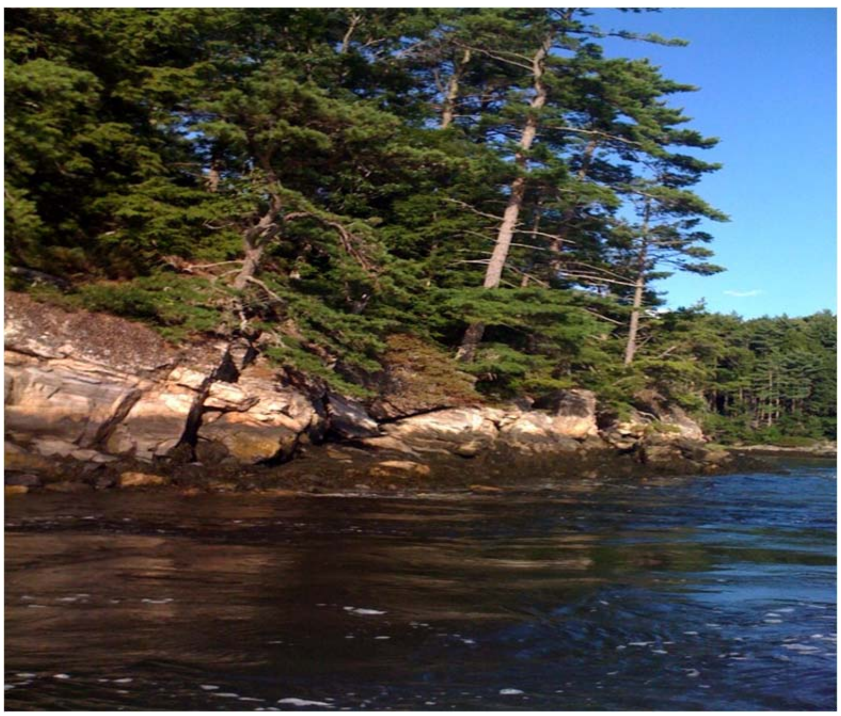
125th Maine State Legislature



March 2012

New Pension Plan Design and Implementation Plan

Report of the Working Group established by the 125th Legislature First Regular Session to develop an implementation plan for a Social Security based retirement plan for newly hired State Employees and Teachers after June 30, 2015

FOREWARD

The 125th Legislature lowered the cost-of-living-adjustment for which members of the State Employee and Teacher, Legislative, and Judicial Retirement Programs are eligible from July 1, 2011 forward. This and other changes were passed to reduce the annual costs of these plans and to reduce the unfunded actuarial liability of the State Employee and Teacher Retirement Program. The basic benefit formula of the plans, however, did not change and they continue to provide a steady replacement income for members in retirement.

The legislation that modified the existing plans also appointed a designated Working Group to design an implementation plan to enroll employees hired on or after July 1, 2015 in Social Security and a supplemental retirement plan.

The designated Working Group responded to the Legislative directive by designing a principles-based supplemental retirement plan that meets the terms of the legislation. That plan design is the basis for this report. Some members of the Working Group may hold the opinion that the current State Employee and Teacher Retirement Program is the retirement plan that best meets the needs of employees and employers in this plan. Similarly, some members may or may not agree that some or all of the legislation’s terms result in a better retirement program for employees.

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EXECUTIVE SUMMARY

PRINCIPLES-BASED PLAN BASED ON LEGISLATIVE DIRECTIVE

This report responds to Part U of PL 2011, c. 380 enacted in 2011 establishing a working group to develop an implementation plan designed to close the current State/Teacher Plan and replace it with a retirement benefit plan that is supplemental to Social Security. The legislation applies to all state employees and teachers who are first hired after June 30, 2015 with no prior creditable service. (See Attachment 1)

The working group included members from the Maine Public Employees Retirement System, the Department of Administrative and Financial Services, the Maine Education Association, the Maine School Management Association, and the Maine State Employees Association.

Current State/Teacher Plan

The current State Employee and Teacher Retirement Program (State/Teacher Plan), started as the State Employees Plan in 1942, has experienced significant underfunding. This resulted in a Constitutional Amendment in 1995 requiring full funding by 2028 and 2011 legislation reducing the cost-of-living-adjustment (COLA) and increasing the normal retirement age from 62 to 65 for non-vested members.

New Plan Criteria

The 2011 legislation requires that every member of the new plan must contribute to both Social Security and Medicare, and the employer of each member must contribute the employer's share of Social Security and Medicare. Each active member of the plan must be entitled to participate in a supplemental retirement plan which is designed to be competitive in attracting qualified employees; limit the State's long-term cost exposure to 2% of employee gross payroll while providing the opportunity to increase this contribution; limit the employee's exposure to loss of retirement security with investment options and financial information; and share administrative costs between employees and employers.

GOAL DRIVEN PLAN DESIGN

The financial crisis of 2008 stressed both business and individual economic security. Defined benefit plans designed for workers of the 20th century in a 21st century economy continue to be evaluated. Many private sector businesses and state governments are seeking to modify or close their existing plan. Simultaneously, many American's are questioning their ability to retire as planned or to retire at all.

The legislative requirements and the current economic environment combined to create a Working Group goal-driven framework for plan selection in order to effectively meet the needs of employees and employers. The working group assessed the needs of current Maine State and teacher employers and future employees in the context of the current and forecasted economic environment in which both employers and employees operate. These needs were compared to national data and Maine was determined to face similar retirement planning challenges as the rest of the country.

The Working Group used the following criteria to assess and select a plan which reflects their goals of providing a retirement plan that assists employees in creating a secure retirement, is affordable, and shares the investment risk between employers and employees:

- Vested employees should receive a benefit similar to what they would receive under the current State/Teacher Plan but using Social Security and the supplemental plan;
- Any defined contribution component of the supplemental plan should offer employees the opportunity and further encourage them to make additional contributions to create a 75-80% of final pay replacement income stream in retirement;
- Employee contribution levels to any defined contribution component should be structured to encourage building a reliable income stream in retirement in ways that are most affordable to employees;
- The plan design should share risk between the employer and employee, specifically addressing or mitigating as much as possible the major risks associated with retirement plans, including investment, funding rate volatility, inflation and longevity, disability, pre-retirement death, and termination risks.

SUPPLEMENTAL PLAN SELECTION – COMBINATION DB/DC

The Working Group selected a combination DB/DC plan for a supplemental retirement plan to meet the legislative objectives. The employer contribution maximum of 2% will be allocated 1% to the DB component and 1% to the DC component. This results in a total employer contribution of 8.2% when combined with the 6.2% employer share of Social Security.

Reasons for Plan Selection

The Working Group selected the combination DB/DC supplemental retirement plan to meet the requirements and intent of the law and its selection criteria and to assist and encourage employees in building a secure retirement:

- Vested employees will receive, on average, a benefit level from Social Security and the DB benefit of the supplemental plan similar to what they would receive under the State/Teacher Plan;
- The supplemental plan, with Social Security, offers employees the opportunity to create a 75-80% of final pay replacement income stream in retirement;
- The defined contribution component encourages employees to save toward a 75-80% replacement income stream through automatic enrollment and automatic employer contributions which can also be adjusted upward based on economic conditions or recruitment and retention needs;
- Employee contribution levels have been structured to encourage building a reliable income stream by sharing the employer contribution between both the DB and the DC;
- The plan is designed to mitigate the major risks associated with historical retirement plans, including investment risk for both the employer and the employee through lower return targets, funding rate volatility risk (limitations on investment risk), inflation and longevity risk (offering options that help create lifetime income streams), coordination of disability with Social Security, provisions for pre-retirement death benefits, and limiting termination risks by encouraging employees to leave their funds in the plan throughout retirement or roll their funds over into other tax-advantaged plans.

How the Plan Works

Table 1 – Combination Plan Supplemental to Social Security

Entry Salary	Required Employee DB Contribution	Suggested Employee DC Contribution	APP DB Replacement Ratio	APP DC Replacement Ratio	Social Security Replacement Ratio	Total Income Replacement Ratio
$30,000*	4.62%	3.75%	20.75%	16.21%	38.14%	75.10%
$40,000*	4.62%	4.75%	20.75%	19.62%	34.66%	75.03%
$50,000*	4.62%	5.35%	20.75%	21.66%	32.57%	74.98%

**Assumes 30 years of service and 5% DC average earnings*

Defined Benefit Component – Adjustable Pension Plan

The selected defined benefit design is called the Adjustable Pension Plan (APP). This is a newly developed hybrid defined benefit plan designed to provide predictable lifelong income at retirement. This plan was created to significantly mitigate and share the investment risk (gains and losses) between the employee and employer. It provides a career average benefit accrual rate of 1% plus a possible share of investment gains and losses from a lower risk investment portfolio.

Defined Contribution Component

The defined contribution component allows both the employee and employer to contribute varying amounts to a defined contribution component of the plan. This component supplements the employee's defined benefit and Social Security benefits to help the employee meet a goal of replacing 75-80% of their income at retirement. A defined contribution component can be designed using sensible risk management measures to provide a third component of a lifetime income stream.

Open Combination DB/DC Plan Issues

The Adjustable Pension Plan defined benefit component is in the process of being approved as a qualified tax-deferred plan. While it has not yet received formal Internal Revenue Service approval, any issues that may arise can be resolved in the determination letter process. Presently a number of plan sponsors are in the process of implementing this plan and submitting applications to the IRS.

Other issues beyond the control of the working group are the future of Social Security benefit levels and the determination of what is a reasonable amount for varying individuals to save for retirement. The plan was designed based on retirement factors as they are known today.

OTHER CONSIDERATIONS

A supplemental retirement plan with a 2% employer contribution may be more modest than comparable large employers with whom the State and School Administrative Units (SAUs) are competing for employees may offer. The overall cost increase to the State of Maine and SAUs of providing a 2% plan and Social Security, however, is high in relation to the current State/Teacher Plan which is exempt from Social Security and has a low normal cost of 2.94%.

Additional factors are important to consider in the transition to a new plan based on Social Security.

Changing Plans and Enrolling New Employees in Social Security

Limiting enrollment to new employees only in Social Security and a new supplemental retirement plan is the most feasible transition to a new plan. Changing employer sponsored retirement plans is nearly always challenging because adding a new tier of benefits for new employees results in employees working side-by-side receiving different benefits, affecting long-term employee morale. This and other obstacles can be addressed in many situations by closing the existing plan and enrolling all employees in a new plan for their prospective service. Enrolling all employees in Social Security and a new supplemental Plan was not contemplated by the legislation, nor is it feasible in Maine because current employees participate in a plan exempt from Social Security.

Cost Impacts

Closing a defined benefit plan to new employees and implementing Social Security with a new supplemental retirement plan has three primary employer cost impacts:

- Changes in the State/Teacher UAL amortization schedule;

  Pension standards are in transition, including those for Unfunded Actuarial Liability (UAL) amortization. Under the current Government Accounting Standards Board (GASB) standards, the State/Teacher Plan UAL amortization method would change if the Plan is closed. This results in higher annual costs through FY 2021 and lower costs through FY 2028 than if the Plan remained open, with overall lower costs of $128 million. The higher costs in the earlier years can be mitigated by extending the amortization schedule through FY 2034, but results in an overall higher long-term cost of $679 million. (See Attachment 6)

Table 2
State/Teacher Plan UAL Amortization
Total Costs to Full Amortization
(in millions)

Open	Closed at 6/30/2015	Closed Extended
$4,746	$4,618	$5,297

- Increased employee and employer costs resulting from participation in Social Security;

  The higher employer cost of participating in Social Security results because the 6.2% employer contribution remitted each pay period is a payroll tax or "sunk" cost, i.e., employer contributions are not returned to the employer if the employee does not earn enough credits to qualify for Social Security. Employees similarly pay a higher annual cost but also receive a portable benefit.

- The transfer of Social Security costs to SAUs for educators.

  Understanding the cost impacts of these changes in part is based on understanding how the active employee population changes in each plan over the 25 years following the closure of the plan, or the length of time before all current State/Teacher Plan members can expect to be retired. Costs increase incrementally to SAUs because the employer share is assumed only for new employees. Retirement costs for employees in the State/Teacher Plan continue to be funded by the State. Costs for the new plan will continue to increase until 2040 when no or few active members are anticipated to remain in the closed State/Teacher Plan. These projections will change if historical turnover patterns change.

