Innovations in Other States

Hybrid Pension Plans, Actuarial Oversight, OPEB Pre-Funding

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Pension and OPEB Reforms

Recent reforms proposed or implemented in other states fall into three categories:

1. Plan Design
2. Funding
3. Governance

Pension and OPEB Reforms

The focus of this presentation is other states' experiences with:

1. Hybrid pension plans (plan design)
2. OPEB Pre-funding (funding)
3. Actuarial oversight (governance)

Hybrid Pension Plans

- Blended plans (DB plus DC)
  - **Typically combine a smaller defined benefit with an individual defined contribution account**
  - **Employer contributions pay for defined benefit**
  - **Employees contribute to the defined contribution account**
- Cash balance plans
  - **Defined benefit plan that maintains hypothetical individual employee accounts**
  - **Guarantees a specified annual return on mandated contributions rather than a specific benefit level**

Blended Plans (DB plus DC)

System	Optional/ Mandatory	DB multiplier	Employer Contrib. to DC	Employee contribution to DC
Indiana PERF, TRF	Mandatory	1.1%	ER may elect	3%
Federal FERS/TSP	Mandatory	1%	1% (up to 5% match)	1% to 10% (EE elect)
Ohio PERS, STRS	Optional	1.0%	ER contrib. divided btw DB and DC	9.5% PERS 10% STRS
Oregon PERS	Mandatory	1.5% (1.8% for safety)	ER may elect	6%
Washington DRS	Optional	1%	No	3%

Cash Balance Plans

State	Optional/ Mandatory	Employer Contrib.	Employee Contrib.	Guaranteed Interest
California – part-time teachers	Optional	4.0%	4.0%	5.0%
Nebraska PERS	Mandatory	6.8% (7.5% after 1ST $19,954 of salary)	4.3% (4.8% after 1ST $19,954)	Highest of 5% or Fed. Mid-term rate plus 1.5%
Texas County and District	Mandatory	9.34% (weighted avg.)	6.9% (weighted avg.)	7.0%

Hybrid Plan Features

- Blended plans (DB plus DC)
  - A smaller guaranteed benefit may reduce the magnitude of employer contribution rate fluctuation.
- Cash balance plans
  - Portability: Similar to a DC plan, a lump-sum payment based on the account balance can be rolled over into another qualified plan.
  - Funds are pooled and invested similar to DB funds, avoiding high individual account fees.

Hybrid Plan Features

- Employees Share Market Risk
  - In a blended plan, the risk for the DC component is borne by the employee.
  - In a cash balance plan with a variable interest credit rate (e.g., Nebraska) employees share risk
- Hybrids provide incentives for employees to work longer
  - With additional years of service employees accumulate more in individual accounts
  - Annuity distributions (as opposed to lump sum) provide longevity incentive because monthly allowance is based on retirement age

Pre-Funding Retiree Health and Other Post-Employment Benefits

It appears that a significant portion of government entities have not yet begun to address OPEB liability

A survey conducted by the International City/County Management Association in Fall 2006 included 2,243 local governments nationwide. Among the survey's findings:

- For each of 17 possible strategies to manage OPEB liability, 70 to 90 percent of local governments responded that they either did not plan to consider or were not sure.
- With respect to pre-funding:
  - 6% currently pre-fund retiree health benefits
  - 14% may consider pre-funding in the next 1 to 5 years
  - 40% do not plan to consider pre-funding
  - 40% were not sure

Pre-Funding Retiree Health and Other Post-Employment Benefits

According to a recent AON consulting study:

- 23 States have OPEB liability valuations completed or in process
- 12 have submitted legislation to establish trusts to pre-fund retiree health and OPEB or have already enacted trusts

Pre-Funding Retiree Health and Other Post-Employment Benefits

401(h) Accounts

- A separate account in a pension fund
- May be used only for retiree health benefits (not other kinds of OPEB)

Ohio PERS 401(h) Account

- Established in 1974
- A portion of employers’ contribution (currently 4% of employees’ gross salary) is directed to the health care fund

Pre-Funding Retiree Health and Other Post-Employment Benefits

Voluntary Employees' Beneficiary Association Trust – IRC 501(c)(9)

- A tax-exempt trust to pay for healthcare and other post-employment benefits
- Must be voluntary and controlled by trustees on behalf of members
- No limits on contributions for government employers. Mandatory employee contributions may be made pre-tax
- Currently, VEBAS are more common in private sector
- Examples of public sector VEBAs: Hawaii, Washington, Oregon, Idaho, Montana

Pre-Funding Retiree Health and Other Post-Employment Benefits

IRC Section 115 Trusts – Retiree Medical Benefit Accounts (RMBA)

- A tax-exempt trust to pay for healthcare and other post-employment benefits
- No limits on contributions. Mandatory employee contributions may be made pre-tax
- Some states with Section 115 trusts established or pending include: California, Michigan, Minnesota, Maryland, South Carolina

Actuarial Review of Pension Legislation

Georgia Public Retirement Systems Standards Law (1983)

Oklahoma Pensions Legislation Actuarial Analysis Act (2006)

- Retirement bills with a fiscal impact can only be introduced in the first legislative session after an election and can only be approved in the second year
- After the actuarial review, no amendments that increase the cost can be made
- If no specific provision is made to fund the legislation the bill is automatically repealed
- The state must maintain minimum funding standards for its pension plans and each year must contribute the pension plan's normal cost plus the amount needed to amortize the unfunded liability (Georgia)