION**

N.J.S.A.43:15A-142 et seq. established special retirement benefits for members of the Public Employees' Retirement System (PERS) employed by the Division of Workers' Compensation of the Department of Labor as judges of compensation. Eligible titles for membership include Chief Judge, Administrative Supervisory Judge, Supervisory Judge , and Judge of Compensation. Other benefits have been added that are similar to those of the Judicial Retirement System.

Workers' Compensation Judges contribute 5% of their base salary as their pension contribution. Members retain many regular PERS benefits, including those in the areas of retirement options, disability retirement, and contributory life insurance coverage. Other benefits have been added that are similar to those of the Judicial Retirement System.

The main types of retirement available under the Workers Compensation Judges Part are as follows:

Mandatory Retirement

Retirement is mandatory for a Workers' Compensation Judge on the first of the calendar month after the age of 70. However, an individual who was a Workers' Compensation Judge on December 6, 2001 and has not attained 10 years of service as a Workers' Compensation Judge by the time he or she reaches the age of 70 may continue to work until 10 years of service has been earned in the Workers Compensation Judges Part.

Service Retirement

Eligibility for a Service Retirement is based on age and years of service as a Workers' Compensation Judge, as well as total years of regular PERS service. A Workers' Compensation Judge is eligible for a service retirement upon turning age 60.

The annual retirement benefit is calculated using 75% of final salary if the individual is:

- Age 60 or older with 20 or more years of Workers' Compensation Judge service.
- Age 65 or older with 15 or more years of Workers' Compensation Judge service.
- Age 70 or older with 10 or more years of Workers' Compensation Judge service.

The annual retirement benefit is calculated using 50% of final salary if the individual is:

- Age 60 or older with five or more consecutive years of service as a Workers' Compensation Judge, and 20 or more years in the aggregate of public service.
- Age 65 or older with five or more consecutive years of service as a Workers' Compensation Judge, and 15 or more years in the aggregate of public service.

Early Retirement

An individual is eligible for early retirement if he or she is under age 60 with five or more successive years as a Workers' Compensation Judge, with a combined total of 25 or more years in the aggregate of public service. Early retirement is calculated at two percent of final salary for each year of service up to 25 years, plus one percent of final salary for each year of service over 25 years, with an actuarial reduction for every month under the age of 60.

Deferred Retirement

If an individual leaves the Workers Compensation Judges Part and PERS employment before he or she becomes eligible for a service or early retirement, and was not removed for cause on charges of misconduct or delinquency, he or she may be eligible for deferred retirement.

An individual is eligible for a Workers Compensation Judges Part deferred retirement if he or she leaves after completing:

- Five or more consecutive years of Workers' Compensation Judge service with an aggregate service credit of 10 years or more.

Deferred retirement is payable at age 60. The annual retirement benefit is calculated at two percent of final salary for each year of service up to 25 years, plus one percent of final salary for each year of service over 25 years.

The Workers Compensation Judges Part is one of four special benefit parts under the PERS; the other three are Law Enforcement Officers (LEOs), Legislative Retirement System and the Prosecutors Part.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to close the Workers Compensation Judges Part of PERS. This legislation should apply prospectively to new members.

The Joint Committee recommends an end to special benefits within the Public Employees' Retirement System for selected groups of public employees and officials. These types of benefit enhancements have elevated retirement system costs. This proposal, coupled with the one to close the Prosecutors Part and the one to require members of the Legislature to enroll in a new defined contribution program, would eliminate prospectively special benefit categories in the PERS (except for a very few remaining law enforcement officers). After the enactment of the recommended legislation, workers' compensation judges, who would have enrolled in the Workers Compensation Judges Part, will be members of the PERS and will receive the same benefits that all other PERS members receive.

<u>RECOMMENDATION 14</u>: REPEAL SPECIAL RETIREMENT BENEFIT ENHANCEMENT IN PFRS

- **DISCUSSION**

Current law enacted in 2003 provides for a prospective increase special retirement benefit in the Police and Firemen's Retirement System (PFRS) upon the attainment of a system funded level of 104%. PFRS members who have 25 or more years of service are currently eligible for a pension of 65% of final compensation, plus 1% of final compensation multiplied by the number of years of creditable service over 25 but not over 30 (70% maximum). This law will increase that benefit to a pension of 70% of final compensation plus 1% of final compensation multiplied by the number of years of creditable service over 25, but not over 30 (75% maximum) once the funded level exceeds 104%.

Upon attainment of this funded level, a benefit enhancement fund would be created in the system from the use of excess valuation assets to support this benefit enhancement. Excess assets equal to the present value of the future normal contributions for the enhanced benefits would be deposited into the benefit enhancement fund. Both the normal and accrued liability contributions for the increased benefits for active employees would be paid from the benefit enhancement fund. However, if assets in this benefit enhancement fund are insufficient to pay the normal and accrued liability contributions, the State is required to pay the contributions not covered by the assets.

At the time the legislation was being considered, the Division of Pensions and Benefits informally estimated the present value of the additional unfunded accrued liability for PFRS from the special retirement enhancement provision at approximately $500 million. The normal cost, to ensure that the future liability for this enhancement is funded, was informally estimated at $36 million per year. These payments would not begin until two years after the fiscal year immediately following the adoption of the valuation report by the PFRS board of trustees in which the funded level is in excess of 104%. At that time, excess assets will be transferred to the new benefit enhancement fund.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to repeal this prospective benefit enhancement, and the corresponding benefit enhancement fund, effective immediately. This recommendation would result in significant cost savings for the State and local public employers.

<u>RECOMMENDATION 15</u>: PROHIBIT NON-UNIFORM PUBLIC EMPLOYEES FROM ENROLLING IN PFRS

- **DISCUSSION**

Enrollment in the Police and Firemen's Retirement System (PFRS), N.J.S.A.43:16A-1 et seq., is required for permanent, full-time employees appointed to an eligible PFRS title in law enforcement or fire fighting in the State who also meet the age and medical criteria for membership. The retirement system has developed a list of those titles that are eligible for enrollment. If an employee not currently included as a member of the system believes that he or she performs duties that meet the definition of "policeman" or "fireman" as set forth in the law, the employee may file an application for membership in the system with the Director of the Division of Pensions and Benefits stating in detail the basis for the employee's belief that the employee is a policeman or fireman.

Current PFRS law defines "policeman" to mean a permanent, full-time employee of a law enforcement unit as defined in N.J.S.A.52:17B-67 or the State, other than an officer or trooper of the Division of State Police whose position is covered by the State Police Retirement System, whose primary duties include the investigation, apprehension or detention of persons suspected or convicted of violating the criminal laws of the State and who:

i. is authorized to carry a firearm while engaged in the actual performance of his official duties;
ii. has police powers;
iii. is required to complete successfully the training requirements prescribed by N.J.S.A.52:17B-66 et seq. or comparable training requirements as determined by the board of trustees; and
iv. is subject to the physical and mental fitness requirements applicable to the position of municipal police officer established by an agency authorized to establish these requirements on a Statewide basis, or comparable physical and mental fitness requirements as determined by the board of trustees.

The term also includes an administrative or supervisory employee of a law enforcement unit or the State whose duties include general or direct supervision of employees engaged in investigation, apprehension or detention activities or training responsibility for these employees and a requirement for engagement in investigation, apprehension or detention activities if necessary, and who is authorized to carry a firearm while in the actual performance of his official duties and has police powers.

"Fireman" is defined to mean a permanent, full-time employee of a firefighting unit whose primary duties include the control and extinguishment of fires and who is subject to the training and physical and mental fitness requirements applicable to the position of municipal firefighter established by an agency authorized to establish these requirements on a Statewide basis, or comparable training and physical and mental fitness requirements as determined by the board of trustees.

The term also includes an administrative or supervisory employee of a firefighting unit whose duties include general or direct supervision of employees engaged in fire control and extinguishment activities or training responsibility for these employees and a requirement for engagement in fire control and extinguishment activities if necessary. A "firefighting unit" means a municipal fire department, a fire district, or an agency of a county or the State which is responsible for control and extinguishment of fires.

The division reviews the application for membership and determines whether the employee meets the definition, and then makes a recommendation to the PFRS board of trustees as to whether the employee should be included in the system. If after considering the recommendation, the board determines that the employee meets the definition the board will publish a notice in the New Jersey Register proposing to include the employee's position in the retirement system. Interested parties will are given 30 days to comment on the proposal. If the board determines that the employee does not meet the definition, the employee will be offered an opportunity for a hearing.

As of July 2005, there were 44,211 active members of this retirement system, and 29,257 retired members and beneficiaries. The July 1, 2005 valuation of PFRS calculated a required contribution by all employers of $893.4 million ($253.7 million by the State and $639.8 million by municipalities and local groups).

- **RECOMMENDED ACTION**

The Joint Committee recommends strict adherence to the legal definition of "policeman" and "fireman."

The Joint Committee offers this recommendation to control costs in the Police and Firemen's Retirement System and to ensure the integrity of that system in providing benefits only to those public employees who serve as law enforcement officers and firefighters.

RECOMMENDATION 16: REQUIRE FORFEITURE OF RETIREMENT SYSTEM BENEFITS FOR PUBLIC OFFICIALS CONVICTED OF CRIMES INVOLVING ABUSE OF OFFICE

- **DISCUSSION**

New Jersey courts have uniformly held that the receipt of a public pension or retirement benefit is conditioned upon the rendering of honorable service by the officer or employee. In the Uricoli case, the New Jersey Supreme Court indicated that: "honorable service is an implicit requirement of every public pension statute, whether or not this conditional term appears in the particular statute . . . Courts in this State have consistently imputed to the Legislature the intent that a public employee's right to pension benefits be conditioned upon honorable service." In analyzing what conduct constitutes dishonorable service that warrants forfeiture of all or part of a public pension, the court in Uricoli called for "flexibility and the application of equitable considerations," and established an 11 point balancing test to determine whether complete or partial pension forfeiture is justified in view of all of the circumstances. Under the Uricoli test, forfeiture may result from conviction of a crime (whether touching upon, or unrelated to, public employment) or other misconduct.

In 1995, the Legislature enacted N.J.S.A.43:1-3 which expressly conditions the receipt of a public pension or retirement benefit "upon the rendering of honorable service by a public officer or employee." That statute also codified the 11-point balancing test established by the Supreme Court in Uricoli and directs the board of trustees of any State or locally-administered pension fund or retirement system to "consider and balance" the 11 factors in determining whether forfeiture or partial forfeiture is appropriate. The factors are: (1) the member's length of service; (2) the basis for retirement; (3) the extent to which the member's pension has vested; (4) the duties of the particular member; (5) the member's public employment history and record covered under the retirement system; (6) any other public employment or service; (7) the nature of the misconduct or crime, including the gravity or substantiality of the offense, whether it was a single or multiple offense and whether it was continuing or isolated; (8) the relationship between the misconduct and the member's public duties; (9) the quality of moral turpitude or the degree of guilt or culpability, including the member's motives and reasons, personal gain and similar considerations; (10) the availability and adequacy of other penal sanctions; and (11) other personal circumstances relating to the member which bear upon the justness of forfeiture.

N.J.S.A.43:3C-9.5, which confers a non-forfeitable right to receive benefits on vested members of public employee pension systems after five years of service, specifically provides that its provisions do not "preclude forfeiture, suspension or reduction of its benefits for dishonorable service." In addition, specific forfeiture provisions applicable to Public Employees' Retirement System deferred retirement, N.J.S.A.43:15A-38, and to ordinary retirement under the Police and Firemen's Retirement System, N.J.S.A.43:16A-11.2, have been found by the courts to coexist with the general forfeiture provisions of N.J.S.A.43:1-3.

The Benefits Review Task Force stated in its 2005 report that "public monies should not be used to provide retirement benefits to individuals at any level, whether elected, appointed or hired, who have been convicted of violating the public trust." The Task Force noted that the forfeiture of pension benefits for convicted employees is not automatic under existing statute, and that of the 50 cases considered for possible pension benefit forfeiture in fiscal year 2005, 34 cases resulted from criminal activity and four were total forfeiture.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to require the forfeiture of retirement benefits for public officials convicted of crimes involving abuse of office. Such legislation should apply to all members and retirees of the State-administered retirement systems.

The Joint Committee supports the forfeiture of pension allowances of individuals who have been convicted of criminal offenses touching upon their office. Such convicted individuals violate the public trust and, therefore, do not deserve a pension supported by public funds.

<u>RECOMMENDATION 17</u>: REPLACE ACCIDENTAL AND ORDINARY DISABILITY BENEFITS WITH PRIVATE DISABILITY INSURANCE COVERAGE

- **DISCUSSION**

Each of the public employee retirement systems contains provisions for disability retirement. The two largest programs, which are identical, are for members of the Teachers' Pension and Annuity Fund (TPAF), N.J.S.A.18A:66-39 et seq., and the Public Employees' Retirement System (PERS), N.J.S.A.43:15A-42 et seq.. Members of the Alternative Benefits Program (ABP) are covered by employer-paid long-term disability insurance, N.J.S.A.18A:66-176.

TPAF and PERS members are covered by two types of disability retirement: ordinary and accidental. To retire under ordinary disability, a member must have an active pension account, have at least ten years of New Jersey service credit, and be considered totally and permanently disabled (i.e., be physically or mentally unable to perform normal or assigned duties, with no possibility of significant improvement). The annual benefit is equal to 43.6% of the member's final average salary (i.e., the last three years before retirement or the highest three fiscal years of salary, whichever is greatest). The benefit is not reduced by any Social Security, Worker's Compensation, or private insurance benefits the member may receive, though a Worker's Compensation award may be reduced. The benefit is subject to federal tax to the same extent as other pensions, but it is not subject to State income tax until the member reaches age 65.

To retire under accidental disability, a member must have an active pension account, be an active member of the retirement system on the date of the traumatic event, file an application within five years of the event, and be examined by physicians selected by the retirement system. A "traumatic event" is one in which the worker is involuntarily exposed to a violent level of force or impact which is not brought into motion by the worker. To receive the benefit, the worker must demonstrate that the injury was not induced by normal work effort, he or she met involuntarily with the object that was the source of the harm, and the source of the injury was a violent or uncontrollable power. Once qualified, the member receives 72.7% of the member's base salary at the time of the traumatic event. If the member receives Worker's Compensation benefits, the retirement benefit will be reduced dollar for dollar by the benefits paid after the member's retirement date. The benefit is not reduced by any Social Security or private insurance benefits the member may receive. The benefit is also not subject to federal income tax and is not subject to State income tax until the member reaches age 65. A member found by the Division of Pensions and Benefits to be totally and permanently disabled, not due to a traumatic event, would receive an ordinary disability retirement benefit.

According to Frederick Beaver, Director of the Division of Pensions and Benefits, in testimony before the Joint Committee on August 24, 2006, under the current system, any member who is out of work for an extended time is forced to apply for either ordinary or accidental disability, because "there is no middle ground" between being temporarily disabled and retired. There is no long term disability program for such members to provide salary replacement while the member is disabled and allow more time to determine if the employee could return to work. Mr. Beaver suggested that changing the disability retirement system to a disability insurance program, which would provide a long-term insurance benefit and permit a worker to return to work, could save the State approximately $28 million per year and save local employers approximately $53 million per year. In testimony before the Joint Committee on August 31, 2006, Mr. Beaver suggested that the State's ABP offered a model on which to base a long-term disability insurance program. Testimony from retirement system members and the public at subsequent meetings of the committee did not address such an alternative, but did note that there were occasions when disability retirement was abused by retirees.