CHAPTER ONE – REPORT BACKGROUND

HISTORY OF 2011 LEGISLATIVE CHANGES

All active Maine State sponsored pension plans were created in the 1900's as defined benefit pension plans. The State Employee and Teacher Retirement Program (State/Teacher Plan) started as the State Employees Plan in 1942 administered by the Employees Retirement System. Legislation was passed in 1947 merging the existing Teachers retirement plan and the Maine Teachers Retirement Association with the State Employees Plan and Employees Retirement System. The Judicial Plan was created in 1984 to replace the now closed Judges Plan with retirement benefits similar to, but not the same as, state employees and teachers. The Legislative Plan was created in 1986 to provide elected officials with benefits related to the unique terms of their state service. The assets of these plans comprise the MainePERS pension trust.

Each of these plans has experienced varying levels of funding in their history. The State/Teacher Plan has experienced the most significant underfunding which resulted in a Constitutional Amendment in 1995 requiring full funding by 2028 and protecting the sustainability of the Plan.

1. 2011 Legislative Changes to the Current State/Teacher Plan

The financial crisis that began in 2008 reduced the total assets in the MainePERS pension trust in a manner similar to all institutional and private funds across the country and around the world. In response, the Legislature changed several plan elements of state-sponsored plans covering over 75,000 active, inactive, and retired state employees and teachers in the 125th Legislature First Regular Session. The following changes were adopted primarily to reduce the unfunded actuarial liability (UAL) of the State/Teacher Plan, but were also applied to the Judicial and Legislative Plans.

Prior Plan Provisions	2011 Enacted Provisions
Cost-of-Living Adjustment (COLA) capped at 4%*	COLA capped at 3% frozen for 3 years
COLA applies to entire benefit	COLA applies to first $20,000**
Age 62 normal retirement age	Age 65 normal retirement age for new hires and employees with less than 5 years of service on July 1, 2011
*COLA based on Consumer Price Index	**The $20,000 will increase annually based on actual COLA awarded

The employee contribution rate remained at 7.65%. The 2011 Legislative Plan changes combined with the results of a regularly scheduled MainePERS experience study created the following FY2011 budget impacts and changes to the funding level of the State/Teacher Plan at 6/30/2010.

State/Teacher Plan at 6/30/2010			
Employer Cost	**Original Calculations**	**Updated for 2011 Experience Study**	**With 2011 Legislative Plan Changes**
Normal Cost	5.51%	4.35%	2.94%
UAL Cost	18.24%	19.57%	11.76%
Funding Ratio	65.9%	66.8%	77.0%
Annual State Cost	$916M	$844M	$508M
Total UAL	$4.3B	$4.1B	$2.5B

2. 2011 Legislation Creating New Pension Plan Working Group

Part U of PL 2011, c. 380 established a working group to develop an implementation plan designed to close the current State/Teacher Plan and replace it with a retirement benefit plan that is supplemental to Social Security and applies to all state employees and teachers who are first hired after June 30, 2015 with no prior creditable service. (See Attachment 1)

The legislation requires that every member of the plan must contribute to both Social Security and Medicare, and the employer of each member must contribute the employer's share of Social Security and Medicare. Each active member of the plan must be entitled to participate in a supplemental retirement plan. The supplemental retirement plan must be designed to:

- Attract new state employees and teachers and meet employer recruitment needs and employee needs for retirement benefit portability and retirement security;
- Be competitive with retirement benefit plans provided by similar employers that contribute to their employees' retirement security in addition to Social Security;
- Limit the State's long-term cost exposure to 2% of employee gross payroll and limit the employee's exposure to loss of retirement security;
- Provide the State with the ability to make additional retirement plan contributions in any given biennium without increasing the 2% long-term contribution ceiling;
- Ensure that employees and employers share plan administrative costs; and
- Provide financial information to assist employees in understanding how to preserve their living standards.

The working group is also required to determine the financial impact on the State and other public employers over time of closing the current retirement plan to new entrants and to establish an implementation date that creates the most predictable and affordable transition from the current plan to the new plan. The working group is also required to identify and develop any modifications that can be made to the existing plan before it is closed to make the cost of the plan more predictable and affordable and to improve the ability of public employers to attract new employees while transitioning to the new plan. Finally, the working group is required to study the impact of options for amending the Constitution of Maine to change the 10-year period required for amortization of experience losses and the requirement that all unfunded liabilities be eliminated by 2028.

The working group consists of:

- The Executive Director of the Maine Public Employees Retirement System, who serves as the chair of the working group
- The Commissioner of Administrative and Financial Services, or a designee of the commissioner
- A member appointed by the chair of the working group nominated by the Maine Education Association
- A member appointed by the chair of the working group nominated by the Maine School Management Association
- A member appointed by the chair of the working group nominated by the Maine State Employees Association.

(See Attachment 12)

CHAPTER TWO – PLAN SELECTION PROCESS

RETIREMENT IN TRANSITION - A CHALLENGING TIME FOR EMPLOYEES AND EMPLOYERS

The financial crisis of 2008 stressed many areas of Americans' economic lives. The turmoil that was seemingly instigated by a credit crisis turned out to be just one of several causes of unprecedented volatility and instability in the financial markets. The ongoing market unpredictability continues to create current and future planning challenges for individuals, businesses, and governments.

Employers around the world have expressed concern about their ability to fund defined benefit retirement plans designed for workers of the 20th century in a 21st century economy. The primary reason is that employers assume 100% of the investment risk in defined benefit plans. Many private sector employers closed their defined benefit (DB) pension plans in the last two decades, replacing them with 401(k) defined contribution (DC) plans in which employees assume 100% of the investment risk.

This economic instability has impacted Americans' ability to retire at a time or in a manner they may have anticipated for many years. Numerous studies document individuals' changing attitudes about retirement. Growing numbers of workers appear to believe they will want or have to continue working to a later age, and some believe they may never be able to retire.[1] Trends indicate that employees continue to be wary about their long-term retirement prospects, are postponing their retirement, are saving more and spending less, and finally are wanting to reduce their retirement risk and therefore are more willing to pay for guaranteed benefits in the future.[2]

Governments are now raising the same questions the private sector faced over the last two decades. While much of the debate about public sector plans is focused on reducing the past incurred costs of existing defined benefit plans, an increasing number of governments are looking at replacing these legacy plans with new plans.[3]

1. Working Group Goals and Guiding Principles for Plan Design and Selection

The Working Group's first step in designing a retirement plan supplemental to Social Security was to understand the requirements of the legislation and to determine what each member of the group expected in a retirement plan. The group concurred that its goal was to design a pension plan that fits the funding authorized by the Legislature, attracts and retains the state and teacher workforce of the future, and assists employees in retirement planning. The group adopted the following guiding principles within which to study, design, and select a pension plan that met the legislative directive:

- **Moral** - State and local school governments want to assist employees in building a reliable and secure retirement income stream
- **Civic** - State and local school governments want to provide valued services to their communities
- **Organizational** - It is in the best interest of all stakeholders to keep schools and the government operating effectively by recruiting and retaining a qualified workforce

[1] EBRI Research Bulletin "Americans' Expected Retirement Age: Older, and 'Never'"
[2] Towers Watson "Retirement Attitudes Part II: Employee Attitudes Toward Risk"
[3] National Conference of State Legislatures October 28, 2011 Memo "Hybrid retirement plans"

- **Budgetary** - The plan will operate responsibly with other government budgetary responsibilities

MainePERS is designated by the Legislature to perform the fiduciary duties as Plan administrator.

2. Designing a Plan with a Unique Challenge: Entering Social Security

Changing employer sponsored retirement plans is nearly always challenging. If a retirement plan is changed by adding a new tier of benefits for new employees, this will result in employees working side-by-side receiving different benefits, affecting long-term employee morale. This and other obstacles can be addressed in many situations by closing the existing plan and enrolling all employees in a new plan for their prospective service. The legal complexity and feasibility of this approach becomes exponentially difficult for Maine's state employees and teachers because it involves enrolling active employees in Social Security who are currently exempt as members of the State/Teacher Plan which is provided in lieu of Social Security. (See Attachments 2, 9 and 10)

The legislative request to the Working Group is substantially more complex than what nearly every other state is facing in changing retirement plans because it does require that new employees participate in Social Security. Current employees will remain in the State/Teacher Plan and they will not participate in Social Security. In addition to potential morale issues, some of the factors affecting the complexity of creating a retirement plan supplemental to Social Security participation are:

- Social Security contributions are a payroll tax, not a retirement plan contribution. Therefore, the full Social Security benefit earned by the employee is portable. Employees retain the credits they earn when changing employment. Therefore, the employer contribution rate is not reduced as a result of forfeited contributions made for non-vested employees who leave employment as the employer does in a defined benefit plan with a vesting period;
- Total employer retirement costs are 8.2%, comprised of 6.2% employer share of Social Security and the 2% legislative directive for a supplemental plan. The comparable normal cost of the State/Teacher Plan is approximately 2.94%, or nearly 1/3 of the employer normal cost of the new plan and Social Security due to the additional cost created by portability;
- Closing the State/Teacher Plan does not eliminate the unfunded actuarial liability (UAL) which must still be retired by the 2028 Constitutional mandate;
- Employee contributions will increase in order for employees to receive the same benefit level as they can earn under the State/Teacher Plan because the employer contribution is capped at an amount lower than the overall increase. This means that vested or career employees will receive a benefit lower than the current plan if their contributions remain at 7.65% of payroll;
- Although total employer costs increase for State/Teacher Plan employers, the limit of 2% of payroll designated in the legislation for a supplemental plan may be considered modest in comparison to employers with whom the State and school districts are competing for talent who already participate in Social Security; (See Attachment 3)
- The State of Maine currently funds the employer share for nearly all members, both State employees and teachers, in the State/Teacher Plan. Under federal law, the employer of record must report and submit payment for 6.2% of payroll for the employer's share of Social Security along with deductions withheld from employee's paychecks. This creates a new cost

of 6.2% of payroll for school administrative units (SAUs) unless subsequently reimbursed by the State. The State bears this cost for its employees.

- Because Social Security is a payroll tax, it eliminates the employer and employee risk for investment gains and losses. The question of whether Social Security benefits will remain at the same level in the face of continuing Federal budget challenges, however, continues to be raised. All costs analyses in this report assume Social Security benefits will continue at their current level and cost.

3. Determining What Employees and Employers Need from a Retirement Plan

Employer sponsored retirement plans serve two primary purposes:

- A component of the employer's workforce recruitment and retention program;
- A component of each employee's retirement income stream.

The retirement plan needs of employees and employers are different but complementary. Employees may need or want differing types of retirement plans depending on their age, income level, marital status, and mobility. Employers may also need differing types of retirement plans depending on the skills, skill level supply and demand, and salary level of the workforce they are trying to recruit and retain.

Private sector retirement benefit plans are trending away from defined benefit plans because life-long careers with one employer are decreasing, and the employer bears the risk of plan investment losses. In addition, most private sector businesses experience consumer demand elasticity which may cause them to re-evaluate their product or service offering and resulting workforce skill set periodically, further reducing career employees through downsizing or replacing existing employees with new employees with different skill sets. Governments differ from the private sector in that they provide basic infrastructure needed by the public such as licensing, roads, schools, etc., which are less elastic than the private sector. This demand inelasticity creates jobs in which required job-specific skill sets may change, but the demand for which do not change significantly over time and are suitable for longer-term employment.

The design of employment benefits to recruit and retain workers in a demand inelastic environment such as government may be different than in demand elastic employment where workforce size is more influenced by consumer demands that may change over time.

