Report of the PLD Advisory Committee on PLD Plan Modernization

January 14, 2013
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Executive Summary

The Consolidated Plan for Participating Local Districts (PLD Plan) is a strong, flexible multi-employer plan consisting of several retirement plan options that each offer different provisions. This versatile employee benefit is a well-managed, fiscally healthy retirement plan which was 100% funded until 2009 when it began to absorb the effects of the severe market downturn.

The Participating Local District Advisory Committee (PLD Committee) continuously monitors the Consolidated Plan for Participating Local Districts to protect the plan’s fiscal health and responsiveness to employer and member needs. Participating employer and employee committee members are unanimously recommending modernization of benefit provisions for newly hired plan members consistent with most defined benefit plans, and rate increases and changes in cost-of-living-adjustments (COLAs) for all members and retirees in response to the impacts of the 2008 severe financial market downturn on plan assets.

In response to the market downturn, PLD Committee members recommended and MainePERS implemented 5 years of 1% per year increases in rates employers pay for the PLD Plan beginning in FY2011. Committee members subsequently requested that MainePERS prepare a report to determine if further actions are needed to maintain the fiscal health of the PLD Plan.

The PLD Plan is 87% funded as of June 30, 2012. PLD Committee members unanimously agreed that actions beyond employer rate increases are needed to maintain the fiscal strength of this plan and to keep the benefits in line with modern workplace practices. Members further agreed those actions should be consistent with good retirement plan management, benefit design, and shared by employers, employees and beneficiaries or retirees.

PLD Advisory Committee members reviewed over several months a comprehensive set of possible actions in addition to the already adopted employer rate increases that could begin to return the PLD Plan to and maintain it at a 90% or higher funded level. Based on this extensive review, Committee members, with the assistance of MainePERS, will meet with members and employers in January, 2013 to share information about the following changes that will be recommended to the 126th Maine State Legislature in January, 2013:

- The normal retirement age for employees new to the plan, and not in a special plan increase to age 65 consistent with changing demographics;¹

¹ Members who change employers within the PLD Plan would not be affected by this change.
- The early retirement reduction factor increases from 2.25% to 6% for employees new to the plan after the changes have been adopted;\(^2\)
- Post-retirement cost-of-living adjustments become available for all active members after 12 months of retirement instead of six months\(^3\);
- The post-retirement cost-of-living-adjustment cap changes from 4% to 3% for all members.

The Committee further recommends that the MainePERS Board of Trustees:

- Increase employee contributions by .5% for three years for a total of 1.5% beginning once the employer contribution rate has reached 8% in fiscal year 2015 and lasting until such time when the funding level of the plan justifies a decrease;
- Increase the minimum employer rate to not less than 75% of the normal cost.

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\(^2\) Members who change employers within the PLD Plan would not be affected by this change.

\(^3\) This change will start 18 months after the effective date of legislation to avoid interfering with plans of members who are currently in the retirement process.
PLD Advisory Committee Report on PLD
Plan Sustainability

The Participating Local District Consolidated Retirement Plan (PLD Plan) is a strong, flexible multi-employer plan consisting of several retirement plan options that each offer different provisions. This versatile employee benefit is a well-managed, fiscally healthy retirement plan which was 100% funded until 2009 when it began to absorb the effects of the severe 2008 market downturn.

The Participating Local District Advisory Committee (PLD Committee) continuously monitors the PLD Plan to protect the plan’s fiscal health and responsiveness to employer and member needs.

In response to the market downturn, PLD Committee members recommended, and the MainePERS Board of Trustees approved, three sequential 1% increases to raise employer rates from 3% to 6% by FY 2013. PLD Committee members simultaneously requested that MainePERS prepare a report to determine if further actions are needed to maintain the fiscal health of the PLD Plan. Based on that report and the 2012 Actuarial Valuation, PLD Committee members recommended, and the MainePERS Board of Trustees approved, two more sequential 1% increases beginning in FY 2014 which returns the employer cost to 8%, the same rate as the original 1994 employer cost of the PLD Plan.4

The PLD Plan is 87% funded as of June 30, 2012. It is intended by design to be funded at a minimum of 90%. PLD Committee members reviewed the report prepared by MainePERS to determine if, in addition to increases in employer rates, the PLD Plan provisions need to be modernized or changed in order to return to and maintain a minimum 90% funding.