Mr. Beaver's testimony on disability pensions closely echoed the findings and recommendations in the Report of the Benefits Review Task Force, issued on December 1, 2005. The report called for all disability retirement benefits to be changed to a privately insured long term disability insurance program, one that would "save money and provide greater flexibility for employees" and be similar to the one provided under the ABP. Like Mr. Beaver, the Task Force estimated that adopting such a program would save the State and local governments a total of approximately $86.7 million per year.

As an example, under the ABP, a member is eligible for such coverage after one year. If a member is totally disabled due to an occupational or non-occupational condition, the member can receive a regular monthly income benefit of 60% of the base salary earned during the 12 months preceding the onset of the disability. The benefit is offset by any other periodic benefit the member receives. In addition, the member's and the employer's mandatory contributions are automatically credited to the member's retirement account while the member is disabled. The benefits are paid as long as the member remains disabled or until the member reaches age 70, but they terminate if the member begins receiving payments under a retirement annuity. To be considered disabled, the member must be unable to perform any and every duty pertaining to his or her occupation. A disability is not considered to exist if the member is gainfully employed, incarcerated, or if the disability resulted from an act of war or was intentionally self-inflicted.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to replace accidental and ordinary disability benefits for new TPAF and PERS members with private disability insurance coverage. This legislation should apply to new employees who become members of the TPAF and PERS after enactment of the legislation.

This Joint Committee agrees with the Director of the Division of Pensions and Benefits that the implementation of this recommendation would be beneficial to public employees who become disabled and would result in savings to both the State and local public employers.

<u>RECOMMENDATION 18</u>: CONTINUE MORATORIUM ON BENEFIT ENHANCEMENTS IN STATE-ADMINISTERED RETIREMENT SYSTEMS

- **DISCUSSION**

The Benefits Review Task Force found that the "current process for reviewing benefits is haphazard at best and excessively influenced by political instead of fiscal motivations. The non-stop requests (and too often action) for legislative action have eroded the State's fiscal health and created a benefit structure that the State cannot currently afford." The Task Force noted that at the time it was organized, there were 466 pension and health-related bills pending in the Legislature. Additionally, the Task Force found that on average, since the year 2000, benefit enhancement bills have passed the Legislature with an average plurality of 89%, and benefits enhancements enacted since 1999 will cost State and local employers well over $6.8 billion. The Task Force concluded, "The benefit enhancement process far too frequently happens in the complete absence of an informed debate on the actual costs of the change, yet alone how it will be paid for over the long term. And far too often, the taxpayer's interests are absent."

One change in the benefits structure that is illustrative of this issue was the enactment of P.L.2001, c.133, which changed the pension calculation formula to "n/55." The Task Force found in its report, however, that the enhancement increased pension liabilities considerably; PERS and TPAF pensions were increased by 9.09%, while over the same time period pension liabilities increased by over $4.2 billion, a portion of which represents the cost of providing the n/55 benefit to retirees, the cost of past service for current employees, and the cost for future service for current employees.

In his testimony before the Joint Committee on October 25, Philip D. Murphy, Chairman of the Benefits Review Task Force, stated that:

> The one area that we said if we had a "do-over" it would be the "n/55" from "n/60." And people disagree with that, and they certainly have a right to disagree with that. But I would argue, the process failed us. Whether we disagree on the substance is separate from whether or not the process was a good process. And that is a multibillion dollar tail that will

> live with us as long as that's in place. And we accept, in this report -- that we believe, based on the advice we got – is that it will stay in place. But it's a good example -- it's probably the best example I can think -- of where the process failed us . . . . We have to have a much more professional, systematic, clear, open-daylight, fully transparent process; and one that we're not sort of nickel and dimed to death without, in some cases, knowing what we're doing, collectively.

To address these issues, the Task Force supported a continued moratorium on benefit enhancement legislation, citing Governor Richard J. Codey's pledge not to sign any benefit legislation that does not provide for a source of funding. Additionally, they recommended that any proposed benefits legislation must include certain elements that should be part of the Pension and Health Benefits Review Commission's analysis of legislation.

- **RECOMMENDED ACTION**

The Joint Committee recommends a continued moratorium on benefit enhancement legislation.

The Joint Committee's recommendation is consistent with that of the Benefits Review Task Force and the Joint Committee supports a continued moratorium on benefit enhancement legislation.

<u>RECOMMENDATION 19</u>: CONTINUE MORATORIUM ON EARLY RETIREMENT INCENTIVES, EXCEPT IN CASES OF REGIONALIZATION AND CONSOLIDATION INITIATIVES RESULTING IN COST SAVINGS

- **DISCUSSION**

Generally, New Jersey's public employee early retirement incentive (ERI) programs have provided limited, short-term savings in exchange for large, long-term retirement system liabilities. Several times over the past decade, State laws have been enacted that have permitted either general or very restrictive retirement incentive programs. Most recently, P.L.2002, c.23 provided retirement incentives to State and State college and university employees. This law increased pension system liabilities by $645.4 million. Cumulative savings to the State for the four years since the early retirement incentive program total approximately $314 million. Thus, the net liability from the ERI is $331.4 million.

P.L. 2003, c.127, P.L.2003, c.128 and P.L.2003, c.129 extended an ERI program similar to that offered under the provisions of P.L.2002, c.23 to members of local government units and school district locations who adopted one of the programs.

Local government and school district employers are not permitted to offer their employees incentives to retire unless specifically authorized by law. Currently, the only two laws that authorize retirement incentive programs are N.J.S.A.43:8C-2 and N.J.S.A.43:8C-2.1. These laws are applicable only to local government units. Any retirement incentive program offered under the provisions of these laws must be approved by the Department of Community Affairs, Division of Local Government Services and must contain cost savings through a permanent reduction in staff.

The cost to an employer for providing a retirement incentive program can be significant. The exact cost must be determined by way of an actuarial analysis of the program and is dependent upon the nature of the incentive provided and the profile of the employees eligible for the program. The cost of the retirement incentive program will include two components:

1. The cost of the incentive itself (e.g., cash payment, post-retirement medical premiums, additional pension credit, etc.); and
2. The pension cost of inducing an employee to retire sooner than actuarially anticipated. Each retirement system operates under a set of assumptions, based on experience, as to when members will retire. If an employer offers its employees an incentive to retire, members retire earlier than would otherwise be the case, thereby increasing costs to the retirement system.

- **RECOMMENDED ACTION**

The Joint Committee recommends a continued moratorium on early retirement incentive programs because such programs have proven costly to the State and to local public employers.

Assemblyman O'Toole and Senator Gormley believe that no moratorium will be effective unless it is established in the Constitution, since the traditional ERI programs have been enacted by legislation. Any lesser moratorium, statutory or otherwise, can simply be overridden by such legislation in the future. They believe the Joint Committee should have recommended that a moratorium be proposed as a constitutional amendment banning any such program that will have a negative impact on a public pension system.

<u>RECOMMENDATION 20</u>: ELIMINATE USE OF EXCESS VALUATION ASSETS TO REDUCE EMPLOYERS' NORMAL CONTRIBUTIONS IN STATE-ADMINISTERED RETIREMENT SYSTEMS

- **DISCUSSION**

Existing law permits the State Treasurer to reduce the amount of normal contributions needed to fund the various State-administered retirement systems by the amount of excess valuation assets. State and local government employers pay annually a normal contribution to the retirement system. This contribution is determined each year on the basis of the annual valuation prepared by the system's actuary and represents the value of the benefits to be earned in the year following the valuation date.

P.L.1997, c.115, however, changed the manner by which the State financed its pension obligations. This law allowed the issuance of $2.75 billion in pension obligation bonds to finance the plans' unfunded liability. Additionally, this law allowed the use of excess valuation assets of the retirement system to offset employers' annual normal contributions to the pension system. This change in funding policy resulted in either full or partial reductions in the State's and local government employers' otherwise required normal contributions to the retirement plan for fiscal year 1997 through fiscal year 2003.

P.L.2003, c.108 has led to a resumption of contributions, but on a phased-in approach. Under the provisions of this 2003 law, local employers' payments to the Public Employees' Retirement System (PERS) and the Police and Firemen's Retirement System (PFRS) are phased-in over five years. The phase-in further increases the unfunded liability of the systems.

State and local government employer pension holidays are one of four main reasons that the unfunded liability of the pension plans total $18 billion. Frederick J. Beaver, Director of the Division of Pensions and Benefits, estimated that State and local employer contributions that were avoided over this time period total approximately $8 billion.

The Benefits Review Task Force recommended that the State and local government employers participating in the retirement systems make the full employer contribution each year as determined by plan actuaries. The full contribution includes: (a) annual payments of the actuarially determined normal pension contribution ? defined as costs associated with service accrual between the past year and the current year; and (b) payments of a portion of any unfunded accrued liability ? the difference between assets and liabilities amortized over a 30-year period. The Task Force stated that the State and local employers must be required, by explicit legislation, to make the full employer contribution each year. It noted that offsetting normal employer contributions with surplus pension assets is not a prudent practice and that unsound funding techniques should not be part of the State's future fiscal practices.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to eliminate the use of excess valuation assets to reduce employers' normal contributions in the State-administered retirement systems.

The Joint Committee recommends that State and local government employers meet their full obligation to make the annual contributions to the State-administered retirement system as determined by the systems' actuaries. The avoidance of contributions has led to the current unfunded liabilities of the retirement systems.

<u>RECOMMENDATION 21</u>: USE CONSISTENT AND GENERALLY ACCEPTED ACTUARIAL STANDARDS FOR PENSION VALUATIONS

- **DISCUSSION**

In recent years, the State has not used consistent actuarial methods to determine pension fund assets, obligations and annual contributions. An actuarial method is a procedure for determining the present value of pension benefits that will be paid in the future, and allocating that value and the cost of the benefits to specific time periods. There are a number of accepted actuarial methods that fulfill the goal of fully funding all pension obligations as they become due, but they allocate costs in different ways during the period of employment of members in the plan.

Beginning in the early 1990s, a number of pension changes were implemented that, in hindsight, have led to an erosion in the financial health of the retirement systems. P.L.1992, c.41, changed the methodology by which plan assets were measured, basing these assets on actual market-related value of assets rather than book value. The calculation that yielded the higher market value of assets and an increase in the projected rate of investment return from 7% to 8.75% resulted in a $733.4 million and $785.7 million reduction in State and local employer pension contributions for fiscal years 1992 and 1993, respectively. The act used a five-year averaging of the market value of plan assets to help protect against sudden market shifts in plan assets, thus maintaining actuarially sound accounting principles. Notwithstanding these principles, the Legislature enacted several laws with the sole intention of reducing employer contributions to the pension funds by the use of excess valuation assets.

Pension funding policy was revised again under the P.L.1994, c.62. It changed the actuarial funding methodology for the State plans from the entry age normal method to the projected unit credit method. Although still an actuarially accepted method of pension funding, the shift from the entry age normal method to the projected unit credit method reduced State and local employer contributions in the short-term. Furthermore, under this funding methodology, the "normal cost" to the employer has a propensity to increase over time. The "normal cost" represents the portion of the cost of projected benefits allocated to the current year.

The most prevalent actuarial method used by various state retirement plans is the entry age normal method. Of 85 plans surveyed by the Wisconsin Legislature in 2004, 66, or 78%, use the entry age actuarial method and only 13, or 15%, of the 85 plans use the unit credit method.

- **RECOMMENDED ACTION**

The Joint Committee recommends that the State maintain consistent and accepted actuarial standards to determine pension fund asset values, obligations and annual contributions. Any modifications to assumptions or actuarial methodology at the direction of the State that change asset values, obligations or annual contributions, should require public disclosure prior to adoption including a financial impact analysis.

The Benefits Review Task Force stated that methodologies for determining pension fund values and contribution requirements should not be changed again in order to mask the true cost of benefit enhancements.

Health Benefits

RECOMMENDATION 22: REQUIRE ALL ACTIVE PUBLIC EMPLOYEES TO PAY SOME PORTION OF COST OF HEALTH CARE INSURANCE PREMIUMS

- **DISCUSSION**

The State Health Benefits Program (SHBP) was established under the provisions of the "New Jersey State Health Benefits Program Act," N.J.S.A.52:14-17.25 et seq., to provide traditional indemnity benefits for State employees and their dependents. The SHBP was extended to include other public and school employees, through voluntary participation by counties, municipalities, school districts, public agencies and certain other authorities and commissions under the provisions of N.J.S.A.52:14-17.34.

Administered by the Division of Pensions and Benefits in the Department of the Treasury, the SHBP is a multiple option program offering health benefits coverage through the indemnity Traditional Plan or one of the managed care options, which include NJ PLUS and several health maintenance organizations (HMOs). SHBP also offers dental coverage and prescription drug benefits. Currently, 934 public employers participate in the SHBP and the program covers about 804,000 individuals, almost 10% of the population of New Jersey. SHBP is an employer health benefits program, not a health benefits program for the public. As is the case with health insurance programs of private sector employers with a large number of employees, the SHBP health plans are self-insured. The State and participating public employers other than the State pay the actual expenses of those plans plus administrative fees, and they assume the ultimate financial risk. "Premium" rates are established annually by the State Health Benefits Commission in order to fund the program's projected expenditures through appropriation for the State's expenses as an employer and through assessment of the participating employers other than the State.

N.J.S.A.54:17.28b provides that State employees and the employees of an independent State authority, board, commission, corporation, agency or organization may be required to contribute toward the cost of SHBP health benefits coverage according to the terms of a binding collective negotiations agreement. The amount of an employee's premium sharing depends upon union affiliation and plan option. In 2006, for example, some union-affiliated State employees, required by contract to contribute toward the cost of their SHBP benefits, pay 25% of coverage cost if electing the Traditional Plan or pay 5% of coverage cost if electing an HMO. The State pays the remaining cost. The State pays the entire cost of coverage for the employees electing NJ PLUS. Non-aligned State employees (those whose positions are not eligible for union representation) contribute in the same manner, consistent with the terms of one of the union contracts binding on the State, as designated by the State Health Benefits Commission pursuant to the law.

Under current law, public employers other than the State participating in SHBP pay the cost of an employee's coverage and have the option of assuming the cost of dependent coverage. Most of these public employers, however, have agreed to assume the cost of SHBP coverage for their employees' dependents. A local employer must offer all SHBP plan options to its employees and any premium sharing must be uniform across all employee groups. Counties, municipalities, school districts and independent authorities that choose not to participate in SHBP may contract independently with one or more health insurance providers, self-insure or participate in a joint health insurance fund. These employers, pursuant to relevant union contracts, may or may not offer more than one plan option, and may or may not require employee premium sharing.

Frederick J. Beaver, Director of the Division of Pensions and Benefits stated that the State and SHBP participating local government units spend a total of $3.6 billion annually on health care benefits. The State alone spends approximately $2 billion per year on active State and higher education employee and State and local retiree health care benefits. Mr. Beaver testified that "cost drivers" include an increase in utilization, a greater and older population, medical price inflation, malpractice costs and the availability and use of more expensive drug therapy and changes in the mix of medical services. He noted that costs have risen by 150% over the past five years and will double by 2010. By 2010, the State cost for active employee benefits is projected to total $1.5

billion and State-paid post retirement medical benefits would total $2.1 billion, for a total State cost of $3.6 billion.

The Benefits Review Task Force recommended that all active and retired State and local government employees contribute some portion of the cost of the health care benefits. The Task Force believes that all active and retired employees should share in the cost of health care. The current cost sharing method should also be revised so that the employee selects a plan based on personal need and cost. The Task Force recommended that the State contribute a fixed dollar amount toward each employee's choice, based upon an established percentage of one of the plans. The employee's cost would be higher or lower depending on the plan they select.

- **RECOMMENDED ACTION**

The Joint Committee recommends that some level of premium sharing be established for all active employees through the collective bargaining process.