3.A. STATE OF MAINE AND SCHOOL DISTRICT NEEDS – RECRUITMENT, RETENTION AND RETIREMENT

The Working Group surveyed all school superintendents and State human resource managers to determine if useful patterns could be identified in how State/Teacher Plan employers view the effectiveness of the current retirement plan in recruitment and retention. Similar questions were asked of those surveyed about how a different retirement plan may affect recruitment and retention. Approximately 1/3 of those surveyed responded, providing a representative sample of opinion. (See Attachment 4)

Factors which seem to be most important to both teacher and state employers today for recruitment are salary, health care and working conditions. In general, the State/Teacher Plan is currently seen as a less effective recruitment tool than factors such as salary or school environment by school superintendents. This may be a result of the fact that the public school system is the primary employment opportunity for people choosing to teach in Maine, and the fact that all public school employers offer the same plan.

Recruitment practices evolve as business and employee needs change. Government employment will need to remain attractive in order to recruit the workforce it needs. School superintendents and HR directors surveyed believe an attractive retirement plan can be an effective recruitment tool.

Government retirement plans are predominantly defined benefit, with employees appearing to prefer defined benefit over defined contribution plans when given a choice.[4] Private sector employers in general find that retirement plans are a factor in employee retention. Most workers seem to value their retirement plan regardless of whether it is a defined benefit or defined contribution plan. Workers who highly value their benefit are more likely to stay with their employer than those who don't according to Towers Watson who studied this behavior.

> *"Employees who are most satisfied with their defined benefit plan are more than three times more likely than other employees to plan on remaining with their employer until retirement. An equivalent relationship emerges for employees who are highly satisfied with their defined contribution plans. However, employees who are much less satisfied with their defined benefit and defined contribution plans are equally likely to plan on staying with their employer or not."*[5]

3.B. STATE EMPLOYEE AND TEACHER NEEDS – A SECURE RETIREMENT

Employee needs are more difficult to assess because 1) a new plan is for future employees who are not yet hired; 2) employment patterns and retirement trends are increasingly difficult to predict as people live and work longer; and 3) the current economic conditions may make future turnover and employee perceptions about retirement resources temporarily more difficult to predict.

Uncertainty and the current economic climate have many older workers opting to extend their working years beyond what they planned or possibly never retire.[6] Anecdotally, many younger workers express they are not sure that any promised benefits such as defined benefit plans, Social Security, or Medicare will exist as they move toward retirement. In the meantime, the federal government is analyzing whether to increase revenues to maintain the benefits of Social Security or to increase the eligibility age and/or decrease the benefits to reduce the cost.[7]

In general, public sector employees have historically demonstrated a preference for defined benefit plans when given a choice. Definitive evidence that this is a conscious choice is difficult to identify. It is not clear whether this is because public employees appreciate the benefit once they understand it, or if they are attracted to public employment because defined benefit plans are offered.[8]

The most significant concern for employees, especially as they age, is how well their retirement plan helps prepare them for retirement. One strength of defined benefit plans from an employee perspective is that they provide guaranteed monthly replacement income for life. Conversely, defined contribution plans provide retirement income security only if the employee participates at a meaningful level. A 2009 study by the Employee Benefits Research Institute (EBRI) found that "401(k) plan participants' contribution rates differ by plan demographics based on participants' income and/or tenure. In particular, participants in 401(k) plans dominated by those with low income and

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[4] National Institute on Retirement Security and Milliman – "Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers." September 2010

[5] Towers Watson "How do Retirement Plans Affect Employee Behavior? http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=14596

[6] EBRI Research Bulletin "Americans' Expected Retirement Age: Older, and 'Never'" December 2011

[7] AARP "Social Security: Where Do We Go From Here?" July 2010

[8] National Institute on Retirement Security and Milliman – "Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers." September 2010

short tenure tend to contribute less than those in plans dominated by participants with high income and long tenure."[9]

A secure retirement is one in which an employee can expect to have an adequate steady stream of income throughout life. This can be created by defined benefit plans, or by defined contribution plans that are securely invested and converted to an annuity at retirement. Plans that simply accumulate savings or wealth and leave the employee with a lump-sum at retirement have a lower chance of providing income throughout an employee's life because the employee has to either continue managing this fund or voluntarily convert it to an annuity.

The Working Group assessed employee needs by reviewing general research about the retirement needs of individuals to determine if there was any indication the public employee population in Maine differed from that in this research.[10] General demographic information and Working Group knowledge of the workforce lead to the assumption for plan design purposes that the State employee and teacher workforce population does not differ significantly from most of the U.S. workforce. However, this population is significantly different in that it is not covered by Social Security.

4. Supplemental Plan Design

The Working Group assumed there are two basic forms of retirement plans that can supplement an employee's Social Security:

- **Defined benefit plans –** These plans define how much an employee receives in a lifetime benefit when they retire. Employees benefit because there is no investment risk for them and they can plan on a fixed income in retirement. Employers make the investment decisions and bear the investment risk which can create budget volatility or unexpected funding requirements if the markets perform poorly. Variations of defined benefit plans exist such as cash balance plans, but with a commonality of providing a fixed benefit. Defined benefit plans are generally more attractive to older or long-term workers who are looking to create stable retirement income.
- **Defined contribution plans –** These plans create individual accounts for employees to which both the employee and employer can contribute. Employers benefit because there is no investment risk for them and they can plan on stable contribution levels. Employees make their own investment decisions and bear the investment risk which can create insufficient retirement funds if the employee does not understand how to invest his or her funds or if the markets perform poorly as they near their retirement date. Defined contribution plans are generally more attractive to younger or short-term workers because the funds are portable.

The strengths and weaknesses of these plans have been widely and publicly debated over the last decade, specifically in light of two major market downturns. The general consensus is that both plans have strengths and weaknesses. The common weakness between the two types of plans is that investment risk is one-sided, i.e., either the employee or the employer bears 100% of the investment risk.

A third retirement plan solution gaining interest in some states is a *combination defined benefit/defined contribution* (DB/DC) plan.[11] This approach is based on adding a defined contribution component to a

[9] EBRI "Plan Demographics, Participant's Saving Behavior, and Target-Date Fund Investments" 2009
[10] National Education Policy Center "Review of Two Reports on Teacher Pensions" 2011
[11] National Conference of State Legislatures October 28, 2011 Memo "Hybrid retirement plans"

defined benefit component that provides a lower benefit than the employer would provide with a defined benefit only plan. For example, a defined benefit plan with a 2% accrual rate might be changed to a plan with a 1% defined benefit accrual rate and a defined contribution component. This model creates risk-sharing between the employee and employer, reducing the one-sided risk in a defined benefit plan or a defined contribution plan.

The Working Group considered and evaluated these three plan designs (defined benefit, defined contribution, or combination DB/DC) for their response to the Legislative request.

5. Selection Process and Criteria

The Working Group determined its selection criteria for a supplemental retirement based on these three potential plan designs under the assumption that neither a DB or DC plan can be demonstrated to be superior in recruitment and retention of employees. They also agreed that a plan that encourages retention is one that employees may find valuable. Further, the group determined a plan that would be considered valuable by employees is one that creates a predictable lifetime 75-80% retirement income replacement stream, as opposed to a plan that allows the employee to simply create asset or wealth accumulation only.

The Working Group used the following criteria to assess and select a plan that meets the goal and guiding principles they adopted:

- Vested employees should receive a benefit similar to what they would receive under the current State/Teacher Plan but using Social Security, a defined benefit component of the supplemental plan, and an employer contribution to a defined contribution component of the supplemental plan;
- Any defined contribution component of a supplemental plan should offer employees the opportunity and further encourage them to make additional contributions to create a 75-80% of final pay replacement income stream in retirement;
- Employee contribution levels to a defined contribution component should be structured to encourage building a reliable income stream in retirement in ways that are most affordable to employees;
- The plan design should share risk between the employer and employee, specifically addressing or mitigating as much as possible the major risks associated with retirement plans, including investment, funding rate volatility, inflation and longevity, disability, pre-retirement death, and termination risks.

The analysis of the three plan designs that were considered centered on the replacement income ratio capability, or benefit percentage of final pay, of each design. Certain assumptions were made when calculating expected income replacement ratios, such as how much an individual may wish to contribute to any voluntary retirement savings plan and how much their investment will earn over time. Income replacement as a percentage of final pay increases with length of employment or contributions to the plan in all designs.

CHAPTER THREE – PLAN DESIGN

SELECTED PLAN DESIGN AND ALTERNATIVES STUDIED

1. Selected Supplemental Plan Design – Combination DB/DC

The plan design selected for a supplemental retirement plan meeting the legislative objectives is a combination DB/DC plan. The employer contribution will be allocated 1% to the DB component and 1% to the DC component. This results in a total employer contribution of 2% in addition to the 6.2% employer share of Social Security for a total employer contribution of 8.2%.

1.A. DEFINED BENEFIT COMPONENT – ADJUSTABLE PENSION PLAN

The selected defined benefit design is called the Adjustable Pension Plan (APP). This is a newly developed hybrid defined benefit plan designed to provide predictable lifelong income at retirement. This plan was created to mitigate and share the investment risk (gains and losses) between the employee and employer. It provides a career average benefit accrual rate of 1% plus a possible share of investment gains and losses from a lower risk investment portfolio.

How it Works

The Adjustable Pension Plan creates a minimum guaranteed benefit accrual for each year of an employee's service. The accrued benefit is annually adjusted up or down based on actual investment performance. However, the benefit can never be less than would occur if the plan always earned a pre-determined floor rate of return (e.g., 5%) each year. Also, earnings in excess of a ceiling rate of return (e.g. 10%) would not be used to increase benefits and instead remain in the Plan as a source of revenues to cover years when returns fall below the floor rate. Other plan provisions include:

- 5 year vesting;
- Benefit is based on career average earnings;
- Age 65 normal retirement age with a 7-8% per year early reduction factor;
- Approximately4.5% employee contribution; 1% employer contribution;
- Employees may elect to convert their fixed benefit to a lower initial benefit at retirement and build in their own COLA;
- Employees may elect a spousal option by receiving a lower initial benefit which continues to be paid to their spouse upon the death of the employee;
- Special employee plans may be created for a higher contribution rate;
- Disability benefits are possible and could be provided by a reduction in the normal benefit.

Why it Works

The Adjustable Pension Plan works because it provides a defined benefit at retirement based on a guaranteed career average accrual rate of no less than 1%, with the potential of a higher benefit if investment performance is higher than the expected earnings assumption. This was set at 5% for purposes of plan design. This means that investment risk is shared between the employee and the employer and is significantly more likely to be fully funded and remain that way over the life of the plan. The benefit is more predictable (and less subject to benefit spike-up) because it is based on career average earnings rather than the highest three years of earnings.

1.B. DEFINED CONTRIBUTION COMPONENT

The defined contribution component allows both the employee and employer to contribute varying amounts to a defined contribution component of the plan. This component supplements the employee's defined benefit and Social Security benefits to help the employee meet a goal of replacing 75-80% of their income at retirement. A defined contribution component can be designed using sensible risk management measures to provide a third component of a lifetime income stream.

How it Works

The defined contribution component consists of two plans to allow for maximum tax-advantaged contributions to employee retirements. The first plan is a 401(a) defined contribution plan for employer contributions. This is where the 1% employer contribution will be deposited. This also is where any additional contributions the employer wishes to make on a one-time or other basis will be deposited. The second plan is a 457(b) deferred compensation plan for employee contributions. Using two plans creates the opportunity for the employee to save the maximum amount allowable by the Internal Revenue Service in the 457(b) if he or she chooses to do so. This is provided separate from the State's existing 457(b) plan or 403(b) plans offered by most schools. (The 457(b) plans will have to be coordinated for purposes of IRS rules.)

Together, these two plans work in a manner similar to a 401(k) plan used in the private sector. Individual accounts are maintained for each employee. Employees and employers determine how much they want to contribute up to maximum allowable amounts. The amount available at retirement for each employee differs depending on how much was contributed and how the investments for that employee performed.

Why it Works

Expert recommendations for building a secure retirement have been based on each individual building three income components: 1) Social Security; 2) a workplace retirement plan; and 3) personal savings. The probability of employees creating adequate personal retirement savings is increased with a plan design that encourages participation, savings, and conversion to annuities.

