Recent Headlines

- Social Services organization in Kentucky’s State plan files for Chapter 11 instead of Chapter 9
- Detroit, San Bernardino and Stockton in Chapter 9 Bankruptcy. Chicago may be next!
- Kentucky tries to advance legislation to require public agencies to pay full retirement liabilities if they withdraw from State System
- Oklahoma House of Representatives passes a bill to move future state employees into a DC plan
- Corpus Christi worries about GASB reporting emphasizing financial troubles
- Andrew Biggs reports that many public employees become pension millionaires
- Rhode Island not expected to meet assumed investment return of 7.5% – per audit by outside actuary
- Warren Buffet predicts decade of “Bad News” about public pension plans
National Public Plans Update

- Falling funded ratios despite recent good returns – recognition of remaining prior losses
- Increasing contribution rates; hopefully about topped out
- Continued financial pressures on plan sponsors
- City of Detroit, San Bernardino and Stockton in Chapter 9 Bankruptcy
- Political antagonism toward public plans
Median Annualized Public Plan Investment Returns for Period Ending 6/30/2013

Recent TMRS Returns

2004 2005 2006 2007 2008 2009 2010 2011 2012 2013*

Market

-5.0% 0.0% 5.0% 10.0% 15.0% 20.0% 25.0%

7.06% actual

7.00% assumption

* Estimated

7.06% average compound return (on market value) over last 10 years
Public Pension Fund Investment Return Assumptions

Distribution of Funded Ratios for Large Public Sector Retirement Plans

Source: Public Plan Survey data for 126 large public sector retirement plans
TMRS Funded Ratio Percentages


84.2% 82.6% 82.8% 82.7% 82.1% 73.7% 74.4% 75.8% 82.9% 85.1% 87.2%
Where are Public Plans Going?

- Benefit changes – largely for new hires
  - Typically start with COLAs
  - Increased employee contributions
  - Tier pressure
- Adapting to changing GASB standards
How Do We Get to Where We Want to Go?

- Design sufficient and sustainable benefits
- Establish a sound funding policy
- Make reasonable valuation assumptions
- Make required contributions
- Avoid basing benefits on “excess assets”
- Mitigate investment and other risks
Overview

- State-administered plans represent only 6% of systems, but represent 88% of active members and 83% of assets
- 30% of the state & local workforce – roughly 6 million workers – are not covered by Social Security.
  - Majority of public safety employees are not covered by Social Security.
- Majority are traditional defined benefit plan designs

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Pension related legislation is or has been considered in at least 52 different states, territories or DC

216 bills were considered in 2013 in 45 different states

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
State legislation changing state retirement plans for general employees and teachers

48 states revised between 2009 and 2013 – some more than once:

- 2009 – 10 states
- 2010 – 21 states
- 2011 – 32 states
- 2012 – 10 states
- 2013 – 5 states and Puerto Rico

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Major Pensions Legislation 2009–2013:

All Topics

Total: 48 States

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Significant Structural Changes in 2013

Total: 5 states + Puerto Rico

Enacted legislation in 2013

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Increases in Employee Contributions
2009-2013

Source: State Retirement Reform Legislation, NCSL Legislative Summit
Higher Age and Service Requirements for New Members 2009-2013

Total: 32 States

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Examples of Plan Changes in 2013
- Teacher Retirement System of Texas

- A one-time cost of living adjustment to members who were retired prior to August 31, 2004 equal to the lesser amount of 3% of the retiree’s monthly annuity or $100 per month
  - Approximate liability increase of $700 million

- Members non-vested as of August 31, 2014 and future hires will have to achieve age 62 (Rule 80) to be eligible for unreduced retirement benefits
  - Current age 60 (Rule 80) for post 8/31/2007 hires

- Interest credited to member account balances is decreased from 5% to 2%, prospectively
Member contribution rates will increase to 7.70% by FY2017
  ▶ Previously 6.40%

State contribution rates increase to 6.80% in FY2015
  ▶ Previously 6.40%

Local School Districts which do not participate in Social Security will contribute 1.50% of minimum salary in FY2015
  ▶ 64% of payroll impacted, effective increase of 0.96%

Results in a Funding Period of 28 years
  ▶ Assumes all scheduled contribution increases occur
Examples of Plan Changes in 2013
- Employees’ Retirement System of Texas

- Changes to benefits for members hired on or after September 1, 2013
  - Minimum unreduced age 62 (was age 60) with Rule of 80 retirement eligibility. Members retiring before age 62 (57 for law enforcement), receive a 5% per year permanent retirement reduction factor
  - Eliminates use of annual leave to increase annuity with cash out
  - Final Average Salary based on highest 60 months (was 48 months)

- Prospective interest on member accounts reduced to 2% (previously 5%)
Examples of Plan Changes in 2013 - Employees’ Retirement System of Texas (cont.)