The Joint Committee believes that all public employees should be required to pay some portion of the employer-provided health care insurance. The Joint Committee defers to the various public employers and employee representatives to determine the appropriate level of premium sharing through collective bargaining.

Senator Gormley and Assemblyman O'Toole believe the Joint Committee's recommendation appears in reality to be no stronger than the status quo. They believe the Joint Committee should have recommended that a specific level of minimum cost sharing be statutorily required. The Benefits Review Task Force suggested that employees carry a share of 5% to 10%. In order to recognize differences in ability to pay and to provide appropriate flexibility in negotiations, this could be achieved by mandating a certain overall percentage employee share, with the distribution of that share among income groups to be subject to collective bargaining.

RECOMMENDATION 23: REQUIRE FUTURE RETIREES TO PAY SOME PORTION OF COST OF HEALTH CARE INSURANCE PREMIUMS

- **DISCUSSION**

Currently, most retirees who are eligible for employer-paid post-retirement health care benefits under the State Health Benefits Program (SHBP) do not contribute any amount toward the cost of that coverage beyond payment of their particular plan's deductible or copayment requirements. Eligibility for such benefits is tied to receipt of a pension based upon 25 or more years of public service. For those retirees, the statutes at the time of their retirement provided for full payment by a public employer. Teachers and employees of boards of education and county colleges, for example, receive free SHBP coverage in retirement, including full reimbursement of the prevailing cost of Medicare Part B, if they have 25 or more years of service (N.J.S.A.52:14-17.32f and 52:14-17.32f1). The State pays the cost of this coverage. State employees who accrued 25 years of service on or before July 1, 1997 also receive fully paid SHBP coverage (N.J.S.A.52:14-17.32).

State employees who attain 25 years of service credit or retire on disability after July 1, 1997, may be required to share in paying the cost of SHBP coverage and Medicare Part B according to the terms specified in the union contract applicable to them at the time they attain 25 years of service credit, or retire for disability (N.J.S.A.52:14-17.28b). In 1996, the statutes were amended to provide that State employees and the employees of an independent State authority, board, commission, corporation, agency or organization may be required to contribute toward the cost of SHBP health benefits coverage while active employees according to the terms of a binding collective negotiations agreement. The amount of an employee's premium sharing depends upon union affiliation and plan option.

For certain police officers and firefighters and their dependents, but not survivors, who retire with 25 or more years of service credit, or on disability, and who do not receive any employer payment toward post-retirement health benefits, regardless of whether their former employers make any payment toward such benefits for other retirees, the State pays 80 percent of the least expensive cost of coverage among the SHBP plans (N.J.S.A.52:14-17.32i). The retiree pays the remainder of the cost of whatever plan is chosen and pays for Medicare Part B.

Public employers other than the State participating in SHBP may choose to offer SHBP benefits in retirement to employees not electing deferred retirement, and their dependents as well as survivors. Before 1999, local government employers offering paid post-retirement SHBP benefits were responsible for the full cost. For more recent retirees, the employer payment obligations for such benefits may be determined by a binding collective negotiations agreement with respect to aligned employees and in the sole discretion of the employer with respect to non-aligned employees (N.J.S.A.52:14-17.38). Employers other than the State may also choose to reimburse retirees for the cost of Medicare Part B.

At the time the State and other public employers agreed to fully support the cost of SHBP coverage during retirement, the costs of doing so were significant but acceptable. Over the past decade, however, that cost has increased exponentially. Frederick J. Beaver, Director of the Division of Pensions and Benefits, explained to the Joint Committee that SHBP costs in general have risen by 150% over the past five years and will double by the year 2010. The statutory modifications to public employers' obligation to pay the full cost of post-retirement SHBP benefits with the development of premium sharing through collective negotiations are part of efforts to control the cost of providing health care benefits in retirement to retirees and their dependents in order to lighten the burden ultimately borne by the taxpayers.

- **RECOMMENDED ACTION**

The Joint Committee recommends that all future retirees receiving employer-paid SHBP benefits pay some amount of health care premiums. The amount should be linked to a retiree's ability to contribute by application of a sliding scale of payments to the range of the amounts of pensions. For those retirees with limited pension resources, the payment would be minimal. Institution of this type of payment would need to be integrated statutorily with current laws already providing for some negotiated premium sharing.

The Joint Committee finds that payment of SHBP coverage for retirees is becoming a significant proportion of budgetary expenses. While public employers should continue to support post-retirement SHBP coverage, some needs-tested cost sharing is appropriate.

<u>RECOMMENDATION 24</u>: PROVIDE FLEXIBILITY TO LOCAL GOVERNMENT EMPLOYERS PARTICIPATING IN SHBP TO NEGOTIATE DIFFERENT LEVELS OF COST SHARING AND PLAN SELECTION WITH THEIR CURRENT EMPLOYEES

- **DISCUSSION**

Currently, local government and school district employers do not have the ability to negotiate the amount of State Health Benefits Program (SHBP) premium or periodic charges to be paid by the employer. This collective negotiation process is available to the State, pursuant to N.J.S.A.52:14-17.28b, which allows active employee and retiree premium sharing resulting from labor contract agreements, effective July 1, 1997. Local governments may negotiate premium sharing with regard to their retirees since 1999, N.J.S.A.53:14-17.38.

The Benefits Review Task Force recommended that the State provide greater health care options for local negotiations. The Task Force stated that local employers should be given the flexibility to negotiate terms and conditions of coverage under the SHBP. This would include premium sharing arrangements for both employees and dependents on a bargaining unit level, as well as the ability to negotiate what plans are to be included for offering to their bargaining units.

Many of the invited constituency groups who testified before the Joint Committee advocated making the SHBP more flexible and specifically mentioned the uniformity rule as an area to be addressed. Lynne Strickland, Executive Director, Garden State Coalition of Schools, testified in favor of allowing school districts to negotiate with individual bargaining units on health benefits. Barbara Horl, Lobbyist, Government Relations, New Jersey School Boards Association, said school districts should be given the ability to negotiate tiered benefits.

Frederick J. Beaver, Director of the Division of Pensions and Benefits, acknowledged that local employers leave SHBP seeking more flexibility.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation that would allow local public employers to negotiate collectively both premium sharing arrangements, as well as offering different plan coverage within the SHBP. A local employer, for example, would be permitted to negotiate SHBP coverage through a health maintenance organization only as opposed to the wide array of options currently mandated to be available. In addition, a local employer would be permitted to negotiate some level of premium cost sharing with their employees.

The Joint Committee recommends that local public employers should be empowered to negotiate collectively with their employees the details of SHBP coverage to be available in order to maximize savings and control costs for the taxpaying public.

<u>RECOMMENDATION 25</u>: REQUIRE THAT SHBP BENEFITS CHANGES NEGOTIATED BY STATE BE APPLIED TO LOCAL GOVERNMENTS

- **DISCUSSION**

The State Health Benefits Program (SHBP) is a multiple option program offering health benefits coverage through the indemnity Traditional Plan or one of the managed care options, which include NJ PLUS and five health maintenance organizations (HMOs). Copayments in the managed care plans, determined in collective negotiations with State employees, are $10. Elimination of dual coverage within SHBP for State employees was also negotiated.

The Benefits Review Task Force suggested that the State Health Benefits Commission apply changes in benefits resulting from the State's collective bargaining agreements to participating local employers. Application of office visit and prescription copayment amounts to local participants of such changes were made from 1996 until 2003. The changes at issue include increasing managed care office visit and prescription copayments as well as eliminating dual coverage, that is, coverage of a person under one or more SHBP plans as both employee and dependent. The State Health Benefits Commission has taken action to apply the copayment increases for office visits and prescriptions. The commission has proposed rules for 2007 prohibiting multiple coverage in SHBP as an employee, retired employee or dependent.

- **RECOMMENDED ACTION**

The Joint Committee recommends that legislation be enacted to ensure that basic changes made in the provision of SHBP benefits to State employees, such as the amount of copayments for office visits and prescription drugs, be applicable at the same time to all individuals covered by SHBP.

The Joint Committee believes that it is important that SHBP benefits changes negotiated by the State with its employees be applicable to employees of local employers not only to reduce administrative expenses for all through conformity but also to extend to those local employers the same cost savings enjoyed by the State. The Joint Committee believes that it is important to ensure consistency in health benefit coverage and cost for all public employees.

RECOMMENDATION 26: LIMIT SHBP PARTICIPATION TO THOSE WHO WORK AT LEAST 35 HOURS PER WEEK

- **DISCUSSION**

N.J.S.A.52:14-17.26 defines an employee who is eligible to participate in the State Health Benefits Program (SHBP) as "an appointive or elective officer or full-time employee of the State of New Jersey." This definition is extended to local government employees by N.J.S.A.52:14-17.36, which states "The commission. . . is hereby authorized to prescribe rules and regulations satisfactory to the carrier or carriers under which employers may participate in the health benefits program provided by that act. All provisions of that act will, except as expressly stated herein, be construed as to participating employers and to their employees and to dependents of such employees the same as for the State, employees of the State and dependents of such employees." This section was added to the law in 1964, three years after the creation of the SHBP, and has never been amended.

However, the law does not establish a minimum number of hours that employees must work to be considered "full-time." The commission has, by regulation, promulgated different definitions for "full-time" as it applies to State and local employees.

For State employees, the commission defines "full-time" at N.J.A.C.17:9-4.2. The definition states, in part, that for State employees full-time means "the normal full-time weekly schedule for the particular class title, and in any case not less than 35 hours per week." For local employees, the commission defines "full-time" at N.J.A.C.17:9-4.6. The definition states, in part, that for the purpose of local coverage, "full-time" means:

> Employment of any eligible employees who appear on a regular payroll and who receive a salary or wages for an average of the number of hours per week as prescribed by the governing body of the participating employer. Each participating employer shall, by resolution, determine the number of hours worked which shall be considered to be "full-time." In no case shall the number of hours for "full-time" be less than 20. The employer, at its option, may grandfather all employees who were eligible for coverage under the location's previous definition of full-time.

The result is that while a State employee generally must work at least 35 hours per week to be enrolled in the SHBP, a local employee need only work a minimum of 20 hours per week to be eligible for enrollment. Additionally, a local employer may have grandfathered in any employees who were eligible for coverage under the location's definition of "full-time" prior to the enactment of the 20 hour requirement.

- **RECOMMENDED ACTION**

The Joint Committee recommends enactment of legislation to clarify that only full-time employees are eligible for SHBP coverage by defining a full-time employee as an employee who works 35 or more hours each week. This proposal should apply only to new employees enrolling in SHBP after the enactment of legislation.

The Joint Committee believes that significant savings to local public employers and their taxpayers are possible by bringing them into conformity with State practice and ensuring that only genuinely full-time employees and their dependents are eligible for the desirable and costly benefits of SHBP coverage. The implementation of this proposal should not impair the obligation in any collective negotiations agreement or contract of employment in effect when the legislation is enacted.

<u>RECOMMENDATION 27</u>: ALLOW LOCAL EMPLOYERS PARTICIPATING IN SHBP TO PROVIDE MONETARY INCENTIVES TO PUBLIC EMPLOYEES WHO ELECT TO WAIVE SHBP COVERAGE

- **DISCUSSION**

Under the provisions of N.J.S.A.52:14-17.31a, municipalities (since 1995), municipal authorities (since 2001), and county colleges (since 2003) have had the option to provide financial incentives to employees who waive coverage under the State Health Benefits Program (SHBP) if the employee is eligible for other health care coverage. The incentive amount is currently, by law, no more than 50% of the amount saved by the employer through the employee's waiver of coverage. It is up to the employer to determine how much of an incentive to offer up to the statutory limit and the SHBP does not track the amount each employer offers or the total amount of premiums waived. The State, State colleges and universities and boards of education are not permitted to offer monetary incentives for waiving SHBP coverage.

The Benefits Review Task Force found that the SHBP eligibility and participation rules should be revised and structured to not encourage employees to enroll spouses and dependents where other employer based coverage is available. One of the Task Force recommendations included an option to provide cash incentives to not enroll in the SHBP when other employer coverage is available, as is currently used by some municipalities.

According to Frederick J. Beaver, Director of the Division of Pensions and Benefits, currently 1,291 local government and county college employees waive SHBP coverage in return for a monetary incentive and 1,000 local government and county college employees voluntarily waive SHBP coverage. In addition, currently 3,580 State, State college, and education employees voluntarily waive SHBP coverage.

At the October 12, 2006 Joint Committee meeting, Lynne Strickland, Executive Director, Garden State Coalition of Schools, spoke about the high costs and inflexibility in the SHBP. She suggested implementing opt-out provisions for employees who already have coverage via a spouse's policy, and instituting a waiver incentive. In addition, Barbara

Horl, a lobbyist for the New Jersey School Boards Association, also advocated for the right to offer waivers for employees with duplicate coverage.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to permit waiver incentives to all local public employers. Such legislation, for example, would allow boards of education to offer monetary incentives to waive SHBP coverage, which they are unable to do currently. The Joint Committee recommends that the maximum amount of the waiver be 25% of the amount saved by the employer through the employee's waiver of coverage but only for employees who waive after the enactment of the legislation.

The Joint Committee believes that permitting all local public employers to offer monetary incentives to waive SHBP coverage to employees with other such coverage will give those employers another tool to use in their efforts to control the costs of providing health benefits, to save taxpayer dollars, and offer property tax relief.

<u>RECOMMENDATION 28</u>: PROHIBIT OUT-OF-STATE PURCHASED PENSION SERVICE FROM BEING CREDITABLE TOWARDS POST-RETIREMENT HEALTH CARE BENEFITS

- **DISCUSSION**

At present, the law allows PERS and TPAF members to purchase credit in their retirement system for temporary, provisional, certain intermittent and substitute employment if the employment was continuous and immediately preceded a permanent or regular appointment, N.J.S.A.43:15A-11; N.J.S.A.18A:66-13 et seq. PFRS members are eligible to purchase credit for temporary service rendered in a title eligible for participation in PFRS that was continuous and immediately preceded a permanent or regular appointment. Members of PERS, TPAF and PFRS may purchase credit for leave of absence without pay, former membership, out-of-State service, federal service, and military service, N.J.S.A.43:15A-73.1; 43:15A-73.4; 18A:66-13 et seq; 43:16A-11.9 et seq.

A member may purchase all or a part of eligible service. A cost estimate is prepared based upon the member's age, current salary, amount of service to be purchased, and whether the purchase is a cost-shared purchase, member pays employee contribution only (most purchases) or a full-cost purchase, employee pays both employee and employer contribution (e.g., local, federal and military service). Credit may be purchased through a lump sum payment or a payroll deduction with interest.

The purchase of credit enables a member to accrue additional time in a retirement system which increases the member's retirement benefit, may enable the member to retire sooner, and may enable the member to qualify for employer-paid post-retirement medical benefits, based upon length of service (currently 25 years for PERS and TPAF retirees).

- **RECOMMENDED ACTION**

The Joint Committee recommends enactment of legislation to provide that purchases, made after its effective date, of service credit in the State-administered retirement systems for service with the federal government or another state, be creditable for purposes of pension benefit calculations but not be creditable in determining eligibility for post-retirement health care benefits. Purchases of credit for in-State service or service with the military should continue to be creditable in determining eligibility for post-retirement health care benefits. This legislation should apply to purchases made by current and future system members.

The Joint Committee, aware of the increasing cost of providing health care benefits to retired public employees and sensitive to property tax burdens, believes that post-retirement benefits should be linked to long-term service within the State.