Defined contribution plan design components which encourage adequate personal savings are:

- Mandatory enrollment accomplished through the proposed employer contribution schedule which are projected to average to approximately 1% of long-term payroll. Employer contributions will change at the beginning of the quarter following the employee's anniversary date.
- 0.50% of payroll in year 2-4
- 0.75% of payroll in years 5-10
- 1.15% of payroll in years 11 and up
- No age restrictions on participation;
- Providing risk management assistance to employees through a limited, low-risk investment menu for contributions up to 10% of payroll, including target date or lifecycle funds designed to continuously provide age-appropriate asset allocations;
- Broader investment options for contributions in excess of 10% of payroll;
- Group and individual retirement education to assist employees in making sound, low-risk decisions regarding their retirement;

- The use of a 401(a) for employer contributions creates the opportunity for employees to save the maximum amount allowable under law in their 457(b);
- No allowance for loans or hardship withdrawals;
- Incentives to encourage conversion of employee fund balances at retirement into annuities.

2. Reasons for Plan Selection

The Working Group selected the combination DB/DC supplemental retirement plan with a 1% employer contribution to the DB (APP) and 1% to the DC to meet the requirements and intent of the law and its selection criteria:

- The supplemental plan, with Social Security, offers employees the opportunity to create a 75-80% of final pay replacement income stream in retirement;
- Vested employees will receive, on average, a benefit level from Social Security and the DB benefit of the supplemental plan similar to what they would receive under the State/Teacher Plan;
- The defined contribution component encourages employees to save toward a 75-80% replacement income stream through automatic enrollment and automatic employer contributions which can also be adjusted based on economic conditions or recruitment and retention needs;
- Employee contribution levels have been structured to encourage building a reliable income stream by sharing the employer contribution between both the DB and the DC;
- The plan is designed to mitigate the major risks associated with historical retirement plans, including investment risk for both the employer and the employee through lower return targets, funding rate volatility risk (limitations on investment risk), inflation and longevity risk (offering options that help create lifetime income streams), coordination of disability with Social Security, provisions for pre-retirement death benefits, and limiting termination risks by encouraging employees to leave their funds in the plan throughout retirement or roll their funds over into other tax-advantaged plans.

How the Plan Works

Entry Salary	Required Employee DB Contribution	Suggested Employee DC Contribution	APP DB Replacement Ratio	APP DC Replacement Ratio	Social Security Replacement Ratio	Total Income Replacement Ratio
$30,000*	4.62%	3.75%	20.75%	16.21%	38.14%	75.10%
$40,000*	4.62%	4.75%	20.75%	19.62%	34.66%	75.03%
$50,000*	4.62%	5.35%	20.75%	21.66%	32.57%	74.98%

**Assumes 30 years of service and 5% DC average earnings*

3. Open Issues

Retirement plans in general are in transition today because of the unexpected economic conditions experienced since 2008 which have impacted retirement plan viability. The open issues that could impact the effectiveness or feasibility of this plan design are:

- The Adjustable Pension Plan defined benefit component is in the process of being approved as a qualified tax-deferred plan. While it has not yet received formal Internal Revenue Service approval any issues that may arise can be resolved in the determination letter process. Presently a number of plan sponsors are in the process of implementing this plan and submitting applications to the IRS;
- Reducing Social Security benefit levels and/or raising the eligibility age has been discussed for several years as one approach to maintaining the long-term viability of that program. Current Social Security benefit and contribution levels were used for purposes of calculating the contributions required and benefits provided from Social Security and the selected supplemental DB/DC plan;
- Opinions vary widely on what assumed rate of return should be used for retirement plans. 5% is significantly lower than most plans use today, but higher than some actuarial, finance and retirement experts recommend using.

CHAPTER FOUR – MANAGING COSTS

CHANGING PLANS AND SOCIAL SECURITY PARTICIPATION CREATE COST IMPACTS

Closing a defined benefit plan to new employees and implementing Social Security with a new supplemental retirement plan has cost impacts for both employers and employees.

1. Cost Impacts

There are three primary employer cost impacts of closing the State/Teacher Plan to new members and implementing Social Security with the supplemental retirement plan selected in Chapter 3:

- Changes in the State/Teacher UAL amortization schedule;
- Increased costs resulting from participation in Social Security;
- The transfer of Social Security cost to School Administrative Units (SAUs) for educators.

Understanding the cost impacts of these changes in part is based on understanding how the active employee population changes in each plan over the 25 years following the closure of the plan, or the length of time before all current State/Teacher Plan members can expect to be retired. Chart 4.1 shows the projected payroll through 2040 of the current State/Teacher Plan and a new plan implemented July 1, 2015 if the current State/Teacher Plan is closed to new members as of June 30, 2015. (See Attachment 5)

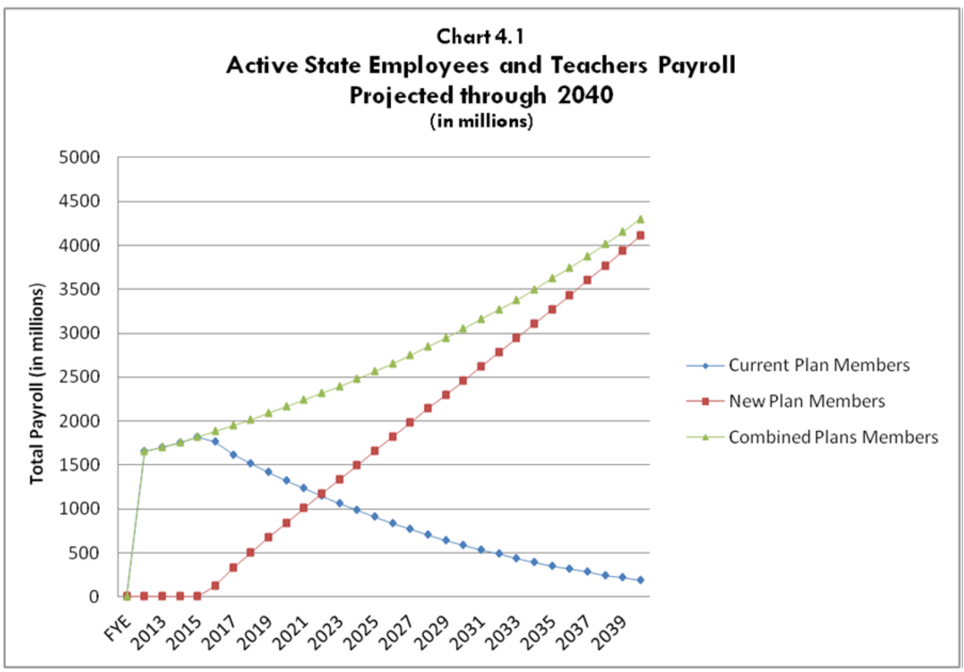


Chart 4.1 assumes overall employment numbers remains the same and total payroll grows at 3.5% annually for inflation and promotion. The chart shows that total payroll in the new plan will continue to increase as new hires increase until 2022 when the payroll for this group begins to exceed active payroll in the State/Teacher Plan. This transition will continue until 2040 when no or few active members are anticipated to remain in the closed State/Teacher Plan. These projections will change if historical turnover patterns change.

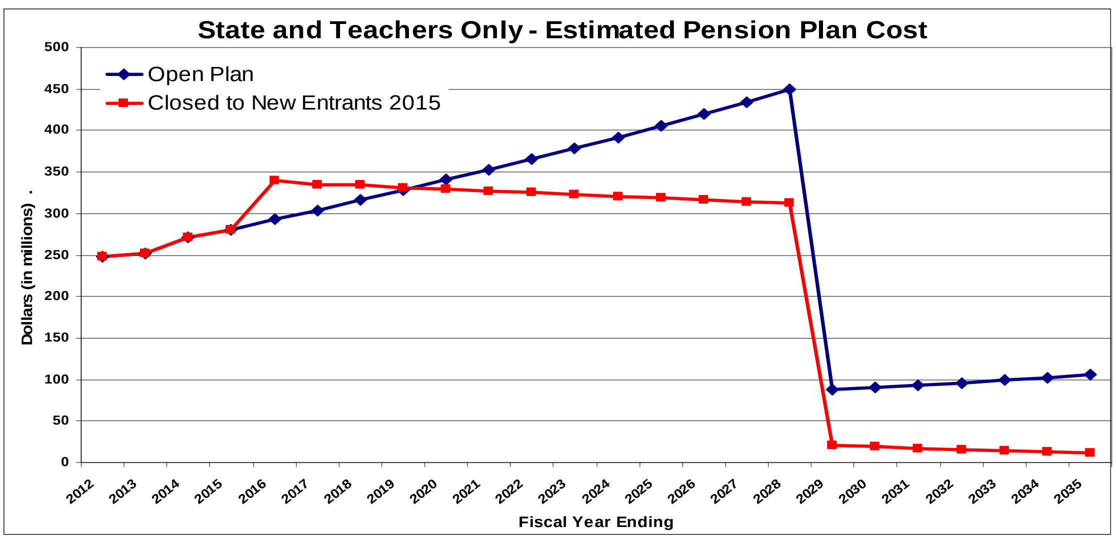
1.A. COST IMPACT 1 – UAL AMORTIZATION

The cost impacts of closing the State/Teacher defined benefit plan to new entrants results from changes in the requirements for amortizing the UAL and the resulting costs.

The Governmental Accounting Standards Board (GASB) specifically addresses how a UAL may be amortized in open and closed plans. However, GASB is currently in the process of revising its standards for public sector pension plans and plan sponsors, and has already issued an exposure draft for public comment. One of the key changes in the draft is the elimination of the Annual Requirement Contribution (ARC) calculation and comparison to the actual contributions made by the plan sponsor. One of the components of the ARC is UAL amortization payment. It is not clear if the elimination of the ARC would also eliminate the actuarial standards for UAL amortization in a closed plan. In the discussion that follows, we are assuming that this requirement would remain the same as before with respect to UAL amortization for a closed plan.

Chart 4.2 demonstrates the projected UAL costs under current GASB standards if the State/Teacher Plan remains open, or if it is closed to new entrants at July 1, 2015. Under the current version of GASB Statement 25, the UAL amortization methodology for the State/Teacher Plan must change from a level percentage of payroll to a level dollar amount if the State/Teacher Plan is closed to new entrants.

Chart 4.2
UAL Amortization of Open and Closed State/Teacher Plan



1.B. COST IMPACT 2 – INCREASED COSTS

Employer costs increase under the requirements designated in the law, with or without a supplemental retirement plan with a long-term cost of 2% of payroll. This is because Social Security is a payroll tax while the State/Teacher Plan employer contributions are reduced by requirements that employees vest in order to actually receive a benefit.

Social Security and State/Teacher Plan Vesting Differences

The higher cost of participating in Social Security results because the 6.2% employer contribution remitted each pay period is a payroll tax or "sunk" cost, i.e., employer contributions are not returned to the employer if the employee does not earn enough credits to qualify for Social Security.

The State/Teacher Plan alternatively provides benefits only to those employees who vest in the Plan by completing five years of service. Approximately ½ of employees in the State/Teacher Plan never receive benefits because they do not vest. Contributions made on behalf of these individuals are used to reduce future contributions to the Plan.

Table 4.1 compares the projected employer normal cost of the current State/Teacher Plan of 2.94% of payroll to the cost of paying 6.2% Social Security employer contribution for the same payroll.

Table 4.1
Comparison of Annual State/Teacher Normal Costs to Social Security Costs for All Employees
(in millions)

FYE	State/Teacher Plan	Social Security
2016	$55.1	$116.7
2017	$57.1	$120.7
2018	$59.1	$125.0
2019	$61.1	$129.3
2020	$63.3	$133.9

Cost Comparison of New Plan Design to Current State/Teacher Plan

The selected plan was designed to provide roughly the same retirement benefit to vested employees, i.e., employees with five or more years of service, as the State/Teacher Plan. As discussed in the previous section, the selected plan creates an overall higher cost for both the employer and employee with entrance into Social Security. Vested employees participating in Social Security and the new plan receive a non-quantifiable benefit through the elimination of the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP), two provisions which can reduce Social Security benefits of employees and spouses who earn pensions provided in lieu of Social Security such as the State/Teacher Plan.