- Employee and Employer contribution increases
  - State Legislators continue to contribute 8%
  - State contributions increased by General Appropriations Act
    - State contributions increased for FY14 and FY15
    - State contributions beginning FY16 are subject to future appropriations

<table>
<thead>
<tr>
<th>ERS Contribution Sources</th>
<th>FY2013</th>
<th>FY2014</th>
<th>FY2015</th>
<th>FY2016</th>
<th>FY2017 and beyond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee</td>
<td>6.50%</td>
<td>6.60%</td>
<td>6.90%</td>
<td>7.20%</td>
<td>7.50%</td>
</tr>
<tr>
<td>Employer</td>
<td>N/A</td>
<td>0.50%</td>
<td>0.50%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
<tr>
<td>State</td>
<td>6.50%</td>
<td>6.50%</td>
<td>7.50%</td>
<td>7.20%</td>
<td>7.50%</td>
</tr>
<tr>
<td>Additional Appropriation</td>
<td>N/A</td>
<td>1.00%</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Total</td>
<td>13.00%</td>
<td>14.60%</td>
<td>14.90%</td>
<td>14.90%</td>
<td>15.50%</td>
</tr>
</tbody>
</table>
## Examples of Plan Changes in 2013

### Nebraska School Employees – Tier 1
**Employees hired before July 1, 2013**

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>Remains at 9.78%.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Final Salary</td>
<td>Average of highest 3 years.</td>
</tr>
<tr>
<td>COLA</td>
<td>Maximum of 2.5%.</td>
</tr>
</tbody>
</table>

### Nebraska School Employees – Tier 2
**Employees hired after July 1, 2013**

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>9.78%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Final Salary</td>
<td>Average of highest 5 years.</td>
</tr>
<tr>
<td>COLA</td>
<td>Maximum of 1%.</td>
</tr>
</tbody>
</table>

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Examples of Plan Changes in 2013

Public Employees Retirement Association of New Mexico – Tier 2
Employees hired after July 1, 2013 General Members

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>Increased by 1.5% for employees earning over $20,000.*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Eligibility</td>
<td>Rule of 85; or 8 YOS + Minimum age of 65.</td>
</tr>
<tr>
<td>Multiplier</td>
<td>Reduced from 3% to 2.5%.</td>
</tr>
<tr>
<td>FAS &amp; Vesting</td>
<td>FAS 5 Years (current plan is 3); Vested at 8 (current plan is 5).</td>
</tr>
<tr>
<td>COLA</td>
<td>Reduced from 3% to 2%*; Delayed until 7 years after retirement.</td>
</tr>
</tbody>
</table>

*Also affects current employees.

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
### Examples of Plan Changes in 2013

#### New Mexico Education Retirement Board – Tiers 1 & 2
Employees hired *before* July 1, 2013

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>Increased from 9.4% to 10.7% (phased in over 2 years).</th>
</tr>
</thead>
<tbody>
<tr>
<td>COLA</td>
<td>Begins at age 65. Existing retirees will see a 10% or 20% COLA reduction.</td>
</tr>
</tbody>
</table>

#### New Mexico Education Retirement Board – Tier 3
Employees hired *after* July 1, 2013

<table>
<thead>
<tr>
<th>Employee Contribution</th>
<th>10.7%.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Eligibility</td>
<td>30 YOS + Minimum age of 55.</td>
</tr>
<tr>
<td>COLA</td>
<td>Begins at age 67.</td>
</tr>
</tbody>
</table>
Reductions in Post-Retirement Benefit Increases 2009-2012

Total: 24 States

- Future hires only (7 states)
- At least some active employees (6 states)
- People already retired and active employees (11 states)

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit, August 2013.
Total: 5 States

- Future hires only (1 state)
- At least some active employees (0 states)
- People already retired and active employees (4 states)

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Non-DB Statewide Retirement Plans

Total: 18 States + Puerto Rico

- Mandatory Hybrid Plan (6 states)
- Mandatory Cash Balance Plan (3 states)
- Mandatory Defined Contribution Plan (2 states)
- Choice of Primary Plan (7 states)

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Replaced DB Plans 2009–2013

Total: 7 States + Puerto Rico

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit
Defined Contribution (DC) Plans

- Function like savings accounts
- Funds are more portable
- Risks and responsibilities shifted to employee:
  - Risk of losing funds with investment fluctuations
  - No guaranteed rate of return
  - Employee must (usually) choose:
    - Employee contribution amount (risk of saving too little)
    - Among investment options
- Administrative & investment costs are generally higher than with DB plans

Sources: Center for Retirement Research at Boston College, A Role for Defined Contribution Plans in the Public Sector
National Institute on Retirement Security, A Better Bang for the Buck
Tennessee Hybrid Plan (2013)