<u>RECOMMENDATION 29</u>: PROHIBIT MULTIPLE HEALTH CARE COVERAGE IN SHBP

- **DISCUSSION**

N.J.S.A.52:14-17.29 provides the State Health Benefits Commission with the authority to limit benefits to "avoid inequity, unnecessary utilization, duplication of services or benefits otherwise available." The commission proposes to amend current regulation N.J.A.C. 17:9-3.5, "Multiple coverage; employee and spouse," by clarifying in both the heading and rule that multiple coverage in the State Health Benefits Program (SHBP) as an employee, retired employee or dependent is prohibited after the effective date of the adoption of these proposed amendments. This amendment clarifies that all multiple coverage in the SHBP is prohibited.

The proposed prohibition of multiple coverage in the SHBP is consistent with the provisions found in all negotiated State employee contracts; however, since many State employees are married to employees of local public employers, the SHBP is unable to implement these provisions unless they are applied uniformly across all SHBP contracts. In addition, local government law already prohibits duplicate coverage under N.J.S.A.40A:10-18 and 40A:10-19, which specifically exclude employees of municipalities from coverage if they have coverage elsewhere. N.J.S.A.18A:16-14 has a similar provision for boards of education. Finally, N.J.S.A.52:14-17.28 and 29 mandate a uniform level of basic benefits for all members of the SHBP. Comments on these proposed regulations should be submitted by January 5, 2007.

The Benefits Review Task Force recommended an end to dual health coverage. The report stated that this change will have a positive economic impact on participating SHBP local employers by no longer requiring a local employer to make premium payments for coverage if an employee or dependent of an employee is already covered in the SHBP.

The commission self-funds all SHBP health plans. The commission said that the elimination of multiple coverage does not eliminate coverage of the member's health claims. The elimination of multiple coverage will, however, achieve some savings through reduction in administrative costs associated with multiple coverage.

In the discussion of the proposed change to regulation, the commission states that health benefits costs represent a significant portion of a public employer's annual budget. With health care costs rising much faster than general inflation, tremendous pressure is being placed on employer-sponsored health plans to better manage the limited funds available for providing employee/retiree health benefits coverage. With ever increasing costs to taxpayers to pay for health care coverage for public employees, the commission believes it is no longer reasonable to provide additional coverage to public employees, or their dependents, who may qualify for enrollment more than once through multiple SHBP contracts. Every SHBP participant should only be entitled to coverage under one SHBP contract at a time. Each dollar spent to provide this redundant coverage is a dollar lost to other public programs. The State Auditor has twice cited the unnecessary expense associated with dual coverage in its audits of the SHBP.

The commission's actuary has estimated $15 million in coordination of benefits savings as a result of the elimination of multiple coverage. Additionally, the commission's actuary has estimated that the SHBP should save $3 million annually by eliminating or reducing administrative expenses associated with providing coverage under multiple contracts.

- **RECOMMENDED ACTION**

The Joint Committee recommends enactment of legislation to ensure that no SHBP duplicate coverage is available to an enrolled individual as an active employee, retiree or dependent.

The Joint Committee recommends that applicable regulations prohibiting multiple coverage within SHBP be codified in law to abolish any current inequities and unnecessary utilization or duplication of services and benefits, and thereby to achieve savings for public employers and the taxpayers.

<u>RECOMMENDATION 30</u>: OFFER SHBP BASIC HEALTH CARE PLAN AT LOW COST TO PUBLIC EMPLOYEES AND DETERMINE COST TO EMPLOYEE OF SHBP PLAN ACCORDING TO SLIDING SCALE WITH REGARD TO EMPLOYEE'S COMPENSATION

- **DISCUSSION**

The State Health Benefits Program (SHBP) is a multiple option program offering health benefits coverage through the indemnity Traditional Plan or one of the managed care options, which include NJ PLUS and five health maintenance organizations (HMOs). Copayments in these managed care plans are now $10. SHBP also offers dental coverage and prescription drug benefits. The SHBP health plans are self-insured. "Premium" rates are established annually by the State Health Benefits Commission in order to fund the program's projected expenditures through appropriation for the State's expenses as an employer and through assessment of the participating employers other than the State.

Current law provides that State employees and the employees of an independent State authority, board, commission, corporation, agency or organization may be required to contribute toward the cost of SHBP health benefits coverage according to the terms of a binding collective negotiations agreement. The amount of an employee's premium sharing depends upon union affiliation and plan option. In 2006, for example, some union-affiliated State employees, required by contract to contribute toward the cost of their SHBP benefits, pay 25% of coverage cost if electing the Traditional Plan or pay 5% of coverage cost if electing an HMO. The State pays the remaining cost. The State pays the entire cost of coverage for the employees electing NJ PLUS. Non-aligned State employees (those whose positions are not eligible for union representation) contribute in the same manner, consistent with the terms of one of the union contracts binding on the State, as designated by the State Health Benefits Commission pursuant to the law. Public employers other than the State participating in SHBP pay the cost of an employee's coverage and have the option of assuming the cost of dependent coverage. Most of these public employers, however, have agreed to assume the cost of SHBP coverage for their employees' dependents.

The Benefits Review Task Force report recommended that all employees and retirees in the State Health Benefits Program (SHBP) contribute toward the cost of their health care benefits. The cost of premiums as well as the cost of sharing any portion of premiums, however, is an objective amount unrelated to an employee's level of compensation. As a percentage of income, premium sharing can create a financial burden on lower-paid employees. The Task Force suggested the establishment of a base plan, a safety net plan, that would require little or no employee contribution and would provide adequate heath care benefits. The cost of such a plan could be equivalent or close to the amount the public employer pays toward the cost of any other SHBP plans. Alternatively, the cost to an employee of any SHBP plan could be determined according to a sliding scale based on an employee's compensation.

- **RECOMMENDED ACTION**

The Joint Committee recommends that the Division of Pensions and Benefits develop a basic benefits health plan as part of the options available to public employers participating in the SHBP, in order to ensure that any negotiated premium sharing does not impose a financial burden on employees with lower compensation. The Joint Committee also recommends that the cost to an employee of any SHBP plan should be determined according to a sliding scale with regard to the employee's compensation.

The Joint Committee is committed to the goal of having all public employees share in the cost of health care coverage, as a way of controlling expenses ultimately supported by property taxes, but does not want that sharing to impose a disproportionate burden on employees with limited income.

Senator Gormley and Assemblyman O'Toole believe the Joint Committee's recommendation in this area falls short of the recommendation of the Benefits Review Task Force, which they endorse. They believe the Joint Committee should have recommended accelerating the phase-out of the traditional indemnity plan, and replacing NJ PLUS with a preferred provider organization (PPO) plan as recommended by the task force. The PPO would offer an essential benefits plan, with the option of purchasing riders for additional coverages to suit the needs of covered members. Employee cost sharing would be subject to negotiations. Senator Gormley and Assemblyman O'Toole recognize that the recommendation is not inconsistent with the Task Force's goal, but believe it should have been more specific.

<u>RECOMMENDATION 31</u>: MANDATE USE OF MAIL ORDER FOR MAINTENANCE PRESCRIPTIONS AND ENCOURAGE GENERIC DRUG UTILIZATION FOR SHBP PARTICIPANTS

- **DISCUSSION**

The State Health Benefits Program (SHBP) has two prescription drug plans, one for active employees and one for retirees. The Employee Prescription Drug Plan is administered by Horizon Blue Cross Blue Shield through Caremark, which is a pharmacy benefits management company. After a copayment of $10 for name brand drugs or $3 for generic drugs, the State Prescription Drug Program for active State employees covers the cost of a 30-day supply at a retail pharmacy. A 90-day supply for any drug obtained through mail order requires a copayment of $15 for name brand drugs or $5 for generic drugs. Three copayments may be paid for a 90-day supply at a retail pharmacy. SHBP participating employers other than the State may offer prescription drug benefits at an additional cost in the SHBP plan options or through a free-standing prescription card. HMOs provide prescription drug coverage to their enrollees.

Caremark also administers the separate SHBP Retiree Prescription Drug Plan for retirees under the Traditional Plan and NJ PLUS. It requires a certain copayment for up to a 30-day supply at a retail pharmacy or up to a 90-day supply through mail order (a 90-day supply at a retail pharmacy requires three copayments). The amount of a copayment varies depending upon which of three prescription drug categories applies and the method of purchase. Generic drugs (FDA approved equivalents to brand name drugs) have a copayment of $8 for either up to a 30-day supply at a retail pharmacy or up to a 90-day supply via mail order. Preferred brand drugs (more cost effective alternatives within a therapeutic class of brand name drugs with comparable therapeutic efficacy - includes over 80% of all brand name drugs) copayments are $16 for retail pharmacy and $25 for mail order. All other brand name drugs are in the third category that requires a copayment of $33 at a retail pharmacy and $41 through mail order. Out-of-pocket prescription drug copayments per person are capped at a maximum of $1,000 annually.

Providing prescription drug benefits through mail order is less expensive to the SHBP prescription drug plans for active employees and retirees. Once a medication becomes part of a person's routine, prescribed for more than 90 days, it no longer needs to be dispensed on short notice by a local pharmacy. The State Health Benefits Commission, on September 5, 2006, tabled the issue of mandatory utilization of mail order until January 2007.

The Benefits Review Task Force has stated that New Jersey is one of the lowest "generic fill" states in the nation. Savings opportunities are sometimes lost through the selection of expensive brand name drugs when equally effective, lower-cost generics are available. There are ways to encourage generic utilization such as creating cost sharing models that compel users to consider alternatives to brand name drugs and increasing the copayment differential between generic and brand name drugs.

The Benefits Review Task Force supports both the use of mail order for maintenance prescriptions for SHBP participants and encourages the greater generic drug utilization.

- **RECOMMENDED ACTION**

The Joint Committee recommends that the State Health Benefits Commission, as part of the administration of the SHBP prescription plans for active employees and retirees, implement educational initiatives and copayment incentives to increase the use of mail order of maintenance prescriptions for brand name and generic drugs.

The Joint Committee also recommends that the SHBP employ programs designed to encourage the use of generic drugs.

The Joint Committee recognizes the medically essential and fiscally significant role of the prescription plans in SHBP coverage and believes that every effort needs to be made to maintain that coverage while controlling its cost to employees and retirees through favorable copayments as well as to taxpayers.

<u>RECOMMENDATION 32</u>: REQUIRE SHBP BULK PURCHASING OF PHARMACEUTICALS

- **DISCUSSION**

The New Jersey Education Association, in testimony before the Joint Committee, suggested the practice of bulk purchasing of prescription drugs to control the cost of health care benefits. Director of the Division of Pensions and Benefits Frederick Beaver explained that the SHBP has "a large-group purchasing power," which allows it to negotiate contracts effectively.

- **RECOMMENDED ACTION**

The Joint Committee recommends that the State Health Benefits Commission ensure maximum cost savings within its two prescription drug plans by requiring bulk purchasing of pharmaceutical drugs whenever possible.

To reduce direct costs and achieve savings through efficiency, the Joint Committee urges the State Health Benefits Commission, when it contracts to provide prescription drug benefits with a pharmacy benefits manager, or authorizes a health care benefits administrator to contract with a pharmacy benefits manager, to require utilization of bulk purchasing of pharmaceutical drugs to the extent appropriate and feasible.

<u>RECOMMENDATION 33</u>: STUDY USE OF PHARMACY BENEFITS MANAGER

- **DISCUSSION**

The State Health Benefits Program (SHBP) has two prescription drug plans, one for active employees and one for retirees. The Employee Prescription Drug Plan is administered by Horizon Blue Cross Blue Shield through Caremark, which is a pharmacy benefits management (PBM) company. SHBP participating employers other than the State may offer prescription drug benefits at an additional cost in the SHBP plan options or through a free-standing prescription card. HMOs provide prescription drug coverage to their enrollees. Caremark also administers the separate SHBP Retiree Prescription Drug Plan for retirees under the Traditional Plan and NJ PLUS.

The Benefits Review Task Force stated that prescription drug costs in the SHBP have doubled in the last 5 years (2001-2005) and are projected to be over $900 million in plan year 2006. It further stated that cost trends suggest continued double digit annual growth in prescription drug expenses, which currently comprise more that 20% of total SHBP expenditures. These expenses will continue to be a significant cost driver in the years ahead.

The Benefits Review Task Force recommended that the State should contract directly with a pharmacy benefits manager through a competitive bid process to provide prescription drug coverage for all employees and retirees. The transfer to a PBM will establish a master contract with greater volume, ensure the State receives the best deal available, eliminate the current subcontracting arrangements that exist with many of the SHBP health plans, streamline administration and the rate-setting processes, standardize coverage and provide greater transparency and audit capabilities.

The State's health care consultant has estimated the potential savings to be approximately 3% to 5% of prescription costs, or $27 million to $45 million, from directly contracting with a PBM.

- **RECOMMENDED ACTION**

The Joint Committee recommends the creation of a commission to study potential savings from contracting directly with a PBM.

The Joint Committee recognizes the fiscally significant role of prescription drug plans in the SHBP and believes that every effort needs to be made to reduce and control their costs to employees and retirees as well as to taxpayers.

RECOMMENDATION 34: REQUIRE DIVISION OF PENSIONS AND BENEFITS SCREENING OF SHBP FOR INELIGIBLE PARTICIPANTS

- **DISCUSSION**

In his presentation on September 13, 2006, the Director of the Division of Pensions and Benefits, Frederick Beaver, stated that the division audits the SHBP plans through both an internal group and external auditors. A report of the State Auditor covering the period July 1, 1997 to November 25, 1998, suggested that the division work to improve the accuracy of employee enrollments, ensuring that terminations and retirements are properly handled by the data system, which was in the process of being improved. The auditor suggested that the division needed to work with employers on proper reporting of employee status. In its report for the period of July 1, 2000 to May 31, 2002, the State Auditor found that the division had resolved issues related to effectively eliminating persons no longer eligible for coverage. At its meeting on September 19, 2006, the Joint Committee received comments from the New Jersey Education Association and a private citizen urging that SHBP be audited to ensure that no ineligible individuals receive benefits.

- **RECOMMENDED ACTION**

The Joint Committee recommends continuing and increasing efforts by the Division of Pensions and Benefits to assure that individuals enrolled in the SHBP are eligible for that coverage and to educate local public employers on the importance of maintaining accurate and up-to-date records of the eligibility of their employees.

The Joint Committee believes that utilizing information available in the administration of the pension systems as well as the Wage Reporting System of the Department of Labor, the Division of Pensions and Benefits can continue to confirm the eligibility of employees covered by the State Health Benefits Program to prevent fiscal waste by saving taxpayer dollars for both the State as an employer and local employers.

<u>RECOMMENDATION 35</u>: ESTABLISH DISEASE AND CHRONIC CARE MANAGEMENT PROGRAM FOR ALL SHBP PARTICIPANTS

- **DISCUSSION**

As part of the Division of Pensions and Benefits efforts to manage the cost of providing health care benefits, Mr. Frederick Beaver mentioned the development of disease management programs. The division reviews utilization of services within SHBP and works with plan administrators to develop programs such as management of diabetes or obesity.

- **RECOMMENDED ACTION**

The Joint Committee recommends that the Division of Pensions and Benefits increase efforts to implement effective management programs for appropriate diseases and chronic conditions whenever possible.

The Joint Committee believes that innovative, but proven, disease and chronic care management plans for specified conditions should be considered for contracts purchased by the State Health Benefits Commission as a way of improving health care and yielding cost savings in the longer term.

Other Benefits

RECOMMENDATION 36: LIMIT SICK LEAVE COMPENSATION PAYABLE UPON RETIREMENT TO $15,000 FOR ALL LOCAL GOVERNMENT AND BOARD OF EDUCATION EMPLOYEES

- **DISCUSSION**

At present, the law does not limit the amount of supplemental compensation for accumulated sick leave that may be paid to a local government or school board employee upon retirement. However, this benefit is limited by N.J.S.A.11A:6-19 to $15,000 for State employees.