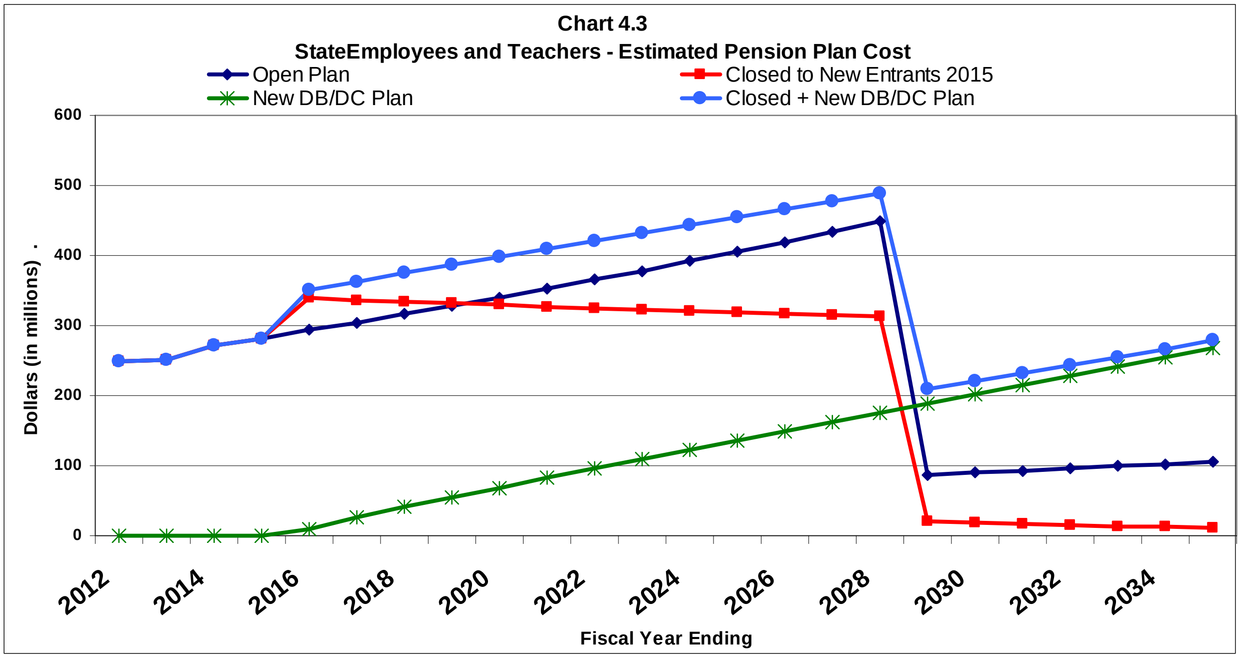
Table 4.2 shows the projected percentage of payroll that the employer and employees will pay for employees hired prior to July 1, 2015 remaining in the State/Teacher Plan and employees hired on or after July 1, 2015 participating in Social Security and the selected combination DB/DC plan.

Table 4.2
Employer and Employee % of Payroll for All Plans on or after July 1, 2015

Plan	State/Teacher Plan		New Pension Plan	
	Employer	Employee	Employer	Employee*
State/Teacher Plan	2.9%	7.65%		
Social Security	-	-	6.2%	6.2%
Combination DB/DC	-	-	2.0%	4.6%
Total	2.9%	7.65%	8.2%	10.8%

*Assumes Social Security resumes at 2009 contribution rates

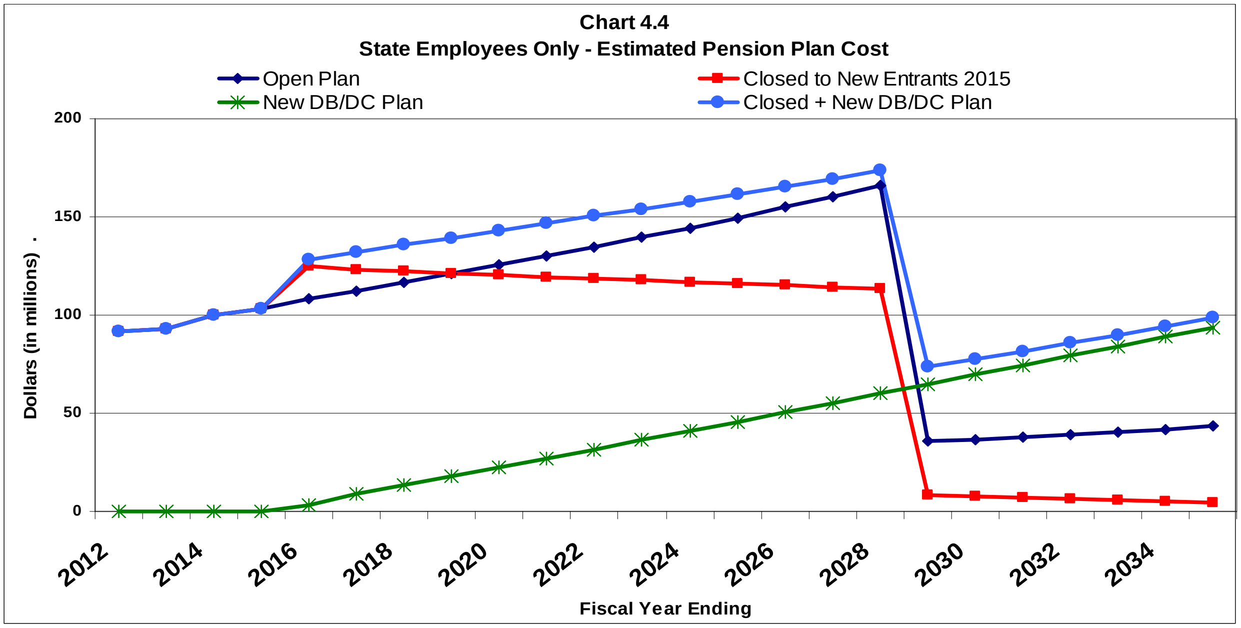
Chart 4.3 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new employees hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience. (See Attachment 7 – Table A7.1)



The actual, or long-term, cost difference between maintaining the State/Teacher Plan and implementing Social Security with the selected combination DB/DC plan is most clearly seen in 2029 and beyond when the State/Teacher Plan UAL is retired as required by the State Constitution.

Employer Cost Impacts for State of Maine Employees Only

The State of Maine's costs for State employees (as a group separate from educators) change if State employees hired on or after July 1, 2015 enter Social Security and are provided the selected combination DB/DC plan. Chart 4.4 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new state employees hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience. (See Attachment 7 – Table A7.2)

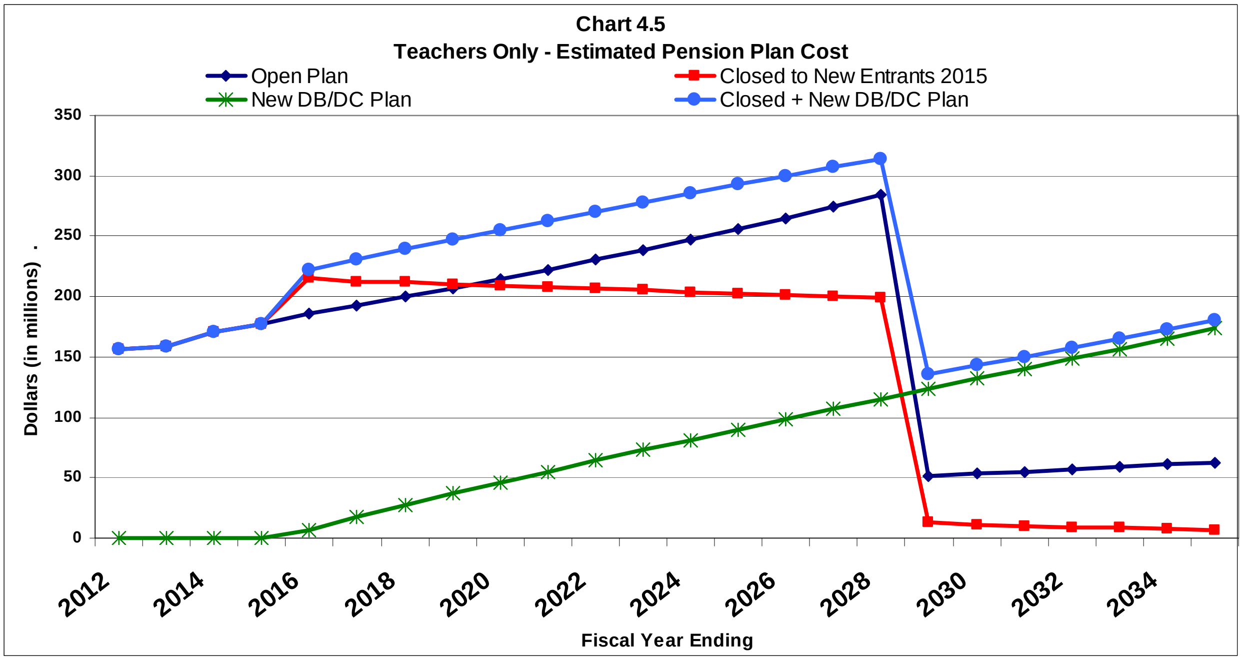


The actual, or long-term, cost difference between maintaining the State/Teacher Plan and implementing Social Security with the selected combination DB/DC plan for State employees only is again most clearly seen in 2029 and beyond when the State/Teacher Plan UAL is retired as required by the State constitution.

1.C. COST IMPACT 3 – SCHOOL ADMINISTRATIVE UNITS

The State of Maine currently pays the normal and UAL amortization costs for the State/Teacher Plan. If educators hired on or after July 1, 2015 enter Social Security, the city, county or municipality that pays their salary is required to remit the Social Security withheld from employee pay along with the employer share each pay period, creating a new cost for these employers. The full cost impact is phased in over time because it is only paid for new hires on or after July 1, 2015. Amounts in the 6.2% Social Security column are the amounts required by year to be remitted by all SAUs with members in the new plan. ***This report does not address whether Social Security costs will be reimbursed by the State or whether the State will pay for the supplemental plan costs.***

Chart 4.5 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new educators hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience. (See Attachment 7 – Table A7.3)



The actual, or long-term, cost difference between maintaining the State/Teacher Plan and implementing Social Security with the selected combination DB/DC plan for educators only is again most clearly seen in 2029 and beyond when the State/Teacher Plan UAL is retired as required by the State constitution.

1.D. OPEN CONSIDERATIONS

The State of Maine currently funds the full cost of the State/Teacher Plan for State employees and teachers. This report only addresses the fact **that** SAUs must remit Social Security costs. It does not address who will pay for the supplemental plan or whether or not Social Security costs will be reimbursed by the State to SAUs.

2. Managing the Cost Impacts of Closing the State/Teacher Plan

Changing from a level percentage of payroll to a level dollar amount required to close the State/Teacher Plan to new entrants in FY 2015 creates higher amortization costs in the years immediately following the plan closure and lower amortization costs in the final years. Table 4.3 demonstrates the difference in UAL cost of an open State/Teacher Plan and one closed to new participants hired on or after July 1, 2015 if the amortization payoff date remains at the 2028 Constitutional requirement. The changes results in an overall cost reduction of $127 million, with costs in the first six years following a FY2015 closure increasing by $154 million and decreasing in the last six years by $282 million.