PLD Committee members met multiple times over a two year period in which they discussed PLD Plan modernization. They reviewed the MainePERS report which provided factual information about a comprehensive range of modernization options.

This report summarizes the PLD Committee’s discussions, reasoning, conclusions and recommendations for changes to the PLD Plan.

The Environment for Change

As highlighted throughout the MainePERS report to the PLD Committee, public defined benefit pension plans have been scrutinized from several perspectives which have created debate about their sustainability:

- Market gains have not fully reversed the defined benefit pension plan losses caused by the severe 2008 market downturn which has required higher annual costs in order to recover these losses;
- Government budgets have not recovered from the recession following the market downturn, making higher pension costs more difficult to absorb within existing revenues while taxpayers demonstrate little sympathy for tax increases;
- Debate within the actuarial and pension professional community is growing about calculating liabilities using a low-risk rate to avoid intergenerational transfer of debt to future generations in the form of unfunded liabilities;
- Non-regulatory organizations such as the Governmental Accounting Standards Board (GASB) or Moody’s Investor Services (Moody’s) that guide or report on public pensions are changing their standards to reflect a higher cost of pension liabilities than previously reported;
- Demographic changes such as rising longevity gradually increase defined benefit plan costs over time, regardless of other factors;
- Defined benefit plans are designed to be evaluated over a 25-30 year period so that short-term economic or demographic anomalies will not cause immediate and dramatic changes to funding levels and requirements;

The PLD Committee considered the above factors, many of which may remain unresolved for the foreseeable future, in evaluating whether or not to recommend rate changes, modernize the PLD Plan with plan changes, or both based on their effect on the PLD Plan and on the following guidelines:

- The PLD Plan be preserved as a valuable benefit that creates a reliable income stream for employees in retirement;
- The PLD Plan return to a 90-100% funding level as soon as feasible;
- All currently required benefits continue to be provided to existing members;
- Changes in the benefit structure continue to support recruitment and retention;
- Risk between the employer and the employee should be introduced, specifically addressing the major risks associated with retirement plans, including investment, funding rate volatility, inflation and longevity, pre-retirement death, and termination risks.

**Returning the PLD Plan to a Minimum 90% Funding**

The PLD Committee concluded that returning the PLD Plan to 90% funding entirely through increases in employer contributions is possible, but is not a realistic approach. This is a common approach adopted by defined benefit plans, and has been used in the PLD Plan since its inception. Up until the 2008 market downturn, this approach benefited employers in the form of reduced rates while employees continued to pay steady rates.

**Risk-Sharing – A Model for Long-term Sustainability**

While the argument for continuing the practice of having the employer assume all of the economic risk can be made given the PLD Plan’s history, PLD Committee members concluded an equally strong argument can be made for moving toward a more modern shared risk approach in the future. This approach can benefit both employees and employers in positive economies, while the current method only benefits employers when economic conditions are good. Additionally, this approach may help gain public support for public sector retirement benefits.

PLD Committee members concluded impacts on retirement plans prompted by the recent recession make an argument for shared risk in both defined benefit and defined contribution plans going forward. In the case of the PLD defined benefit plan, identifying indicators to trigger appropriate changes can be a mutually beneficial way of keeping the retirement benefit safe for the employee at a reasonable cost to both parties.

*Risk Sharing Methods Triggered by Economic Indicators*

Changes in investment returns, employee salary increases, and the rate of inflation impact the plan funding level and trigger changes in the economic assumptions recommended by the actuary and adopted by the MainePERS Board. These changes can create risk, positive or negative, for the plan which can be shared between the employee and employer by adjusting both employee and employer contributions gradually up or down or by adjusting the Cost-of-Living-Adjustment (COLA) cap.