State employees in the career service, and those in the senior executive and unclassified services who have been granted sick leave under terms and conditions similar to career service employees, are entitled to supplemental compensation for sick leave upon retirement, N.J.S.A.11A:6-16. Similar provisions apply to employees of Rutgers, the New Jersey Institute of Technology, and the University of Medicine and Dentistry of New Jersey who perform services similar to those performed by career service employees of State colleges, N.J.S.A.11A:6-17. Supplemental compensation is computed at the same rate of one-half of the employee's rate of pay for each day of accumulated sick leave based upon compensation during the last year of employment, but may not exceed $15,000. The Merit System Board has adopted regulations establishing procedures for the payment of supplemental compensation, N.J.A.C.4A:6-3.1 et seq.

The provisions of law governing State employee supplemental compensation for accumulated sick leave were enacted as part of Title 11A of the New Jersey Statutes in 1986. The prior law, enacted in 1973, capped supplemental compensation at $12,000. This was increased to $15,000 by the 1986 enactment.

The Report of the Benefits Review Task Force recommended, "The State's cap on sick leave payouts of $15,000 must be implemented at all government levels." The Task Force noted that the 1998 State Commission of Investigation (SCI) Report on Pension and Benefits Abuses indicated that the 11 highest payouts for accumulated sick leave in one year totaled approximately $1 million, with an average per person payout of nearly $100,000.

Recently, the SCI issued a report on questionable and hidden pay and perks for top school officials entitled Taxpayers Beware: What You Don't Know Can Cost You. An Inquiry Into Questionable and Hidden Compensation for Public School Administrators. The SCI found "significant weaknesses in the statutory and regulatory structure governing public employee benefits in New Jersey that enable public employees below the State level of government to obtain lucrative packages involving sick and vacation leave." This investigation revealed the widespread practice of allowing administrators to cash-in substantial amounts of accumulated sick and vacation leave at retirement or upon departure.

This issue was discussed at meetings of the Joint Committee. Persons testifying before the committee were generally opposed to a State-mandated limit of $15,000 on sick leave payouts for local government and school district employees, arguing that this should be the subject of contract negotiations between employers and employees. One witness noted that most counties already cap this benefit.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to limit sick leave compensation payable upon retirement to $15,000 for local government and education employees. The legislation should apply to sick leave granted after enactment. Local government and school board employees who, as of the law's effective date, have accrued supplemental compensation based upon accumulated sick leave in an amount in excess of $15,000 should remain eligible to receive the full accumulated amount as of the conclusion of an existing contract or $15,000, whichever is greater. The legislation should take effect after the expiration of any collective bargaining agreement or individual contract of employment in effect at the time of enactment so that no obligation in a contract is impaired.

The Joint Committee has concluded that this recommendation will bring supplemental compensation for accumulated unused sick leave in line with the current law and practice for State employees, thus standardizing this benefit for public employees serving at different levels of government in the State. In addition, this recommendation will enable local governments to control public employee benefit costs which, in turn, will reduce property tax revenue needs.

<u>RECOMMENDATION 37</u>: LIMIT ACCUMULATION OF VACATION LEAVE TO ONE YEAR FOR ALL LOCAL GOVERNMENT AND BOARD OF EDUCATION EMPLOYEES

- **DISCUSSION**

At present, the law does not limit the amount of unused vacation leave that may be accumulated by employees of boards of education or local governments that have not adopted Title 11A (Civil Service) of the New Jersey Statutes. Employees of local governments that have adopted the Civil Service law are limited by N.J.S.A.11A:6-3 as follows. Vacation not taken in a given year because of business demands accumulates and can be granted during the next succeeding year only; except that vacation leave not taken in a given year because of duties directly related to a state of emergency declared by the Governor may accumulate at the discretion of the appointing authority until, pursuant to a plan established by the employee's appointing authority and approved by the Commissioner of Personnel, the leave is used or the employee is compensated for that leave, which shall not be subject to collective negotiation or collective bargaining.

The recent SCI report on questionable and hidden pay and perks for top school officials revealed the widespread practice of allowing administrators to cash-in substantial amounts of accumulated sick and vacation leave at retirement or upon departure.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to limit the indefinite accumulation of vacation leave accruing after the legislation's enactment. The legislation should take effect after the expiration of any collective bargaining agreement or individual contract of employment in effect at the time of enactment so that no obligation in a contract is impaired. The indefinite accumulation of vacation leave by those employees should cease for vacation leave accruing after the legislation's effective date.

The Joint Committee has concluded that this recommendation will bring the carry forward of unused vacation time in line with the current law and practice for State employees, thus standardizing these benefits for public employees serving at different levels of government in the State. In addition, this recommendation will enable local governments to control public employee benefit costs which, in turn, will reduce property tax revenue needs.

<u>RECOMMENDATION 38</u>: ELIMINATE STATE'S SICK LEAVE INJURY PROGRAM

- **DISCUSSION**

New Jersey is one of only five states that provide a sick leave benefit at full wages in addition to workers' compensation to State employees injured at the workplace. N.J.S.A.11A:6-8 provides for the program that has been in effect since 1986. Regulations promulgated by the Merit System Board in the Department of Personnel regulate the use of the program by providing full wages for up to one year.

As opposed to workers' compensation, which pays injured employees a temporary benefit not to exceed 70% of the Statewide average weekly wage, the sick leave injury program is a salary continuation program that provides full pay to employees, although sick leave injury program payments are reduced by amounts received by the employee for workers' compensation.

The purpose of the sick leave injury program, defined in N.J.A.C. 4A:6-1.6 et seq., is to provide a continuation of pay for up to one year for State employees who are injured or become ill from work-related causes. Employees continue to pay income taxes and both employee and employer continue to pay social security and other payroll taxes. After a year on sick leave injury, employees are moved to the State's workers' compensation program until final disposition of their case.

Governor Corzine proposed in his fiscal year 2007 budget to eliminate the sick leave injury program for State employees. Elimination of this program would save an estimated $3 million annually. This estimate was prepared by the State Auditor who found in a March 2003 report that elimination of the sick leave injury program and utilizing, in lieu thereof, the workers' compensation program would save the State money and that injured State employees making $50,000 or less would take home about the same amount because taxes and deductions are not to be taken from the workers' compensation benefit.

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to eliminate the State's sick leave injury program. The legislation should close the program to all current and future State employees. The legislation should take effect after the expiration of any collective bargaining agreement in effect at the time of enactment so that no obligation in a contract is impaired.

The Joint Committee concludes that the proposals to end the sick leave injury program are sound and that employees will generally not be disadvantaged by this change because workers' compensation benefits will continue to be available. In addition, the State will realize savings in the form of reduced employee benefit costs.

<u>RECOMMENDATION 39</u>: INCREASE INTEREST RATE CHARGED FOR PENSION LOANS IN STATE-ADMINISTERED RETIREMENT SYSTEMS

- **DISCUSSION**

Public employees are permitted to borrow from the funds they have contributed to their pensions. The same requirements and limitations apply to members of the Public Employees' Retirement System (PERS), N.J.S.A.43:15A-34 et seq., the Teachers' Pension and Annuity Fund (TPAF), N.J.S.A.18A:66-35 et seq., the Police and Firemen's Retirement System (PFRS), N.J.S.A.43:16A-16.1 et seq., the Judicial Retirement System (JRS), N.J.S.A.43:6A-34.3 et seq., and the State Police Retirement System (SPRS) N.J.S.A.53:5A-29. The program began with members of PERS in 1954 and was extended gradually to the members of other retirement systems.

Under the program any member who is actively working and making pension contributions and has at least three years of service credit and contributions posted to his or her pension account may borrow up to one-half of the posted contributions. Loans are made in multiples of $10, with $50 the minimum amount of a loan and $50,000 the maximum amount. A member may borrow twice in any calendar year, as determined by the date of the check, not the date of the request. Loans are usually repaid through payroll deductions, with the minimum amount equal to the normal pension contribution rate of a member's salary at the time the member applies for the loan (5% for PERS and TPAF, 8.5% for PFRS, 7.5% for SPRS and 3% for JRS). The maximum deduction toward repayment is 25% of base salary. Loans have a maximum repayment schedule of five years, but may be repaid in full at anytime. The interest rate is set by law at 4%.

According to Frederick Beaver, Director of the Division of Pensions and Benefits, in testimony before the Joint Committee on August 9, 2006 and August 24, 2006, although this program is very popular with public employees and there are hundreds of thousands of loans taken every year, it is costly for the State. This is because the pension system assumes an annual rate of return on investments of 8.25%. Since the interest rate for these loans is set by law at 4%, the pension system loses 4.25% on the money lent to members. Mr. Beaver estimates this amount equates to $11 million for each 1% of interest, so that the lost earnings potential exceeds $45 million per year. He also notes that only New York and West Virginia also offer pension loans, but these programs differ significantly from New Jersey's.

Prior to Mr. Beaver's testimony, the cost of the pension loan program was discussed in the Report of the Benefits Review Task Force. The report called for the end of the program. It noted that the program "is outdated, not only in that employees are charged an insufficient rate of interest....but also because other resources are available for whatever need the loan is addressing. Most states do not have such programs, which are not commonly available to private sector employees."

- **RECOMMENDED ACTION**

The Joint Committee recommends the enactment of legislation to increase the interest rate charged for pension loans in the State-administered retirement systems. The interest rate should be increased to the prime rate minus 1%, and the Division of Pensions and Benefits should be authorized to charge an administrative fee for such loans. The legislation should be applicable to all current and future members of the State-administered retirement systems.

The Joint Committee recommends that the loan program should be retained, but that the interest rate should be increased to more closely reflect market rates of interest. These loans deprive the State-administered retirement systems of funds that would otherwise be available for investment for the benefit of the systems. This recommendation would ensure that the loss to the retirement systems is reduced while access to borrowing against employee contributions is continued.

<u>RECOMMENDATION 40</u>: REVIEW NUMBER OF STATE HOLIDAYS FOR PUBLIC EMPLOYEES

- **DISCUSSION**

New Jersey public holidays are designated by statute under N.J.S.A.36:1-1, and on each of those days the offices of State and local government are closed for the transaction of business. Currently, the law designates 13 public holidays, and permits the Governor of this State and the President of the United States to order or recommend any other additional holidays. In practice, the day after Thanksgiving is usually granted as a holiday by the Governor, increasing to 14 days per year the number of paid holidays for State and local government employees.

The statutorily designated holiday schedule for New Jersey government employees includes 3 more days than the 10 designated by the federal government for federal employees, or 4 when adding the day after Thanksgiving. The following is a list of the New Jersey public holidays designated by statute, not including the day after Thanksgiving usually granted by the Governor as a holiday. Ten out of the 13 holidays listed below are also federal holidays, except for the ones shown in bold.

New Jersey State Holidays*	
(1) New Year's Day	(8) Labor Day
(2) Martin Luther King Jr. Day	(9) Columbus Day
(3) Lincoln's Birthday	**(10) Election Day**
(4) Washington's Birthday	(11) Veteran's Day
(5) Good Friday	(12) Thanksgiving Day
(6) Memorial Day	(13) Christmas Day
(7) Independence Day	
* **Ten of these 13 holidays are also federal holidays, Except for the ones shown in bold**	

The paid public holidays for government employees in this State are not only authorized by statute, but are also part of existing contracts between public employee unions and the State. For example, Article 17 of the current contract between the State of New Jersey and the Communications Workers of America recognizes, and binds the State to granting those employees, the statutorily designated holidays and any additional holidays that may be designated by the Governor.

- **RECOMMENDED ACTION**

This Joint Committee recommends that the number of State holidays be reviewed with the goal of bringing the number of State holidays more in line with federal holidays.

The Joint Committee concludes that paid time off provided to public employees exceeds that provided to private sector employees and imposes costs upon the State and local governments at all levels. This recommendation would serve to reduce State and local government costs for public employee benefits.

<u>RECOMMENDATION 41</u>: BAN DUAL ELECTIVE OFFICE HOLDING

- **DISCUSSION**

The issue of whether or not it is appropriate to hold more than one elective public office is a complex one. Current law allows elected officials to hold multiple elective offices, with some exceptions. Nineteen other states allow dual office holding unconditionally and a number of others permit it with certain conditions. Many states do not ban dual-office holding, but rather place restrictions on the practice, such as requiring an individual only to accept the salary of one position (Massachusetts, Illinois, Virginia, and Pennsylvania) or only allowing an individual to hold multiple part-time positions (North Dakota).

The committee reviewed arguments both in favor of, and opposed to, the current system that allows multiple office holding. Proponents believe that it enables a very effective leader to serve more people and achieve public policy goals in various levels of government. It is also argued that holding multiple offices gives a legislator greater perspective on the consequences of certain legislative actions. Finally, proponents argue that voters already have the ability to turn aside those seeking multiple offices on election day.

Critics of multiple office holding say that it is problematic and that it presents conflicts for the individuals serving. There are issues of dual responsibilities, time management, and a perception that an individual might be holding two offices for the purposes of collecting two public paychecks and a larger pension benefit. There are also the questions of whether it gives one person too much power and whether it diminishes the opportunities for other citizens to serve.

- **RECOMMENDED ACTION**

The Joint Committee recommends that an elected public official be prohibited from holding another elective office, but that the action to effectuate this recommendation use a method and timeline that will not disrupt the governance of any existing office.

The Joint Committee studied and carefully weighed the arguments both for and against multiple elective office holding and concluded that it is time for New Jersey to prohibit future elected officials from holding multiple elective offices. The implementation of this prohibition must be done thoughtfully so as to acknowledge the many outstanding leaders currently holding multiple elective offices and to avoid disrupting the governance of any existing elective office.

Senator Gormley and Assemblyman O'Toole believe the Joint Committee should have eschewed a grandfathering provision and recommended that those presently holding more than one elective office be required to resign from all but one such office.

Appendix 1

Assembly Concurrent Resolution No. 3 of 2006

A CONCURRENT RESOLUTION supplementing the Joint Rules of the Senate and the General Assembly to establish four joint legislative committees to make recommendations to both Houses of the Legislature regarding proposals to bring about property tax reform and to provide for the jurisdiction and procedures thereof.

WHEREAS, The most fundamental obligation of a government is to protect the welfare and well-being of its citizens; and

WHEREAS, Under the New Jersey Constitution, this responsibility is vested in the Legislature and the Governor; and

WHEREAS, This State's high property taxes are a matter of great concern to the people of New Jersey who view the current system as regressive, inequitable, burdensome, and a threat to the financial security of individuals and communities; and

WHEREAS, There is a need for the Legislature to address this situation by devising, and acting upon, means to bring about property tax reform based upon a fairer distribution of tax burdens and the adoption of efficiencies; and

WHEREAS, This process should be initiated by the creation of joint legislative committees that review and formulate proposals concerning school funding, government consolidation and shared services, public employee benefits, and constitutional reform and property tax constitutional convention; now, therefore

BE IT RESOLVED *by the General Assembly of the State of New Jersey (the Senate concurring):*

The following Joint Rules are adopted:

1. There are created four joint legislative committees. Each committee shall consist of six members, three of whom shall be members of the Senate appointed by the President, and three of whom shall be members of the General Assembly appointed by the Speaker. No more than two members of a committee appointed by the President of the Senate or the Speaker of the General Assembly shall be members of the same political party. A member may be removed from a committee for cause by the appointing officer, except that if any member is so removed, the appointing officer shall forthwith appoint another member in the same manner that the original appointment was made. The President and the Speaker shall each designate one appointee to a committee as co-chairperson of that committee.