Table 4.3
UAL Amortization Differences for
Closing the State/Teacher Plan June 30, 2015

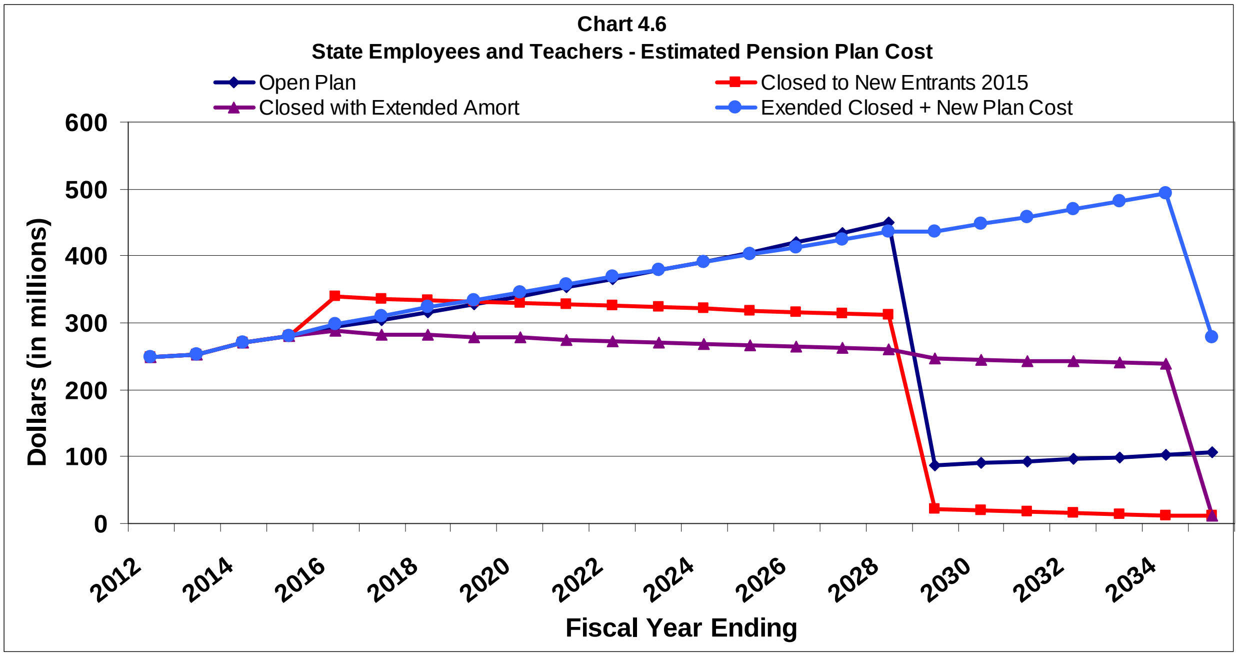
FYE	Open Plan UAL	Closed Plan UAL	Difference
2016	$239	$286	$47
2017	$247	$286	$39
2018	$258	$284	$31
2019	$267	$288	$21
2020	$277	$290	$13
2021	$287	$290	$3
2022	$298	$290	($7)
2023	$308	$290	($18)
2024	$319	$291	($28)
2025	$330	$291	($39)
2026	$342	$291	($51)
2027	$354	$291	($63)
2028	$366	$291	($75)
Total	$3,892	$3,764.5	($127)

Differences may exist due to rounding

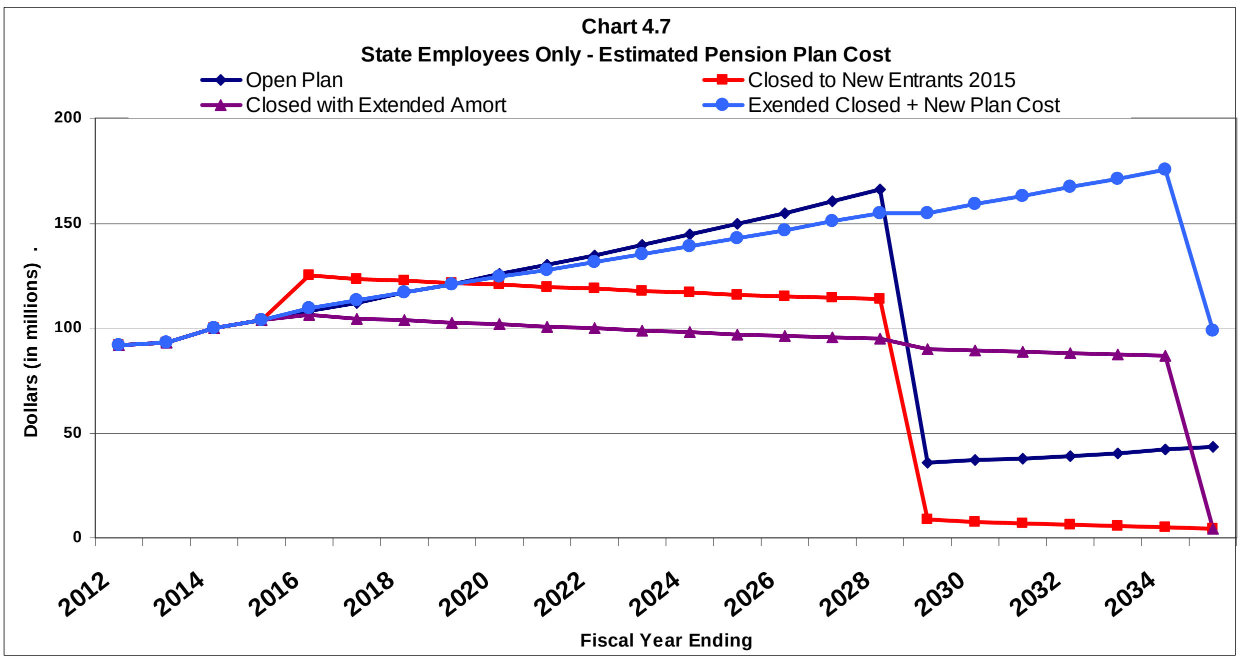
1.A. EXTENDING THE AMORTIZATION SCHEDULE

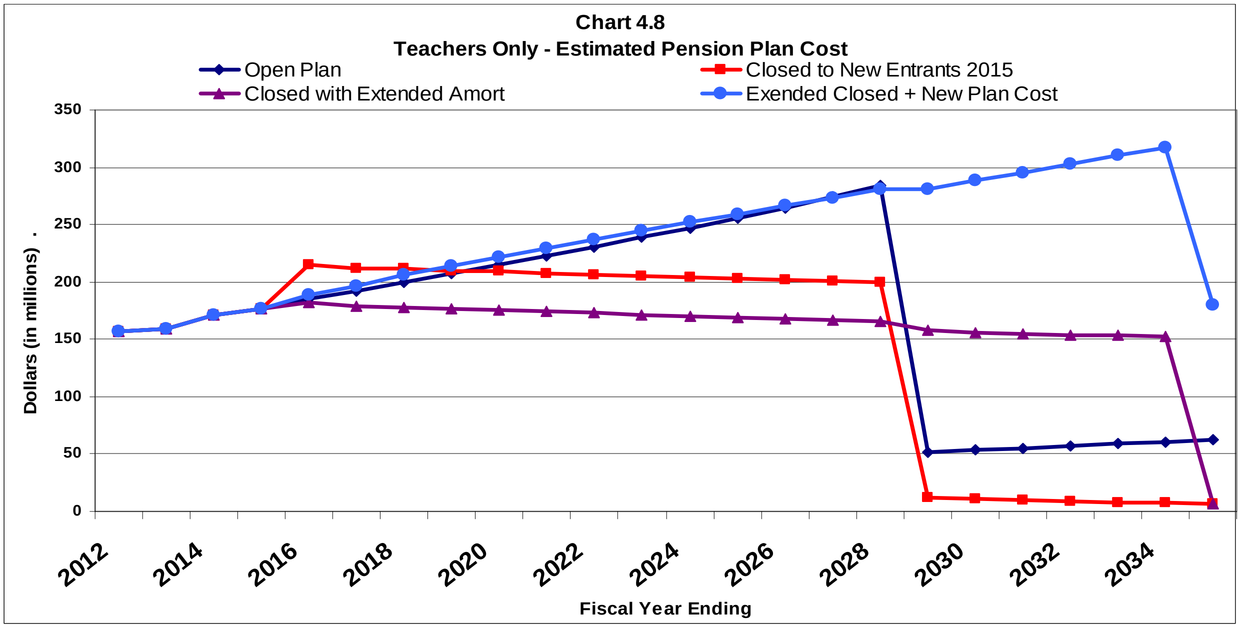
The only method for maintaining the UAL amortization costs in the State/Teacher Plan closed to new participants at an annual level similar to those in the open plan in the first years where the annual cost is higher is to extend the amortization schedule beyond 2028. This requires a Constitutional amendment.

Extending the amortization schedule by six years to 2034 creates a schedule that most closely keeps the UAL amortization costs in a closed plan at an annual level similar to those in the open plan. Chart 4.6 projects the total employer cost of closing the State/Teacher Plan to new entrants with an extended amortization schedule to 2034 and enrolling new educators hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience. (See Attachment 8 – Table A8.1)



Charts 4.7 and 4.8 demonstrate the total employer costs for State Employees and teachers separately if the amortization period is extended through 2034. (See Attachment 8 – Tables A8.2 and A8.3)





3. Summary of Cost Impacts and Managing those Impacts

The cost impacts of closing the State/Teacher Plan as of June 30, 2015 and entering Social Security with a supplemental employer plan are that overall costs increase in order to provide similar employee benefits to long-term workers. This is because costs incurred for workers staying less than five years in the State/Teacher Plan stay in the Plan and defray future costs while Social Security costs are incurred for all workers, consequently making participation more costly than a plan provided in lieu of Social Security.

Cost impacts to employees are the opposite. Employees staying less than five years in the State/Teacher Plan receive no employer benefit for these years, and further earn no Social Security credits during their employment.

CHAPTER FIVE - IMPLEMENTATION

IMPLEMENTATION

Action	Target Date
• Passage of Legislation Establishing Critical Terms of New DB and new DC plan, effective July 1, 2015.	April 2012
• Creation of new plan documents for new DB, new DC plan and new 457(b) plan.	Summer/Fall 2012
• Work with Social Security Administration on implementation plan and on any amendments to 218 Agreement.	Summer/Fall 2012
• Creation of Investment Policy Statement(s).	Fall 2012
• Develop and conduct RFP searches for record-keepers(s).	January to June 2013
• Develop conduct RFP searches for investment options.	July to December 2013
• File determination applications for new plans (DB & DC).	February to April 2013
• Secure any necessary IRS PLRs (457(b)).	February 2013
• Forms development.	January to June 2014
• Operating systems changes – legal review; actuarial review.	January to July 2014
• MainePERS staff training in Plan fundamentals.	Fall 2014

EMPLOYEE OUTREACH PLAN

Action	Target Date
• Develop outreach and education policies	Spring 2013
• Develop and conduct RFP searches for employee education tailored to the policy in the selected plan design to assist employees in creating a predictable income stream in retirement with low-risk investment	Summer 2013
• Develop and conduct RFP searches for materials and website development	Summer 2013
• Recruit and train MainePERS specialists to provide plan information, effective plan use, and education to all employers and members	Spring 2014

ATTACHMENT 1 – 125TH LEGISLATURE PL 2011, C.380, PART U

Sec. U-1. Design of new retirement benefit plan for state employees and teachers; working group established. A working group, referred to in this Part as "the working group," is established to develop an implementation plan designed to close the current defined benefit retirement plan for all state employees and teachers and replace it with a retirement benefit plan, referred to in this Part as "the plan," that is supplemental to Social Security and applies to all state employees and teachers who are first hired after June 30, 2015 with no prior creditable service. The working group must be staffed within the existing resources of the Maine Public Employees Retirement System and the Department of Administrative and Financial Services.

1. Definitions. For purposes of this Part, the following terms have the following meanings.

A. "State employee" has the same meaning as in the Maine Revised Statutes, Title 5, section 17001, subsection 40.

B. "Teacher" has the same meaning as in the Maine Revised Statutes, Title 5, section 17001, subsection 42.

2. Working group membership. The working group consists of:

A. The Executive Director of the Maine Public Employees Retirement System, who serves as the chair of the working group;

B. The Commissioner of Administrative and Financial Services, or a designee of the commissioner;

C. A member appointed by the chair of the working group nominated by the Maine Education Association;

D. A member appointed by the chair of the working group nominated by the Maine School Management Association; and

E. A member appointed by the chair of the working group nominated by the Maine State Employees Association.

3. New retirement plan. The working group shall design a retirement plan to supplement Social Security for state employees and teachers in accordance with this subsection.

A. Every member of the plan must contribute to both Social Security and Medicare, and the employer of each member must contribute the employer's share of Social Security and Medicare.