Changes in economic conditions can occur quickly, and as the 2008 market downturn demonstrates, have the potential to create a large and immediate cost
impact. Changing contribution rates or the COLA cap can have a significant impact on a defined benefit plan funding level.

**Risk-Sharing Created by Demographic Indicators**

Changes in pre-retirement employee turnover, employee longevity, age at retirement, and rate of disability also change plan funding levels and trigger changes in the demographic assumptions recommended by the actuary and adopted by the MainePERS Board. These changes can also create risk which can be shared between the employer and employee by changing the benefit formula and/or plan provisions for newly hired or unvested employees.

Changes in demographic factors tend to occur more gradually than changes in economic factors because they reflect the changing nature of the population covered. The cost impact therefore develops more slowly. For example, as longevity increases (people live longer in retirement), increasing the retirement age stabilizes the cost. Changing the plan provisions as these factors show up in member demographics keeps a defined benefit plan current with changing social trends such as how long people live.

**Other Employer Options to Address Demographic Change and Retirement Benefits**

Changing the provisions of a defined benefit pension plan is not the only way an employer can affect pension cost or the benefit a plan provides. The advantages of a defined benefit plan can be complemented by employment practices that retain valuable employees.
Governments are different from much of the private sector because they provide services for which demand does not change over time. Public safety, public health, road maintenance and utilities are just a few examples of the steady nature of the many services governments provide. Traditionally, these jobs have been considered full, lifetime careers. Defined benefit retirement plans were designed to encourage retention by promising a sound retirement benefit at the end that career.

Steadily increasing lifespans creates a dilemma for this traditional employment approach for governments and their employees. Aging workers are not necessarily able to continue to safely perform the duties of physically demanding jobs. Workers in jobs that are not physically demanding may also need to change careers over time in order to grow and remain challenged as the length of the work life they need to retire increases. However, if the normal retirement age is not increased, pension costs continue to increase which may jeopardize the sustainability of the plan.

This is where an important feature of the PLD Plan, portability or the transferability of membership between participating employers, can offer strength in encouraging retention, containing pension costs and assisting employees in building secure income retirement streams.

If PLD employers, either alone or jointly, create career pathways which enable employees to work longer in a series of jobs that match their needs as those needs change, employees may not wear out as easily, may be able to work longer, retire later and build a secure retirement income stream at a reasonable cost. For example, employees whose jobs require a significant amount of physical work may be acquiring knowledge or skills that qualify them for different and less strenuous, but still challenging and interesting work for the same or a different employer.

Retaining employees and creating a higher average age of retirement in the PLD Plan is an important factor in containing the cost of the plan.

**PLD Advisory Committee Recommendations**

PLD Advisory Committee members reviewed and considered risk-sharing in the PLD Plan between employers and employees to be appropriate going forward. This approach will modernize the plan so that it continues to be strong in ongoing economic uncertainty.

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5 Employee Benefits Research Institute August 2012 • Vol. 33, No. 8 “Is Working to 70 Really the Answer for Retirement Income Adequacy?”
PLD Advisory Committee members unanimously recommend modernizing the PLD Plan provisions, reducing the UAL, and maintaining the strength of this valuable plan for both employers and employees consistent with the guidelines for sound plan management.

Employer and employee PLD Committee members recommend that, in addition to the already adopted employer rate increases, the following be recommended to the 126th Maine State Legislature in January, 2013:

- The normal retirement age for employees new to the plan, and not in a special plan, increase to age 65 consistent with changing demographics;\(^6\)
- The early retirement reduction factor increases from 2.25% to 6% for employees new to the plan after the changes have been adopted;\(^7\)
- Post-retirement cost-of-living adjustments become available for all active members after 12 months of retirement instead of six months;\(^8\)
- The post-retirement cost-of-living-adjustment cap changes from 4% to 3% for all members.

The Committee further recommends that the MainePERS Board of Trustees:

- Increase employee contributions by .5% for three years for a total of 1.5% beginning once the employer contribution rate has reached 8% in fiscal year 2015 and lasting until such time when the funding level of the plan justifies a decrease;
- Increase the minimum employer rate to not less than 75% of the normal cost.