2. Each committee shall meet at the call of its Co-Chairpersons. The committees may review the functions, duties, operations and programs of agencies of the State and its political subdivisions relevant to the areas of review as set forth herein, as well as the relevant governing statutes, regulations, ordinances, resolutions, opinions, and orders. As part of that review, the committees may consider pending and proposed bills and resolutions, as well as relevant reports and testimony. The deliberations of the committees shall conclude with a report, that shall be transmitted to the Senate and the General Assembly, which shall include proposals for constitutional amendments and legislation to bring about property tax reform. The report shall be transmitted no later than November 15, 2006 unless an extension is approved jointly by the President of the Senate and the Speaker of the General Assembly.

3. a. There is created the Joint Legislative Committee on Public School Funding Reform. It shall be the duty of the committee to review and formulate proposals that address the manner in which government provides for the maintenance and support of a system of free public schools for the instruction of the children of this State. The committee may consider proposals to: provide State support based on student needs rather than geographic location; eliminate disincentives to the regionalization of school districts; control school district spending, particularly administrative spending; and improve the effectiveness of the current law limiting increases in school district spending; as well as such other proposals as the committee deems appropriate.

b. There is created the Joint Legislative Committee on Government Consolidation and Shared Services. It shall be the duty of the committee to review and formulate proposals that address the sharing of services and regionalization of functions at all levels of government, as well as such other proposals as the committee deems appropriate. As a basis for these deliberations, the committee shall use the CORE agenda proposed by the Speaker of the General Assembly. In addition, the committee shall consider proposals to consolidate or eliminate State agency functions and State agencies or commissions.

c. There is created the Joint Legislative Committee on Public Employee Benefits Reform. It shall be the duty of the committee to review and formulate proposals that address abuses of the system of benefits provided to public employees, including all branches of State government and all local government entities, and to control the costs of the State and its political subdivisions for public employee retirement, health care and other benefits, as well as such other proposals as the committee deems appropriate. As a basis for its deliberations, the committee shall use the recommendations of the Benefits Review Task Force contained in its December 1, 2005 report, as well as other relevant reports.

d. There is created the Joint Legislative Committee on Constitutional Reform and Citizens Property Tax Constitutional Convention. It shall be the duty of the committee to review and formulate proposals that address property tax reform through amendments to the Constitution of the State of New Jersey, as well as such other proposals as the committee deems appropriate. The committee shall also determine whether amendments to the State Constitution should be recommended to the Legislature for submission directly to the voters or whether such amendments should be referred to a citizens property tax constitutional convention to be convened for the purpose of reforming the system of property taxation.

4. Each joint legislative committee shall organize as soon as possible after the appointment of its members.

5. Four members of a joint legislative committee shall constitute a quorum for the transaction of any business. Official committee action shall be by a majority vote of the members serving on the committee.

6. The joint legislative committees shall be entitled to call to their assistance and avail themselves of the services of such employees of any State, county or municipal department, board, bureau, commission, agency or authority as they may deem necessary or desirable, and as may be available for their purposes.

7. Any member or members of a joint legislative committee who do not concur with the report of the committee may issue a minority statement, that shall be included in the transmitted report of the committee.

8. All public meetings shall be recorded and transcribed, and, when feasible, audio and video of public meetings shall be broadcast on the State Legislature's website. All meetings at which official committee action is taken shall be open to the public. The chairpersons of a joint legislative committee shall notify the Office of Legislative Services, for posting and distribution to the public, of the time, place and agenda of each meeting of the committee. The notice shall be distributed to the public at least five days prior to the meeting, except in the case of an emergency, or except when the presiding officers, acting jointly, waive the notice requirement.

9. To the extent that the jurisdiction or recommendations of Joint Committees may overlap or conflict, the Co-Chairpersons of those committees shall consult with each other to coordinate and resolve differences.

10. This concurrent resolution shall take effect immediately.

STATEMENT

This concurrent resolution would establish four joint legislative committees to review and formulate proposals that address property tax reform for the people of this State. The committees are the Joint Legislative Committee on Public School Funding Reform, the Joint Legislative Committee on Government Consolidation and Shared Services, the Joint Legislative Committee on Public Employee Benefits Reform, and the Joint Legislative Committee on Constitutional Reform and Citizens Property Tax Constitutional Convention. The committees will review and formulate proposals within their respective subject areas as set forth in this resolution, and make recommendations to both Houses of the Legislature.

Appendix 2

Individuals and Organizations Speaking Before Joint Committee

August 9, 2006

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

JOHN D. MEGARIOTIS, Deputy Director
Finance
Division of Pensions and Benefits
New Jersey Department of the Treasury

August 23, 2006

PETER J. KELLY
Principal Counsel
State Government Section
Office of Legislative Services

PAMELA H. ESPENSHADE
Principal Counsel
State Government Section
Office of Legislative Services

August 24, 2006

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

August 31, 2006

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

JOHN D. MEGARIOTIS, Deputy Director
Finance
Division of Pensions and Benefits
New Jersey Department of the Treasury

WILLIAM A. REIMERT, Actuary
Milliman Global

H. CHARLES WEDEL, Chief Financial Officer and Treasurer
New Jersey Transit Corporation

September 13, 2006

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

FLORENCE SHEPPARD, Deputy Director
Division of Pension and Benefits
New Jersey Department of the Treasury

JOHN D. MEGARIOTIS, Deputy Director
Finance
Division of Pensions and Benefits
New Jersey Department of the Treasury

September 19, 2006

JAMES ANZALDI, Mayor
City of Clifton, and
Member Executive Board
New Jersey League of Municipalities

MARIE HAKIM, President
Clifton Board of Education, and
President
Passaic City School Boards Association

ANTHONY WIENERS, Executive Vice President
New Jersey State PBA

DEBRA J. BRADLEY, Esq.
Director
Government Relations
New Jersey Principals and Supervisors Association

RICHARD DOROW, Executive Director
School Business Administrators of New Jersey

LYNNE STRICKLAND, Executive Director
Garden State Coalition of Schools

DANIEL FISHBEIN, ED, D.
Superintendent of Schools
Glen Ridge

RICHARD SNYDER, Executive Director
Dollar$ & Sense, and
Member
Board of Directors
New Jersey School Boards Association

ALAN KAUFMAN, Legislative Political Coordinator
Communications Workers of America

VIKKI THURSTON, Executive Vice President
Communications Workers of America

JOSEPH COPPOLA JR., President
Bergen County Education Association

JACQUI GREADINGTON, President
East Orange Education Association

JOE CHEFF, President
Passaic City Education Associations

JOYCE POWELL, President
New Jersey Education Association

FRED AUG, President
New Jersey Retirees Education Association

DUDLEY BURDGE, Senior Staff Representative
Local 1032
Communications Workers of America

DANIEL M. BERGIN, President
Passaic County Probation Officers' Association

MAUREEN TAFFE, Director
Johnson Public Library
City of Hackensack

JOHN GROSS, Administrator and Chief Financial Officer
City of South Orange

JOHN MCCONNELL, Operating Engineer
Montclair State University

RALPH E. BLAKESLEE, Administrator
Mendham Borough, and
Adjunct Professor
Political Science and Law
Montclair State University

HELEN BERKENBUSH, Private Citizen

ELLEN BROCKMAN, Private Citizen

JEAN PIERCE
Representing
Health Professionals and Allied Employees

GEORGE DIKDAN, Ph.D.
Representing
Health Professionals and Allied Employees
Local 5094, and
Research Teaching Specialist
University of Medicine and Dentistry of New Jersey, Newark

DIANA L. TAYLOR, Health Service Representative
Union County

VIRGINIA OSBORNE, Private Citizen

MICHAEL KISTNER, Private Citizen

T. DONALD CAIRNS, Private Citizen

DAVID MONTRONI, Private Citizen

GERRY DRUMMOND, President
Local 755
USWU/IUJAT

PATRICK RUSSO, Private Citizen

WILLIAM J. BROWN, Member
Legislative Committee

Division of Senior Services
Bergen County, and
New Jersey Coalition for Property Tax Reform

RAE ROEDER, President
Local 1033
Communication Workers of America

JOSEPH GOLOWSKI, Member
Local 1033
Communications Workers of America

FRAN EHRET, President
Local 194
New Jersey Turnpike Employees Union

ELIZABETH DAVIES, Private Citizen

JAY WEBBER, Esq.
Private Citizen

DAVID HEEREMA, Construction Official
Borough of Prospect Park

CLAYTON MULL, Private Citizen

October 12, 2006

RICHARD R. DOROW, Executive Director
New Jersey Association of School Business Officials

JOYCE POWELL, President
New Jersey Education Association

ROBERT MASTER, Legislative and Political Director
District 1
Communications Workers of America

ROB NIXON, Lobbyist
Legislative Committee
New Jersey State Policemen's Benevolent Association, Inc., and
Representing
New Jersey State Firemen's Mutual Benevolent Association

PETER GUZZO
Representing
American Association of University Professors,
New Jersey American Federation of Teachers,
Health Professionals and Allied Employees,
New Jersey State Fraternal Order of Police, and
Professional Firefighters Association

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

KATHLEEN A. DAVIS, Executive Vice President and Chief Operating Officer
Chamber of Commerce
Southern New Jersey

CHRISTINE STEARNS, Esq.
Vice President
Health, Legal Affairs, and Small Business Issues
New Jersey Business and Industry Association

LYNE STRICKLAND, Executive Director
Garden State Coalition of Schools

BARBARA HORL, Lobbyist
Government Relations
New Jersey School Boards Association

JOHN G. DONNADIO, Esq.
Legislative Director
New Jersey Association of Counties

L. MASON NEELY, Co-Chair
Pension and Health Study Committee
New Jersey State League of Municipalities

<u>October 18, 2006</u>

LOUIS N. MAGAZZU, Freeholder
Cumberland County

RICHARD P. CUSHING, Esq.
Member
Board of Trustees
New Jersey Institute of Local Government Attorneys

PETER R. THORNDIKE, Esq.
Member
Board of Trustees
New Jersey Institute of Local Government Attorneys

FRANCIS A. FORST
Representing
International Federation of Professional Technical Engineers
Local 194

FRANCELINE EHERT, President
International Federation of Professional Technical Engineers
Local 194

JOEL L. FRANK, Private Citizen

CHRISTOPHER EGAN, Private Citizen

RAE ROEDER, President
Communication Workers of America
Local 1033

TONY MISKOWSKI, Secretary
Communication Workers of America
Local 1033

GULAB GIDWANI, Private Citizen

GIUSEPPE 'JOE" CHILA, Mayor
Woolwich Township, and
Executive Board Member
New Jersey State League of Municipalities

VINCENT J. FRANTANTONI, Trustee
United Taxpayers of New Jersey

JEROME JACKSON, Member
Communication Workers of America
Local 1034

LEE LUCAS, Private Citizen

ERIC STINSON, President
Educational Assistants
Cherry Hill

SANDRA HASSLER, President
Salem City Education Association

BILL FALLON, President
Washington Township Education Association

BETSY RUSNAK, Private Citizen

<u>October 25, 2006</u>

PHILIP D. MURPHY, Chairman
Governor's Benefits Review Task Force, and
Principal
Murphy Endeavors, LLC

FREDERICK J. BEAVER, Director
Division of Pensions and Benefits
New Jersey Department of the Treasury

Appendix 3

Legal Opinions of the Office of Legislative Services and Attorney General

2004-2005

LEGISLATIVE SERVICES COMMISSION

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New Jersey State Legislature

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First Assistant Legislative Couns

MARCI LEVIN HOCHMAN
Assistant Legislative Counsel

JAMES G. WILLSON
Assistant Legislative Counsel

August 21, 2006

Honorable Members of the Joint Legislative Committee
on Public Employee Benefits Reform
State House Annex
PO Box 068
Trenton, New Jersey 08625

Dear Members of the Committee:

You have asked for a legal opinion as to whether the Legislature, by law, may reduce the retirement benefits that have been provided for public employees in the statutes establishing the various State-administered retirement systems.

For the reasons set forth below, it is our opinion that legislation that has the effect of detrimentally altering the retirement benefits of active members of State-administered retirement systems who have accrued at least five years of service credit, or of retired members, would be unconstitutional as violative of the federal and State constitutional proscription against impairment of the obligation of contracts.

"Pensions for public employees serve a public purpose. A primary objective in establishing them is to induce able persons to enter and remain in public employment, and to render faithful and efficient service while so employed." Public pensions "act as an inducement to continued and faithful service." Geller v. Dept. of the Treasury of

New Jersey, 53 N.J. 591, 597 (1969) (citation omitted). "It is common knowledge that a pension is an element in encouraging qualified individuals to enter and remain in public service." Masse v. Public Employees' Retirem. Sys., 87 N.J. 252, 261 (1981). Similarly, "one of the 'fundamental purposes' underlying the pensioning of civil servants is to 'secure good behavior and the maintenance of reasonable standards of discipline during service.'" Uricoli v. Police & Fire. Retirem. Sys., 91 N.J. 62, 70 (1982) (citation omitted).

In Uricoli, the New Jersey Supreme Court acknowledged the evolution of the philosophy underlying public employee pensions from the early view that they were mere gratuities bestowed by a grateful sovereign to the more modern concept that a public pension is a form of deferred compensation to which an employee has a contractual right. In addressing the issue before it, specifically pension forfeiture for dishonorable service, the court found it unnecessary to embrace either view as to the nature of a public pension. Nevertheless, the court recognized the trend toward the acceptance of a contractual right to promised benefits:

> This view of a pension as deferred compensation, designed to induce individuals to enter public service through its guarantee of payment for services and retirement security, has led some courts to regard pensions as a vested contractual right, with such benefits to be subject to forfeiture only where the Legislature clearly provided for that result. [Uricoli, 91 N.J. at 71]

More recently, in a case involving pension forfeiture for misconduct in office, the Appellate Division of the Superior Court stated: "Deferred compensation benefits have been earned by an employee and are no longer considered a gratuity." Charles C. Widdis v. Retirement System, 238 N.J. Super. 70, 77 (App. Div. 1990). On this point, the Appellate Division also quoted from its prior decision in Fiola v. N.J. Treas. Dept., 193 N.J. Super. 340, 347 (App. Div. 1984):

> It is virtually axiomatic that statutory pension provisions are to be liberally construed in favor of public employees and that pensions represent not merely the gratuity of a benevolent governmental employer but rather that they constitute deferred compensation earned by the employee during his years of service. [Widdis, 238 N.J. Super. at 78]

While the New Jersey courts have not had occasion to recognize a contractual right to a public pension, a majority of jurisdictions now "take the view that public employees have certain contractual rights in a public pension where a pension is part of the terms of employment." 60A Am. Jur. 2d, *Pensions*, §1175 (2003). The modern trend has "been to protect pension rights on the theory that a state's promise of pension benefits represents an offer that can be accepted by the employee's performance."

Transport Workers v. SEPTA 145 F.3d 619, 623 (3rd Cir. 1998). However, states differ "regarding the point at which rights under public pension programs become protected from change where no right to modify is expressly reserved by the employer." Id.