B. Each active member of the plan must be entitled to participate in a supplemental retirement plan.

C. The supplemental retirement plan must be designed to:

(1) Attract new state employees and teachers and meet employer recruitment needs and employee needs for retirement benefit portability and retirement security;

(2) Be competitive with retirement benefit plans provided by similar employers that contribute to their employees' retirement security in addition to Social Security;

(3) Limit the State's long-term cost exposure to 2% of employee gross payroll and the employee's exposure to loss of retirement security;

(4) Provide the State with the ability to make additional retirement plan contributions in any given biennium without increasing the 2% long-term contribution ceiling;

(5) Ensure that employees and employers share plan administrative costs; and

(6) Provide financial information to assist employees in understanding how to preserve their living standards.

4. Duties. The working group shall consult, as needed, with experts in the retirement and investment field and shall:

A. Determine the financial impact on the State and other public employers over time of closing the current retirement plan to new entrants and offering a new retirement plan consisting of Social Security and a supplemental retirement plan;

B. Develop an implementation date that creates the most predictable and affordable transition from the current plan to the new plan;

C. Identify and develop any modifications that can be made to the existing plan before it is closed to make the cost of the plan more predictable and affordable and to improve the ability of public employers to attract new employees while transitioning to the new plan; and

D. Study the impact of options for amending the Constitution of Maine to change the 10-year period required for amortization of experience losses and the requirement that all unfunded liabilities be eliminated by 2028.

Sec. U-2. Report. The working group shall submit a report on the design of the plan under section 1, together with any necessary implementing legislation, to the Joint Standing Committee on Appropriations and Financial Affairs by January 1, 2012. After receipt and review of the report, the joint standing committee may report out a bill to the Second Regular Session of the 125th Legislature.

ATTACHMENT 2 – MOVING FROM A PLAN IN LIEU OF SOCIAL SECURITY TO PARTICIPATING IN SOCIAL SECURITY

Background: Current Social Security Coverage Situation

State employees and teachers who participate in a Maine retirement system are currently not covered by Social Security. See Maine/Social Security Administration 218 Agreement dated December 3, 1951. A government employee will only be excluded from Social Security coverage if he or she: (1) is a member of a qualified replacement plan, and (2) is not in a position that is covered by a State's Section 218 Agreement. Thus, with respect to the current members of the State/Teacher Plan, both of the following are true:

- **The State/Teacher Plan is a "qualified replacement plan" with respect to all current members.**
- **The State's Section 218 Agreement excludes members of the State/Teacher Plan from Social Security coverage.**

II. How to Obtain Social Security Coverage for New Hires

In order for new State and local employees to be covered by Social Security, one of the above circumstances for current State/Teacher Plan members must cease to apply to the new hires. In other words, either: (1) the retirement plan provided to new hires must not be a "qualified replacement plan" with respect to any new hires; or (2) the new hires must provide service in a position that becomes covered by the State's Section 218 Agreement (which generally, but not necessarily, must occur by referendum). The purpose of this Section is to outline these two separate "routes" to Social Security coverage, including the comparative advantages and disadvantages of each.

Route 1: Design Benefits Provided to New Members to Either Automatically Satisfy or Not Satisfy the Requirements of a Qualified Replacement Plan.

The selected plan contemplates a defined benefit plan with defined contribution components with Social Security coverage. The APP plan design would trigger mandatory Social Security for all new hires only so long as the accrual rate and other benefit features do not satisfy IRS safe harbors or otherwise provide a benefit that is comparable to Social Security.

Considerations Regarding this Route of Entry to Social Security.

- Mandatory Social Security coverage is always tied to the level of benefit provided to employees under the State-sponsored plan. Increasing benefits under a State-sponsored plan in the future could trigger a loss of automatic Social Security coverage for affected employees. Any change in benefit design must take into account the potential impact to Social Security coverage.

- Mandatory Social Security can be used to supplement retirement benefits in an effort to provide new hires with a benefit contribution similar to the State/Teacher Plan. However, the benefit provided under the State-sponsored plan may not rise to the level of a "qualified replacement plan," in order to maintain the mandatory Social Security coverage under this Route 1.

- Mandatory Social Security provides flexibility to cover State employees under Social Security for one period and to exclude State employees from Social Security at a future period. This is done by increasing benefits in the future to provide a qualified replacement plan.

- Benefits designs that use variable benefit rates based on years of service or other factors require careful consideration under the Social Security rules to determine whether the plan is a qualified replacement plan with respect to <u>all</u> members. Otherwise, a particular benefit design could result in members falling into and out of Social Security coverage over the course of their State employment.

Route 2: <u>Cover New Employees' Positions Under the State's 218 Agreement.</u>

When an employee group is covered by a Section 218 Agreement, that group will have Social Security coverage via the Agreement regardless of whether any or all of the employees in the group are eligible to participate in a State-sponsored retirement plan, and regardless of whether such plan is a "qualified replacement plan." <u>Coverage under a 218 Agreement is independent from the mandatory Social Security rules.</u>

Ice Miller, the System's pension counsel, believes it is critical to clearly establish the Social Security coverage status of the new hires on a permanent basis. Thus, Ice Miller's primary recommendation is that if Social Security coverage is intended, the Social Security Administration should be consulted by Ice Millerand Cheiron, the System's actuary, and ultimately a clear position on coverage should be secured from them.

1. <u>Considerations Regarding this Route of Entry to Social Security</u>.

- Once a Section 218 Agreement is modified to include a particular group of positions, those positions will <u>always</u> be covered by Social Security in the future, regardless of the level of pension benefits provided to the employees in such positions.

- When employees are covered by Social Security through a Section 218 Agreement, there is not an ongoing concern that a change to benefit plan designs will affect the Social Security coverage status of the employees. The State is able to increase or decrease benefits without jeopardizing the Social Security coverage that employees expect.

- The Social Security Administration would need to agree to a modification of Maine's 218 Agreement based on the new plan and its covered population, without a referendum.

ATTACHMENT 3 – SOCIAL SECURITY STATE PLANS NORMAL COSTS

Table A3.1 provides a comparison of the normal cost of several New England and surrounding state public pension plans based on the most recent valuation. The table also indicates what provisions of the plans were affected by 2011 legislation.

Table A3.1
Comparative Employer Normal Costs for Select Social Security States

State	Covered Group	Employer Normal Cost	Member Normal Cost	Valuation	2011 Enacted Legislation*					
					Contr Rate	COLA	Eligibility	Formula	RTW	Governance
Connecticut	State Employees	9.0%	2.0%	2010		√	√	√		
Delaware	State Employees/Teachers	6.85%	3% above $6k comp	2010	√		√	√		
Maryland	State Employees	4.17%	6.71%	2011	√	√	√	√	√	
New Hampshire	State Employees	10.44%	7%	2011	√		√	√		√
New Hampshire	Teachers	11.96%	7%	2011	√					
New Jersey	State Employees	.67%	6.5%	2010**	√	√	√	√	√	√
New York	Teachers	8.62%	3.5%	2011						
Rhode Island	State Employees	2.64%	8.75%	2010						
Rhode Island	Teachers	2.32%	9.5%	2010						
Vermont	Teachers	1.80%	5.0%	2011						
Vermont	State Employees	3.99%	5.1%	2011	√					

*Source: National Conference of State Legislatures, *Pensions and Retirement Plan Enactments in 2011 State Legislatures*
***reflects 2011 legislative changes*

ATTACHMENT 4 – STATE HR DIRECTOR AND SCHOOL SUPERINTENDENT SURVEY

Question	Group	Rating				
		1 (least effective)	2	3	4	5 (extremely effective)
How would you rate the effectiveness of the current MainePERS retirement plan in your recruitment efforts	State	0	3	7	1	1
	Teacher	9	12	15	7	4
How would you estimate the effectiveness of a different retirement plan based on participation in Social Security in your recruitment efforts	State	2	2	2	5	1
	Teacher	12	5	20	5	4
How effective is the current retirement plan in retaining employees	State	0	2	4	2	4
	Teacher	8	9	15	9	6
How effective is any retirement plan in retaining employees	State	0	2	3	4	3
	Teacher	5	5	16	13	8

Question	Group	Career	20 years	10 years	5 years	Other
What is your goal for retaining employees in the current and future environment	State	4	0	6	0	2
	Teacher	17	9	14	3	4

Question	Group	Yes	No	Other
Does the current retirement plan inhibit organizational turnover	State	4	6	1
	Teacher	18	24	5

Question	Group	Fewer than 100	100-300	300-500	More than 500
How many employees are in your assigned area of responsibility	State	4	1	1	6
	Teacher	7	17	12	11

When asked to prioritize the effectiveness of nine separate items as tools and incentives in recruitment efforts, <u>retirement plan</u> was ranked fifth by both State and Teacher respondents.

- The category of vacation, holidays, sick, personal or other leaves took first place with State respondents while salary gained the top spot with Teachers.
- Both State and Teacher respondents ranked healthcare as the second most effective recruitment tool or incentive.
- Organization culture received overall third and fourth place rankings by Teacher and State respondents respectively.

When asked what retirement benefits would be most effective for recruitment and retention in the future, a stable, reliable, and portable retirement plan and affordable healthcare were common themes by both State and Teacher respondents.

ATTACHMENT 5 – PROJECTED PAYROLL BY EMPLOYER CATEGORY

Table A5.1 projects total payroll by employer category of the State of Maine for State employees or SAUs for educators through 2040. Payroll growth is assumed to increase by 3.5%, which includes both inflation and promotion growth.

Table A5.1
Payroll by Employer with 3.5% Projected Growth
(in millions)

FYE	State Employees			Educators			All Covered Employees		
	State / Teacher Plan	New Hires 2015+	Total	State / Teacher Plan	New Hires 2015+	Total	State / Teacher Plan	New Hires 2015+	Total
2012	$581	-	$581	$1,075	-	$1,075	$1,658	-	$1,658
2013	$604	-	$604	$2,093	-	$2,093	$1,697	-	$1,697
2014	$625	-	$625	$1,132	-	$1,132	$1,757	-	$1,757
2015	$647	-	$647	$1,171	-	$1,171	$1,818	-	$1,818
2016	$629	$41	$669	$1,132	$81	$1,212	$1,761	$121	$1,882
2017	$583	$110	$693	$1,035	$220	$1,255	$1,618	$329	$1,948
2018	$552	$165	$717	$962	$336	$1,299	$1,514	$502	$2,016
2019	$522	$220	$742	$894	$451	$1,344	$1,416	$671	$2,086
2020	$493	$275	$768	$829	$563	$1,391	$1,322	$838	$2,159
2021	$465	$330	$795	$767	$673	$1,440	$1,232	$1,003	$2,235
2022	$437	$386	$823	$709	$781	$1,490	$1,146	$1,167	$2,313
2023	$410	$442	$852	$655	$888	$1,542	$1,064	$1,330	$2,394
2024	$382	$499	$882	$603	$994	$1,596	$985	$1,493	$2,478
2025	$356	$557	$912	$554	$1,098	$1,652	$909	$1,655	$2,565
2026	$329	$615	$944	$508	$1,202	$1,710	$838	$1,817	$2,654
2027	$304	$673	$977	$465	$1,305	$1,770	$769	$1,978	$2,747
2028	$279	$732	$1,012	$426	$1,406	$1,832	$705	$2,138	$2,844
2029	$256	$791	$1,047	$389	$1,507	$1,896	$645	$2,298	$2,943
2030	$234	$850	$1,084	$355	$1,608	$1,962	$588	$2,458	$3,046
2031	$213	$909	$1,122	$322	$1,709	$2,031	$535	$2,618	$3,153
2032	$193	$968	$1,161	$292	$1,811	$2,102	$487	$2,778	$3,263
2033	$175	$1,027	$1,201	$263	$1,913	$2,176	$438	$2,939	$3,377
2034	$158	$1,086	$1,244	$237	$2,015	$2,252	$394	$3,101	$3,495
2035	$149	$1,145	$1,287	$212	$2,119	$2,330	$353	$3,264	$3,618
2036	$127	$1,205	$1,332	$188	$2,224	$2,412	$315	$3,429	$3,744
2037	$113	$1,266	$1,379	$169	$2,330	$2,497	$279	$3,596	$3,875
2038	$99	$1,328	$1,427	$147	$2,437	$2,584	$246	$3,765	$4,011
2039	$87	$1,390	$1,477	$128	$2,546	$2,675	$215	$3,937	$4,151
2040	$75	$1,453	$1,529	$111	$2,657	$2,768	$187	$4,110	$4,297

ATTACHMENT 6 – CLOSED AND OPEN PLAN AMORTIZATION COMPARISON

Table A6.1 compares the State/Teacher Plan Unfunded Actuarial Liability (UAL) amortization if the Plan 1) remains open to new members; 2) is closed to new members as of June 30, 2015 but remains open to existing members; and 3) is closed to new members as of June 30, 2015 but remains open to existing members and the amortization date is extended to June 30, 2034.