Table 1 compares the costs of the current plan to projected costs with modernized provisions. The PLD Committee further recommends that PLD Plan provisions continue to be modernized when necessary as demographic and economic factors change in order to keep this valuable benefit relevant and cost appropriate.

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\(^6\) Members who change employers within the PLD Plan would not be affected by this change.  
\(^7\) Members who change employers within the PLD Plan would not be affected by this change.  
\(^8\) This change will start 18 months after the effective date of legislation to avoid interfering with plans of members who are currently in the retirement process.
### Table 1 – PLD Committee Recommendations  
(in millions)

<table>
<thead>
<tr>
<th>Plan Provision</th>
<th>Current Plan</th>
<th>Proposed Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New and Unvested Members</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Accrual Rate</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>• AFC</td>
<td>36 months</td>
<td>36 months</td>
</tr>
<tr>
<td>• Vesting</td>
<td>5 years</td>
<td>5 years</td>
</tr>
<tr>
<td>• NRA</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>• Service Retirement</td>
<td>25 Year</td>
<td>25 Year</td>
</tr>
<tr>
<td>• Early Retirement</td>
<td>2.25%</td>
<td>2.25%</td>
</tr>
<tr>
<td>• Disability Retirement</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>• Death Benefits</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>All Active Members</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Employee Contribution</td>
<td>As is</td>
<td>+1.5%*</td>
</tr>
<tr>
<td>• COLA Availability</td>
<td>6 months</td>
<td>12 months**</td>
</tr>
<tr>
<td><strong>All Members and Retirees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• COLA</td>
<td>Up to 4%</td>
<td>Up to 3%</td>
</tr>
<tr>
<td><strong>Average Employee Cost</strong></td>
<td>6.59%</td>
<td>6.59-8.09%</td>
</tr>
<tr>
<td>Employer Normal Cost</td>
<td>10.78%</td>
<td>9.58%</td>
</tr>
<tr>
<td>Employer UAL</td>
<td>7.15%</td>
<td>3.58%</td>
</tr>
<tr>
<td>Total Employer Cost</td>
<td>17.93%</td>
<td>13.16%</td>
</tr>
</tbody>
</table>

* Increased rates would be phased in 0.5% per year beginning in FY 2015 only after employers reach an 8% contribution rate  
** Change will start 18 months after the effective date of legislation to avoid interfering with plans of members who are currently in the retirement process
## Attachment 1 - Participating Local District Advisory Committee

<table>
<thead>
<tr>
<th>MEMBER</th>
<th>NOMINATED BY</th>
</tr>
</thead>
<tbody>
<tr>
<td>David Barrett</td>
<td>Maine Municipal Association</td>
</tr>
<tr>
<td>Vacant, awaiting appointment</td>
<td>Appointed by Governor</td>
</tr>
<tr>
<td>Steven Butterfield</td>
<td>Maine State Employees Association</td>
</tr>
<tr>
<td>Rick Cailler</td>
<td>Professional Firefighters of Maine</td>
</tr>
<tr>
<td>John Kosinski/Rob Walker</td>
<td>Maine Education Association</td>
</tr>
<tr>
<td>John Eldridge</td>
<td>Maine Municipal Association</td>
</tr>
<tr>
<td>Carl Guignard (vacant 1-1-13)</td>
<td>Teamsters Union Local #340</td>
</tr>
<tr>
<td>Janice Kimball</td>
<td>Maine Municipal Association</td>
</tr>
<tr>
<td>Terry McCabe</td>
<td>Maine School Management Association</td>
</tr>
<tr>
<td>Vacant, awaiting designation</td>
<td>AFSCME, Council 93</td>
</tr>
<tr>
<td>Dr. Thomas J. Ward</td>
<td>Maine School Management Association</td>
</tr>
<tr>
<td>Sandy Matheson, Executive Director</td>
<td>Ex-officio</td>
</tr>
<tr>
<td>Maine Public Employees Retirement System</td>
<td></td>
</tr>
</tbody>
</table>