In 1997, the New Jersey Legislature addressed this issue through the enactment of N.J.S.A.43:3C-9.5 which established, for members of State-administered retirement systems, a non-forfeitable right to receive benefits, as follows:

> a. For purposes of this section, a "non-forfeitable right to receive benefits" means that the benefits program, for any employee for whom the right has attached, cannot be reduced. The provisions of this section shall not apply to post-retirement medical benefits which are provided pursuant to law.
>
> b. Vested members of the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pension Fund, the Police and Firemen's Retirement System, and the State Police Retirement System, upon the attainment of five years of service credit in the retirement system or fund or on the date of enactment of this bill, whichever is later, shall have a non-forfeitable right to receive benefits as provided under the laws governing the retirement system or fund upon the attainment of five years of service credit in the retirement system or fund or on the effective date of this act, whichever is later.
>
> . . .
>
> d. This act shall not be construed to preclude forfeiture, suspension or reduction in benefits for dishonorable service.
>
> e. Except as expressly provided herein and only to the extent so expressly provided, nothing in this act shall be deemed to (1) limit the right of the State to alter, modify or amend such retirement systems and funds, or (2) create in any member a right in the corpus or management of a retirement system or pension fund.

Thus, the law provides that a member of a retirement system with five years of service on the act's effective date, June 5, 1997, has a non-forfeitable right to receive benefits under the laws governing the retirement system on that date.[1] A member

[1] Use of the term "vested members" in N.J.S.A. 43:3C-9.5 is apparently intended to mean that a member's non-forfeitable right to receive benefits as provided

accruing five years of service credit after the law's effective date has a non-forfeitable right to benefits based on the laws governing the retirement system on the date the member completes five years of service.[2] In either case, the non-forfeitable right to receive benefits means that the benefits program for that member "cannot be reduced." The enactment of N.J.S.A.43:3C-9.5 also served to provide notice to persons beginning public employment after the law's effective date that their pension rights will not become unalterable until they accrue five years of service. Although it appears that the retirement benefits for members with fewer than five years of service could be detrimentally altered, implementation of any change may have to be limited to prospective application, the rescission of any credit earned for the period prior to completing five years of service being problematic.[3]

"In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State." United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

The United States Constitution provides that:

> No State shall…pass any…Law impairing the Obligation of Contracts… . [U.S. Const. Art.I, Sec.X, cl.1]

Similarly, the New Jersey Constitution states that:

> The Legislature shall not pass any…law impairing the obligation of contracts, or depriving a party of any

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by law after five years of service is contingent upon the member vesting (that is, eligible for deferred retirement) in the retirement system after ten years of service. See, for example, N.J.S.A. 18A:66-36 for Teachers' Pension and Annuity Fund (TPAF) and 43:15A-38 for Public Employees' Retirement System (PERS).

[2] When a member has served and retired, all of the conditions precedent to the receipt of a pension have been fulfilled and the member's benefits may not be changed to his or her detriment. 60A Am. Jur. 2d, *Pensions*, §1175 (2003). In addition, we believe that, because N.J.S.A.43:3C-9.5 created a contractual right for the members to whom it is applicable, any subsequent amendment or repeal thereof would not extinguish the rights conferred on those members.

[3] For example, this may mean that if legislation were to be enacted that changes the formula for calculating benefits to reduce the benefit payable upon retirement for employees having fewer than five years of service on the bill's effective date, the benefit should be calculated by applying the prior formula to service accrued before that effective date and the revised formula to the service accruing thereafter.

> remedy for enforcing a contract which existed when the contract was made. [N.J. Const. Art.IV, Sec.VII, par.3]

It has been held that these two constitutional provisions provide "parallel guarantees" and are to be construed in the same way to provide the same protection. Fidelity Union Trust Co. v. N.J. Highway Auth., 85 N.J. 277, 299 (1981). In general, "Our federal and state courts apply a three-prong test to determine whether legislation has unconstitutionally impaired a contract: they ask (1) has it substantially impaired a contractual relationship? (2) if so, does it have a significant and legitimate public purpose? and (3) is it based on reasonable conditions and reasonably related to appropriate governmental objectives?" In re PSE&G Co.'s Rate Unbundling, 330 N.J. Super. 65, 93 (2000); aff'd 167 N.J. 377.

In United States Trust Co., the United States Supreme Court established the standard of review to be applied when a state impairs a contract to which it is a party. The Port Authority of New York and New Jersey had issued bonds containing a statutory covenant restricting the extent to which revenues could be applied to deficits created by mass transit operations. Both states subsequently repealed the covenants. A trustee and holder of Port Authority bonds challenged the constitutionality of New Jersey's legislation repealing the covenant. The court held that repeal of the covenant violated the Contract Clause by impairing the obligation of the State's contract with the bondholders. In reaching this conclusion, the court said that a state statute which impairs a financial obligation of the state, like laws impairing private contracts, may be constitutional if it is reasonable and necessary to serve an important public purpose. The extent of the impairment is a relevant factor in determining its reasonableness. However, because the state's self interest is at stake, complete deference to a legislative assessment of reasonableness and necessity is not appropriate. "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." United States Trust Co., 431 U.S. at 26.

The standard of review established in United States Trust Co. was applied by the New Jersey Supreme Court in Fidelity Union Trust Co. v. N.J. Highway Auth., 85 N.J. 277 (1981). Bondholders brought a challenge under the Contract Clause to an amendment to the New Jersey Highway Authority Act which provided that toll increases could not become effective without the prior approval of the Governor and the Treasurer or Comptroller of the Treasury. The court summarized the appropriate standard of review as follows:

> When a state's contract is involved, the initial inquiry is whether the state had the power to create an irrevocable contract right in the first place, since a state cannot surrender "an essential attribute of its sovereignty". …
>
> The next step in the analysis is whether the impairment is reasonable and necessary to serve an important public

> purpose. Necessity is met if the objectives could not have been achieved by a less drastic alternative. Reasonableness depends upon the extent of the impairment and upon whether the circumstances giving rise to the impairment were foreseeable when the contract was made. [85 N.J. at 287, 288 (citations to United States Trust Co. omitted)]

When these standards are applied to legislation having the effect of reducing pension benefits to which, by law, non-forfeitable rights have attached, it is apparent that the State would be impermissibly impairing the obligation of a contract to which it is a party.[4] There can be no doubt that the State has the authority to contractually obligate itself to the payment of public employee pensions as a means of attracting and retaining qualified employees and has not thereby relinquished an essential aspect of its sovereignty. In addition, public employees who rely upon an offer of deferred benefits to their detriment and to the benefit of the employer, who gains the employee's services and loyalty, have expectations which are protected by the law of contract. Thus, any impairment of these rights would not be reasonable given the expectations of the parties and the employees' detrimental reliance on the employer's representations. Nor would it appear that a reduction in benefits is necessary to prevent the financial collapse of the State. More modest means of saving or raising money are available to the State that do not affect contractual obligations. A reduction of promised benefits would effectuate an impairment of the State's responsibility under a unilateral contract that it created. In addition, the circumstance giving rise to the need for a proposed benefit reduction, that the State at a future time may wish to reduce its financial obligations, was foreseeable at the inception of the contractual relationship and the State, nevertheless, committed itself and did not reserve the right to unilaterally adopt substantial modifications of the pension program.

"In many states recognizing contractual or vested rights of a public employee in a state or local pension system, those rights are subject to a reserved legislative power to make reasonable modifications in the plan, or to modify benefits, if there is a simultaneous offsetting new benefit of equal or greater value." 60A Am Jur. 2d, *Pensions*, §1178 (2003). Thus, such a substitution of one benefit for another may be

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[4] Benefit increases do not appear to raise the same problem. P.L.2001, c.133 increased the retirement allowance of members of PERS and TPAF by changing the benefit formula for members of PERS and TPAF. It would seem that this increase represented a modification of the contract which, having been accepted by the members, cannot be detrimentally altered.

permissible without impairing the obligation of contract as long as the change is reasonable and any disadvantage to the members is accompanied by offsetting and counterbalancing advantages, apparently under the theory that when there is no net loss in overall benefits the contractual relationship is not substantially impaired.[5]

In conclusion, it is our opinion that a law that has the effect of detrimentally altering the retirement benefit of an active member of a State-administered retirement system who has accrued at least five years of service credit, or of a retired member, would be unconstitutional as violative of the federal and State constitutional proscription against impairment of the obligation of contracts.

Very truly yours,

Albert Porroni
Legislative Counsel

By: ______________________________
Peter J. Kelly
Principal Counsel

AP:K/sl

[5] Examples of reasonable modifications in other jurisdictions include raising the retirement age but increasing benefits and reducing the pension benefit but providing death benefits and payments to a surviving spouse. 60A Am. Jur. 2d, *Pensions*, §1178 (2003).

State of New Jersey

JON S. CORZINE
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August 24, 2006

ATTORNEY CLIENT PRIVILEGED AND CONFIDENTIAL

Hon. Bradley Abelow, Treasurer
Department of Treasury
State House
PO BOX 002
Trenton, NJ 08625-0002

Re: Limitations on the Ability of the Legislature to Reduce Retirement Benefits Provided to Public Employees Under Certain Pension Systems

Dear Treasurer Abelow:

You have asked whether the Legislature may reduce the retirement benefits that have been provided by law for public employees in several state retirement systems.[1] This question arises in the

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[1] This opinion addresses the pension systems referred to in N.J.S.A. 43:3C-9.5, namely the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Retirement System, the Police and Firemen's Retirement System and the State Police Retirement System. These systems shall

context of the ongoing deliberations of the Joint Legislative Committee on Public Employee Benefits Reform. For the reasons set forth below you are advised that N.J.S.A. 43:3C-9.5 created legally enforceable rights in vested members of the state pension systems to the benefits programs of those systems. The extent of those rights is described in more detail herein. Under the State and Federal Constitutions, the Legislature may not enact laws which substantially impair those rights, except in the narrow circumstances recognized by state and federal courts. You are further advised that even where the federal and State constitutions do not bar changes to the pension systems, there may be federal tax consequences to any legislative action.

The Contract Clauses of State and Federal Constitutions

The federal Constitution limits the authority of a state to impair the obligations of contract. It provides that "No State shall...pass any...law impairing the obligation of contracts." U.S. Const. art. I, §10, cl.1. Our State Constitution has long contained a similar prohibition. N.J. Const. art. IV, §7, ¶3 provides:[2]

> The Legislature shall not pass any...law impairing the obligation of contracts, or depriving a party of any remedy for enforcing a contract which existed when the contract was made.

Although the language of these provisions (hereafter "the Contract Clauses") is not identical, our Supreme Court has found that "the provisions of the federal and state constitutions provide parallel guarantees." Fidelity Union Trust Co. v. New Jersey Highway Authority, 85 N.J. 277, 299 (1981) (internal

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be referred to, hereafter, as the "state pension systems."

[2] The 1844 Constitution contained a similar prohibition. See N.J. Const. (1844) art. IV, §7, ¶3.

quotations omitted). These two provisions are applied in the same way to provide the same protection. IMO Allegations of Violations of Law and the New Jersey Administrative Code by Recycling & Salvage Corp., 246 N.J. Super. 79, 100 (App. Div. 1991).

The limitations found in the Contract Clauses are not as broad as the language would suggest and the prohibitions set forth therein are not absolute. IMO Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, 330 N.J. Super. 65, 93 (App. Div. 2000) aff'd. 167 N.J. 377 (2001). These clauses do not deprive the States of their broad powers to adopt general regulatory measures. United States Trust Co. v. New Jersey, 431 U.S. 1, 22, 97 S. Ct. 1505, 1517, 52 L. Ed. 2d 92 (1977). Instead, the courts have recognized that the Contract Clauses accommodate "the inherent police power of the State to safeguard the vital interests of its people." Energy Reserves Group, Inc. v. Kansas Power and Light Co., 459 U.S. 400, 410, 103 S. Ct. 697, 704, 74 L. Ed. 2d 569 (1983) (citing Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 434, 54 S. Ct. 231, 239, 78 L. Ed. 413 (1934)); In re PSE&G, supra, 330 N.J. Super. at 93.

The United States Supreme Court has fashioned, and our Supreme Court has adopted and applied, a three part test for determining whether legislation impermissibly impairs a contract. They ask

(1) has it substantially impaired a contract? (2) if so, does it have a significant and legitimate public purpose? and (3) is it based on reasonable conditions and reasonably related to appropriate governmental objections? [In re PSE&G, supra, 330 N.J. Super. at 92 citing State Farm Mutual Automobile Ins. Co. v. State, 124 N.J. 32, 64 (1991).]

See also Energy Reserves Group, supra, 103 S. Ct. at 704-705.

In determining whether the impairment of contractual rights is substantial the courts have considered several factors such as whether a particular industry has been regulated in the past and whether one of the parties reasonably relied on the contractual terms and whether the legislative action constitutes an unexpected modification of those terms. Energy Reserve Group, supra, 459 U.S. at 416, 103 S. Ct. at 707, In re PSE&G, supra, 330 N.J. Super. at 93. The more substantial the impairment, the greater the level of scrutiny to which the law will be subjected. Energy Reserve Group, supra, 459 U.S. at 411, 103 S. Ct. at 704.

The court next looks at whether the impairment is reasonable and necessary to serve an important public purpose. Fidelity Union Trust Co., supra, 85 N.J. at 288. In determining reasonableness, the foreseeability of the circumstances giving rise to and the extent of the impairment are important considerations. Ibid. As for necessity, a court will look to whether the legislative objectives could have been achieved by a less drastic alternative, including one that does not impair contractual rights. Ibid.[3]

As to the second and third prongs, courts generally defer to the legislative judgment as to the reasonableness and legitimacy of the law. Energy Reserve at 413, PSE&G at 94. However, where a State is itself a party to the contract, the courts will not simply allow the State to walk away from its financial obligations. Instead, the courts have applied a "stricter standard" and said that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." Energy Reserves, supra, citing United States Trust Co., supra, 431 U.S. at 26, 97 S.

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[3] Chief Justice Burger in a concurring opinion in United States Trust emphasized that the State must demonstrate that the impairment was essential to the achievement of an important state purpose and that the state would have to show it was unaware of the state interest at the time the agreement was made. Ibid.

Ct. at 1519; In re PSE&G, supra, 330 N.J. Super. at 94.

The Legislature Created Contractual Rights in Chapter 113

To determine whether the Contract Clauses limit legislative action, we must first determine whether L. 1997, c. 113 created contractual rights.[4] Fidelity Union Trust Co., supra, 85 N.J. at 287. We recognize that as a general matter statutes do not create private contractual or vested rights, absent "clear statutory language indicating that the Legislature intended to bind itself contractually...." New Jersey Ass'n of Health Plans v. Farmer, 342 N.J. Super. 536, 575 (Chan. Div. 2001). Indeed, many early cases said clearly that the incidents of the pension funds did not constitute a contractual right with the employees. Rather, the employees had no rights except those based on the pertinent statute. See McFeely v.

[4] The constitutions of five states, Alaska, Hawaii, Illinois, Michigan and New York confer contractual status on public pension membership. The proposed constitution of 1942 would have accorded contractual status to the benefits payable by virtue of membership in any State pension or retirement system. It said "benefits payable by virtue of membership in any State pension system shall constitute a contractual relationship and shall not be diminished or impaired." Proposed Constitution (1942) art. VI, §1, ¶6. Reported in Record of Proceedings before the Joint Committee of the New Jersey Legislature Constituted under SCR No. 19 at 1032. A similar proposal was debated in a Committee of the 1947 Constitutional Convention, see 3 Proceedings of the Constitutional Convention of 1947 at 192. While not ultimately enshrined in the Constitution, it is evident that the framers in 1947 intended to leave to the Legislature the determination whether to accord contractual status to state pension rights. See 1 Proceedings at 475, 501 (regarding judicial pensions). See also Spina, supra, 41 N.J. at 400 n3. (discussing legislative attempts to accord contractual status).