<table>
<thead>
<tr>
<th>Applicability</th>
<th>Future State Employees, Teachers and Higher Ed Employees hired after July 1, 2014.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Contribution</td>
<td>7% (DB: 5%, DC: 2%) – Provision for employees to opt out of 2% DC contribution.</td>
</tr>
<tr>
<td>Employer Contribution</td>
<td>8% (DB: 4%, DC: 4%).</td>
</tr>
<tr>
<td>Retirement Eligibility</td>
<td>Age 65 with 5 YOS or Rule of 90 (current plan is 30 YOS or age 60).</td>
</tr>
<tr>
<td>Multiplier</td>
<td>1% (current plan is 1.575%).</td>
</tr>
<tr>
<td>Vesting</td>
<td>5 Years for DB Benefits. Immediate vesting for DC contributions.</td>
</tr>
</tbody>
</table>

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit, August 2013.
Cash Balance Plan

- Kentucky adopted in 2013
- Kansas and Louisiana adopted in 2012, but the Louisiana plan was ruled unconstitutional

A cash balance plan:
- Provides each member with an individual account
- Employees and employers contribute to the account
- The member cannot choose how the money is invested
- Members’ accounts are managed in one trust fund, and members are guaranteed a return on investment
- If investment return makes it possible, member accounts can receive additional returns
- In public plan, upon retirement, the member receives an annuity based on the account balance

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit, August 2013.
## Kentucky Cash Balance Plan (2013)

<table>
<thead>
<tr>
<th>Applicability</th>
<th>State Employees and County Employees hired after July 1, 2013.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee Contribution</strong></td>
<td></td>
</tr>
<tr>
<td>5% for non-hazardous employees.</td>
<td></td>
</tr>
<tr>
<td>8% for hazardous employees.</td>
<td></td>
</tr>
<tr>
<td><strong>Employer Contribution</strong></td>
<td></td>
</tr>
<tr>
<td>4% for non-hazardous employees.</td>
<td></td>
</tr>
<tr>
<td>7.5% for hazardous employees.</td>
<td></td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>After 5 Years.</td>
</tr>
<tr>
<td><strong>Guaranteed Interest Credit</strong></td>
<td>4% annually with additional interest credits made each year equal to 75% of the 5 year average investment return in excess of 4%.</td>
</tr>
</tbody>
</table>

Source: State Retirement Reform Legislation Presentation, NCSL Legislative Summit, August 2013.
Sources and Contact

- Visit [www.ncsl.org/pensions](http://www.ncsl.org/pensions) for retirement reports, legislative summaries, webinars and presentation materials prepared by NCSL
- Luke Martel, [luke.martel@ncsl.org](mailto:luke.martel@ncsl.org)  
  303-856-1470
- Tamara Rivale, [tamara.rivale@ncsl.org](mailto:tamara.rivale@ncsl.org)  
  303-856-1476
Changing GASB Standards
Background

In June 2012, the GASB approved two new accounting and reporting standards for pensions provided by state and local governments

- GASB Statement 67, Financial Reporting for Pension Plans, amends Statements 25 and 50
- GASB Statement 68, Accounting and Reporting for Pensions, amends Statements 27 and 50
What has GASB done?

- The Statements change current pension accounting and financial reporting standards for state and local governments
  - Disconnect pension accounting from pension funding
    - This was very deliberate
  - Require employers to recognize the Net Pension Liability (NPL) on their balance sheets (*where NPL is code for the Unfunded Accrued Liability based on Market Value of Assets*)
  - Require employers to recognize a new measure of the Pension Expense (PE) on their income statements, which would be different from their actuarially determined contributions (ARC)
  - Replace most of the current note disclosures and required supplementary information with information based on the new measures
Timing

- GASB 67 Plan Reporting
  - Effective for fiscal years beginning after June 15, 2013
  - For TMRS, 2014 calendar year financial statements

- GASB 68 Employer Reporting
  - Effective for fiscal years beginning after June 15, 2014
  - For most TMRS Cities, September 30, 2015 financial statements
GASB will require valuing ad hoc COLAs to the extent they are considered to be “substantively automatic”

Considerations that might be relevant in determining whether such changes are substantively automatic include the historical pattern of granting the changes, the consistency in the amounts of the changes or in the amounts of the changes relative to a defined cost-of-living or inflation index, and whether there is evidence to conclude that changes might not continue to be granted in the future despite what might otherwise be a pattern that would indicate such changes are substantively automatic.
Circular 230 Notice: Pursuant to regulations issued by the IRS, to the extent this presentation concerns tax matters, it is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) marketing or recommending to another party any tax-related matter addressed within. Each taxpayer should seek advice based on the individual’s circumstances from an independent tax advisor.

This presentation shall not be construed to provide tax advice, legal advice or investment advice.

Readers are cautioned to examine original source materials and to consult with subject matter experts before making decisions related to the subject matter of this presentation.

This presentation expresses the views of the author and does not necessarily express the views of Gabriel, Roeder, Smith & Company.