Pension Com'n of Hoboken, 8 N.J. Super. 575, 577 (Law Div. 1950); Sganga v. Police and Firemen's Pension Fund Com'n of Teaneck, 2 N.J. Super. 575, 579 (Law Div. 1949); Laden v. Daly, 132 N.J.L. 440, 443 (Sup. Ct. 1945) aff'd o.b. 133 N.J.L. 314 (E. & A. 1945); cf. Spina v. Consolidated Police and Firemen's Pension Fund Com'n, 41 N.J. 391, 400 (1964) (1920 pension statute did not create contractual rights). Here, however, we must look to the provisions of N.J.S.A. 43:3C-9.5 to determine whether the Legislature intended to and did create private contractual rights in enacting this law. See Spina, supra, (in deciding whether statute creates a contract or merely declares state policy it is of first importance to examine language of act).

The primary goal when interpreting statutes is to ascertain the Legislature's intent. Higgins v. Pascack Valley Hospital, 158 N.J. 404, 418 (1999). In that regard we are counseled to look first to the language employed as the surest indicator of the legislative design. McCann v. Clerk of the City of Jersey City, 167 N.J. 311, 320 (2001). Where that language is clear, the sole task is to enforce the statute in accordance with its terms. New Jersey Dep't of Law and Public Safety v. Bigham, 119 N.J. 646, 651 (1990). In ascertaining the legislative plan we may consider as well pertinent legislative history as a valuable aid in determining the legislative intent. State v. McQuaid, 147 N.J. 464, 480 (1997); Chasin v. Montclair State University, 159 N.J. 418, 427 (1999).

N.J.S.A. 43:3C-9.5 speaks of a "non-forfeitable right to receive benefits." The term "non-forfeitable" means "not subject to forfeiture." Black's Law Dictionary, 1076 (7th ed. 1999). See also Columbian National Life Ins. Co. v. Griffith, 73 F.2d 244, 246 (8th Cir. 1934). It implies that the right is legally enforceable, one which can be protected by resort to legal means.[5] The legislative history

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[5] The scope of the right to a private pension protected under ERISA is more circumscribed than the

supports this understanding that the Legislature intended to create a legally enforceable right under this act. Because Chapter 113 creates a contractual right for certain members of the pension system, any subsequent amendment or repeal of Chapter 113 would not extinguish the rights conferred on those members.

N.J.S.A. 43:3C-9.5 traces its origin to L. 1997, c. 113. That section provides:

a. For purposes of this section, a "non-forfeitable right to receive benefits" means that the benefits program, for any employee for whom the right has attached, cannot be reduced. The provisions of this section shall not apply to post-retirement medical benefits which are provided pursuant to law.

b. Vested members of the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pensions Fund, the Police and Firemen's Retirement System, and the State Police Retirement System, upon the attainment of five years of service credit in the retirement system or fund or on the date of enactment of this bill, whichever is later, shall have a non-forfeitable right to receive benefits as provided under the laws governing the retirement system or fund upon the attainment of five years of

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rights accorded under c. 113. Federal case law has determined that the "non-forfeitable" provisions of ERISA assure that an employee's claim to the protected benefit is legally enforceable but not the particular amount or method of calculating the benefit. Bonovich v. Knights of Columbus, 963 F. Supp. 143, 146 (D. Conn. 1997) aff'd 146 F. 3d 57 (2d Cir. 1998). This ruling was rendered on March 21, 1997 at a time when the Legislature was actively considered c. 113 (Committee amendments adding the "non-forfeitable" language were added on April 17, 1997). Chapter 113, in contrast, specifies that the "benefits program" cannot be reduced and they have a right to receive those benefits.

service credit in the retirement system or fund or on the effective date of this act, whichever is later.

* * * *

d. This act shall not be construed to preclude forfeiture, suspension or reduction in benefits for dishonorable service.

e. Except as expressly provided herein and only to the extent so expressly provided, nothing in this act shall be deemed to (1) limit the right of the State to alter, modify or amend such retirement systems and funds, or (2) create in any member a right in the corpus or management of a retirement system or pension fund.

This section was added to the bill by the Senate Budget and Appropriations Committee. The purpose was to

provide[] that a vested member of a retirement system or fund listed in the bill will have non-forfeitable right [sic] to receive benefits as provided under the laws governing the retirement system or fund upon the attainment of five years of service credit in the system or fund or on the date of the enactment of the bill, whichever is later. However, this provision of the bill will not apply to post-retirement medical benefits which are provided pursuant to law. [Senate Budget and Appropriations Committee Statement to S1119, April 17, 1997]

The bill made clear that the granting of a non-forfeitable right did not limit suspension or reduction of benefits for dishonorable service nor did it limit the State's right to alter, modify or amend the retirement system. However, it made no such reservations with respect to those employees who have obtained non-forfeitable rights, Thus, it clearly recognized that the effect of the bill was to circumscribe the State's ability to reduce the benefits package for members who have accrued rights under the non-forfeiture provision.

The bill will not preclude the forfeiture, suspension or reduction of benefits for dishonorable service. In addition, the right to receive benefits will not be deemed to: (1) limit the right of the State to alter, modify or amend the retirement systems, other than the above-mentioned benefits for members who have attained 10 years of service, or (2) create in any member a right in the corpus or management of a retirement system. [Ibid.]

Finally, the Legislature fully anticipated that the non-forfeiture provision would have fiscal consequences for the State, particularly if further changes in pension benefits were made by future Legislatures. The Fiscal Note presented to the Committee and considered by the Legislature observed:

The fiscal impact of [the non-forfeiture] provision, if any, cannot be calculated because any impact would only occur as the result of future statutory changes in pension benefits....
[Ibid.]

While not totally free from doubt, the Legislature may also reasonably be taken to have intended that future increases in the benefits accorded to state employees covered by the state pension systems would increase the scope of the non-forfeitable benefits accorded to covered employees and would, thus, similarly constrain the ability of the Legislature to circumscribe those benefits in the future.

Because the length of service varies for each employee covered by a state pension system, this act has had the effect of creating different categories of employees. Chapter 113 granted non-forfeitable rights to all vested members of the state pension systems. However, vesting occurs, for most of the state pension systems, upon obtaining 10 years of creditable service. The extent of the non-forfeitable benefits for individual employees is determined not at the time of vesting but with reference to the benefits provided by law for that pension system when the employee accrued 5 years of service credit. In the case of employees vested on the effective date of c. 113, the pertinent benefits were those existing by law as of that date. Employees who currently have at least 5 years of service credit, but have not yet vested, are not completely without rights under the act. A court may well find that Chapter 113, by setting the benchmark of protected rights at five years, has created an inchoate right in these employees, one which, upon vesting, matures into a fully protected, non-forfeitable right. Those employees with less than 5 years of service have neither vested nor attained the benchmark that fixes their protected benefits. It would appear, therefore, that the Legislature may, without offending the Contract Clauses, make substantial revisions to the benefits for these employees. However, as noted below, any change for these employees, and indeed all other employees, must be considered in light of the federal tax consequences of such a change.

We have not been provided with a description of the particular measures being considered by the Joint Committee, the rationale supporting those reforms or the groups of employees to which those acts would apply. We can, therefore, provide only general guidance. In weighing such measures under the Contract Clauses, a court will look at whether the changes are minimal or significant, the extent of any financial burden, what broad societal purpose the changes serve, whether the measures are temporary or permanent, whether the State was aware of its interest at the time the contract was made and the availability of alternative measures that do not impair contractual rights.

In certain instances, courts in other jurisdictions have upheld modifications to the contractual pension rights of public employees against contracts clause challenges where comparable benefits were substituted for each employee. A leading California case held:

An employee’s vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine on the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, <u>and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages</u>.

<u>City of Downey v. Board of Administration</u>, 47 <u>Cal. App.</u> 3d 621, 631-32 (Cal. Court of Appeal 1975) (emphasis added) (upholding an increase in the employee contribution rate, because it was matched by an increase in the retirement allowance).

In <u>City of Frederick v. Quinn</u>, a Maryland appeals court stated: "The contractual or vested rights of the employee in Maryland are subject to a reserved legislative power to make **<u>reasonable modifications</u>** in the plan, or indeed to modify benefits <u>if there is a simultaneous offsetting new benefit or liberalized qualifying condition</u>." 371 <u>A.</u> 2d 724, 726 (Md. App. 1977) (bold emphasis in original other emphasis added); <u>see also</u> <u>Wisconsin Professional Police Ass'n v. Lightbourn</u>, 627 <u>N.W.</u> 2d 807, 841 (Wis. 2001), <u>cert. den.</u> 534 <u>U.S.</u> 1080, 122 <u>L. Ed.</u> 2d 696 (2002) (upholding numerous changes to the Wisconsin Retirement System). In <u>Quinn</u>, the City of Frederick adopted a non-contributory retirement plan for police officers in 1951, but later repealed the plan and substituted a private contributory plan. The trial court found for the plaintiff plan members, holding that, under the Contract Clauses, the plan could not be modified to the members' detriment. The court of appeals vacated the judgment and remanded for further fact-finding as to the overall benefits and detriments of the City's plan changes. <u>Quinn</u>, <u>supra</u>; <u>see also</u> 60 <u>Am. Jur.</u> 2d §1178.

The persuasive value of decisions such as those above, coming as they do from other jurisdictions, is difficult to gauge. The opinions must also be read with a specific caveat: none of the decisions construed a statute comparable to Chapter 113 in its identification of particular plan provisions as non-forfeitable rights.

Tax Consequences

The potential exists that legislation modifying pension benefits, even if it passes constitutional muster under the Contract Clauses, could nevertheless create adverse tax consequences under the Internal Revenue Code ("IRC" or "Code"). The state pension systems currently enjoy two important tax benefits under the Code. First, the respective pension trusts are not liable for federal income tax on the earnings of the assets on deposit. 26 U.S.C. §501(a). Second, the members of the pension plans are taxed only at the time they actually receive benefit distributions from the respective pension trusts. 26 U.S.C. 402(a). To secure these two tax benefits, the trust fund for each State pension plan must be deemed a "qualified trust" under IRC §401(a). 26 U.S.C. 401(a).

We note in particular that any bill that would reduce the retirement benefits available to employees with less than five years service credit on the effective date of the bill's enactment should be examined in light of the detailed benefit accrual requirements specified by the Code. 26 U.S.C. §401(A)(7); 26 U.S.C. §411(b)(1). Failure to meet the benefit accrual standards – or any of the other qualification requirements under IRC §401(a) – could result in large tax liabilities for the trusts and the plan members. It may be advisable, therefore, to have specific proposed legislation reviewed by special tax counsel to ensure that any proposed legislation will not adversely affect the status of the State's pension trusts under the Code.

Conclusion

For the reasons set forth above you are advised that N.J.S.A. 43:3C-9.5 created legally enforceable rights in vested members of the State pension systems to the benefits programs of those systems. Under the State and Federal Constitutions, the Legislature may not enact laws which substantially impair those rights, except in the narrow circumstances recognized by state and federal courts. You are further advised that even where the Contract Clauses do not bar changes to the pension systems, there may be federal tax consequences to any legislative action.

Our conclusion is rooted in the language, purpose and history of c. 113. It is also consonant with the well established treatment of pension laws by New Jersey courts. Pension laws are remedial in nature, and, as such, are to be construed liberally. Smith v. Consolidated Police and Firemen's Pension Fund Commission, 149 N.J. Super. 229, 232 (App. Div. 1977). Pension acts, in particular, are to be construed most favorably to the employee's interests. Mercer County v. State, 193 N.J. Super. 229, 233 (App. Div. 1984), cf. In re Smith, 57 N.J. 368, 380 (1971) (accidental disability pension law set forth in light most favorable to public employee); Greico v. Employee's Retirement System of Newark, 173 N.J. Super. 474, 478 (App. Div. 1980). Our conclusion reflects, as well, the majority view among the states that public employees have some contractual rights in their public pensions. See Darryl B. Simko, Of Public Pensions, State Constitutional Contract Protection, and Fiscal Constraint, 69 Temp. L. Rev. 1059, 1060 (1996), at 1061-62, 60A Am Jur. 2d Pensions §1175.[6]

Sincerely yours,

ZULIMA V. FARBER
ATTORNEY GENERAL OF NEW JERSEY

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[6] Those states generally recognize that although these rights are vested, the Legislature may make reasonable modifications if there is a simultaneous offsetting by new benefits of equal or greater value. Id. at §1178 (and cases cited therein).

By:______________________________

John P. Bender
Assistant

Attorney General

/smb

Appendix 4

Glossary of Terms

Accidental Disability Retirement – A form of job-related disability retirement benefit available under the defined benefit plans.

Alternate Benefit Program (ABP) – A defined contribution plan for full-time faculty members of public institutions of higher education and certain administrative and professional titles. The employee contribution rate is 5 percent; the employer contribution rate is 8 percent. See N.J.S.A.18A:66-167 et seq.

Defined Benefit Pension Plan – A pension plan which provides a certain benefit determined by a stated formula for the life of the beneficiary, often with cost-of-living increases. The formula is usually related to an employee's length of service and salary. Public employee defined benefit plans usually require an employee contribution of a certain percentage of compensation through payroll deduction. The actuarial valuation, together with the plan's benefit provisions, determines the employer's periodic contribution. The employer's annual cost may fluctuate from year to year due to the investment performance of plan funds.

Defined Contribution Pension Plan – A plan that looks like a bank account because the contributions from the employer and employee are deposited into the employee's account, which then accumulates interest and investment earnings. A 401(k) plan is a defined contribution plan for private sector employees. Unlike a defined benefit plan, a defined contribution plan does not guarantee a stated retirement allowance regardless of the employee's salary or years of service. The benefit is a function of the amounts of employee and employer contributions, wage history, and investment earnings. The employee is usually responsible for the investment choices.

Final Average Compensation, Final Average Salary, Final Salary, Highest Fiscal Years – A collection of terms used in the various State administered defined benefit plans pertaining to the base salaries/compensation utilized in the various benefit calculations, specified by the statues governing the various systems. The compensation used in the calculation may be based upon the average salary of the last three years, the highest fiscal years (July 1/June 30) the final 12 months (or highest 12-month period) or simply the last reported salary, depending upon the requirement of the governing statute.

Government Accounting Standards Board (GASB) – Establishes reporting standards applicable to public employee benefit plans.

Judicial Retirement System (JRS) – A defined benefit plan for members of the State judiciary. The employee contribution rate is 3 percent. See N.J.S.A.43:6A-1 et seq.

Ordinary Disability Retirement – A form of disability retirement for members of various defined benefit plans.

Police and Firemen's Retirement System (PFRS) – A defined benefit plan for all municipal police and fire personnel, and certain State and county employees. The employee contribution rate is 8.5 percent. See N.J.S.A.43:16A-1 et seq.

Post-Retirement Medical Benefits – Refers to employer-sponsored health insurance coverage after the retirement of pension system members.

Public Employees' Retirement System (PERS) – A defined benefit plan for State and local public employees not required to become members of another contributory retirement program. The employee contribution rate is 5 percent. See N.J.S.A.43:15A-1 et seq.

State Health Benefits Program (SHBP) – Program provides medical and prescription drug coverage to State employees and employees of local public employers who choose to participate, retirees, and their dependents. It includes a basic indemnity type plan (Traditional Plan), a point-of-service plan (NJ PLUS), and several HMOs. See N.J.S.A. 52:14-17.26 et seq.

State Police Retirement System (SPRS) – A defined benefit plan for all uniformed officers and troopers of the Division of State Police in the New Jersey Department of Law and Public Safety. The employee contribution rate is 7.5 percent. See N.J.S.A. 53:5A-1 et seq.

Teachers' Pension and Annuity Fund (TPAF) – A defined benefit plan for all teachers or members of the professional staff certified by the State Board of Examiners and employees of the Department of Education who have titles that are unclassified, professional and certified. The employee contribution rate is 5 percent. See N.J.S.A.18A:66-1 et seq.