Table A6.1
State/Teacher Plan UAL Amortization Comparison
(in millions)

FYE	Open	Closed at 6/30/2015	Closed Extended
2012	$200	$200	$200
2013	$203	$203	$203
2014	$220	$220	$220
2015	$227	$227	$227
2016	$239	$286	$234
2017	$247	$286	$234
2018	$258	$288	$236
2019	$267	$288	$236
2020	$277	$290	$237
2021	$287	$290	$237
2022	$298	$290	$238
2023	$308	$290	$238
2024	$319	$291	$239
2025	$330	$291	$239
2026	$342	$291	$239
2027	$354	$291	$239
2028	$366	$291	$239
2029	$2	$1	$228
2030	$1	$1	$228
2031	$1	$1	$227
2032	$1	$1	$227
2033	<$1	<$1	$227
2034	<$1	<$1	$227
Total	$4,746	$4,618	$5,297

Differences may occur due to rounding

ATTACHMENT 7 – COST IMPACTS

Table A7.1 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new State Employees and educators hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A7.1
Total Employer Cost for both State Employees and Teachers
(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan	No New Plan	Change
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New			
2016	$54	$286	$340	$8	$1	$1	$10	$350	$294	$56
2017	$49	$286	$335	$20	$3	$3	$27	$362	$304	$58
2018	$46	$288	$334	$31	$5	$5	$41	$375	$317	$59
2019	$43	$288	$331	$42	$7	$7	$55	$386	$328	$58
2020	$40	$290	$330	$52	$8	$8	$69	$399	$340	$58
2021	$37	$290	$327	$62	$10	$10	$82	$409	$352	$57
2022	$35	$290	$325	$72	$12	$12	$96	$421	$365	$56
2023	$32	$290	$323	$83	$13	$13	$109	$432	$378	$54
2024	$30	$291	$321	$93	$15	$15	$122	$443	$392	$52
2025	$28	$291	$319	$103	$17	$17	$136	$454	$405	$49
2026	$26	$291	$317	$113	$18	$18	$149	466	$420	$46
2027	$24	$291	$315	$123	$20	$20	$162	$477	$435	$42
2028	$22	$291	$313	$133	$21	$21	$175	$488	$450	$38
2029	$20	$1	$21	$143	$23	$23	$188	$210	$88	$122
2030	$18	$1	$19	$152	$25	$25	$202	$221	$90	$130
2031	$16	<$1	$17	$162	$26	$26	$215	$232	$93	$139
2032	$15	<$1	$15	$172	$28	$28	$228	$243	$96	$147
2033	$14	<$1	$14	$182	$29	$29	$241	$255	$99	$156
2034	$12	<$1	$12	$192	$31	$31	$254	$267	$103	$164
2035	$11	<$1	$11	$202	$33	$33	$268	$279	$106	$173
2036	$10	<$1	$10	$213	$34	$34	$281	$291	$110	$181
2037	$9	<$1	$9	$223	$36	$36	$295	$304	$114	$190
2038	$8	<$1	$8	$233	$38	$38	$309	$317	$118	$199
2039	$7	<$1	$7	$244	$39	$39	$323	$330	$122	$208
2040	$6	<$1	$6	$255	$41	$41	$337	$343	$126	$217

Differences may occur due to rounding

Table A7.2 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new State employees hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A7.2
Total Employer Cost for State Employees Only
(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan	No New Plan
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New		
2016	$22	$103	$125	$3	$0.4	$0.4	$3	$129	$108
2017	$20	$103	$123	$7	$1	$1	$9	$132	$112
2018	$19	$104	$123	$10	$2	$1	$14	$136	$117
2019	$18	$104	$121	$14	$2	$2	$18	$139	$121
2020	$16	$104	$121	$17	$3	$3	$23	$143	$126
2021	$15	$104	$120	$21	$3	$3	$27	$147	$130
2022	$14	$105	$119	$24	$4	$4	$32	$150	$135
2023	$13	$105	$118	$27	$4	$4	$36	$154	$140
2024	$12	$105	$117	$31	$5	$5	$41	$158	$145
2025	$11	$105	$116	$35	$6	$6	$46	$162	$150
2026	$10	$105	$115	$38	$6	$6	$50	$166	$155
2027	$10	$105	$114	$42	$7	$7	$55	$170	$160
2028	$9	$105	$114	$45	$7	$7	$60	$174	$166
2029	$8	<$1	$9	$49	$8	$8	$65	$74	$36
2030	$7	<$1	$8	$53	$9	$9	$70	$77	$37
2031	$7	<$1	$7	$56	$9	$9	$75	$82	$38
2032	$6	<$1	$6	$60	$10	$10	$79	$86	$39
2033	$6	<$1	$6	$64	$10	$10	$84	$90	$41
2034	$5	<$1	$5	$67	$11	$11	$89	$94	$42
2035	$5	<$1	$5	$71	$12	$12	$94	$98	$43
2036	$4	<$1	$4	$75	$12	$12	$99	$103	$45
2037	$4	<$1	$4	$79	$13	$13	$104	$107	$46
2038	$3	<$1	$3	$82	$13	$13	$109	$112	$48
2039	$3	<$1	$3	$86	$14	$14	$114	$117	$50
2040	$2	<$1	$2	$90	$15	$15	$119	$122	$51

Differences may occur due to rounding

Table A7.3 projects the total employer cost of closing the State/Teacher Plan to new entrants and enrolling new educators hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A7.3
Total Employer Costs for New Educators Only
(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan	No New Plan
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New		
2016	$32	$183	$215	$5	$0.8	$0.8	$7	$222	$186
2017	$29	$183	$212	$14	$2	$2	$18	$230	$192
2018	$27	$185	$212	$21	$3	$3	$28	$239	$200
2019	$25	$185	$210	$28	$5	$5	$37	$247	$207
2020	$24	$186	$209	$35	$6	$6	$46	$255	$215
2021	$22	$186	$208	$42	$7	$7	$55	$263	$222
2022	$21	$186	$207	$48	$8	$8	$64	$271	$231
2023	$20	$186	$205	$55	$9	$9	$73	$278	$239
2024	$18	$186	$204	$62	$10	$10	$82	$285	$247
2025	$16	$186	$203	$68	$11	$11	$90	$293	$256
2026	$15	$186	$201	$75	$12	$12	$99	$300	$265
2027	$14	$186	$200	$81	$13	$13	$107	$307	$274
2028	$13	$186	$199	$87	$14	$14	$115	$314	$284
2029	$12	<$1	$13	$93	$15	$15	$124	$136	$52
2030	$11	<$1	$11	$100	$16	$16	$132	$143	$53
2031	$10	<$1	$10	$106	$17	$17	$140	$150	$55
2032	$9	<$1	$9	$112	$18	$18	$149	$158	$57
2033	$8	<$1	$8	$119	$19	$19	$157	$165	$59
2034	$7	<$1	$7	$125	$20	$20	$165	$173	$61
2035	$7	<$1	$7	$131	$21	$21	$174	$180	$63
2036	$6	<$1	$6	$138	$22	$22	$182	$188	$65
2037	$5	<$1	$5	$145	$23	$23	$191	$196	$67
2038	$5	<$1	$5	$151	$24	$24	$200	$204	$70
2039	$4	<$1	$4	$158	$26	$26	$209	$213	$72
2040	$4	<$1	$4	$165	$27	$27	$218	$221	$75

Differences may occur due to rounding

ATTACHMENT 8 – MANAGING COST IMPACTS

Table A8.1 projects the total employer cost of closing the State/Teacher Plan to new entrants with an extended amortization schedule to 2034 and enrolling new employees hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A8.1
Total Employer Costs Extending the UAL Amortization Schedule through 2034 for All Employees
(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan	Current Plan w/o ext.
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New		
2016	$54	$234	$288	$8	$1	$1	$10	$298	$294
2017	$49	$234	$283	$20	$3	$3	$27	$310	$304
2018	$46	$236	$282	$31	$5	$5	$41	$323	$317
2019	$43	$236	$279	$42	$7	$7	$55	$334	$328
2020	$40	$237	$278	$52	$8	$8	$69	$346	$340
2021	$37	$237	$275	$62	$10	$10	$82	$357	$352
2022	$35	$238	$273	$72	$12	$12	$96	$369	$365
2023	$32	$238	$271	$83	$13	$13	$109	$380	$378
2024	$30	$239	$269	$93	$15	$15	$122	$391	$392
2025	$28	$239	$266	$103	$17	$17	$136	$402	$405
2026	$26	$239	$264	$113	$18	$18	$149	$413	$420
2027	$24	$239	$262	$123	$20	$20	$162	$424	$435
2028	$22	$239	$260	$133	$21	$21	$175	$436	$450
2029	$20	$228	$248	$143	$23	$23	$188	$436	$88
2030	$18	$228	$246	$152	$25	$25	$202	$447	$90
2031	$16	$227	$244	$162	$26	$26	$215	$458	$93
2032	$15	$227	$242	$172	$28	$28	$228	$470	$96
2033	$14	$227	$240	$182	$29	$29	$241	$481	$99
2034	$12	$227	$239	$192	$31	$31	$254	$493	$103
2035	$11	<$1	$11	$202	$33	$33	$268	$279	$106
2036	$10	<$1	$10	$213	$34	$34	$281	$291	$110
2037	$9	<$1	$9	$223	$36	$36	$295	$304	$114
2038	$8	<$1	$8	$233	$38	$38	$309	$317	$118
2039	$7	<$1	$7	$244	$39	$39	$323	$330	$122
2040	$6	<$1	$6	$255	$41	$41	$337	$343	$126

Differences may occur due to rounding

Table A8.2 projects the total employer cost of closing the State/Teacher Plan to new entrants with an extended amortization schedule to 2034 and enrolling new State employees hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A8.2
Total Employer Costs Extending the UAL Amortization Schedule through 2034 for State Employees Only
(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New	
2016	$22	$84	$106	$3	<$1	<$1	$3	$110
2017	$20	$84	$104	$7	$1	$1	$9	$113
2018	$19	$85	$104	$10	$2	$2	$14	$117
2019	$18	$85	$103	$14	$2	$2	$18	$121
2020	$16	$85	$102	$17	$3	$3	$23	$124
2021	$15	$85	$101	$21	$3	$3	$27	$128
2022	$14	$86	$100	$24	$4	$4	$32	$132
2023	$13	$86	$99	$27	$4	$4	$36	$135
2024	$12	$86	$98	$31	$5	$5	$41	$139
2025	$11	$86	$97	$35	$6	$6	$46	$143
2026	$10	$86	$96	$38	$6	$6	$50	$147
2027	$10	$86	$96	$42	$7	$7	$55	$151
2028	$9	$86	$95	$45	$7	$7	$60	$155
2029	$8	$82	$90	$49	$8	$8	$65	$155
2030	$7	$82	$89	$53	$9	$9	$70	$159
2031	$7	$82	$89	$56	$9	$9	$75	$163
2032	$6	$82	$88	$60	$10	$10	$79	$167
2033	$6	$82	$87	$64	$10	$10	$84	$171
2034	$5	$82	$87	$67	$11	$11	$89	$176
2035	$5	<$1	$5	$71	$12	$12	$94	$98
2036	$4	<$1	$4	$75	$12	$12	$99	$103
2037	$4	<$1	$4	$79	$13	$13	$104	$107
2038	$3	<$1	$3	$82	$13	$13	$109	$112
2039	$3	<$1	$3	$86	$14	$14	$114	$117
2040	$2	<$1	$2	$90	$15	$15	$119	$122

Differences may occur due to rounding

Table A8.3 projects the total employer cost of closing the State/Teacher Plan to new entrants with an extended amortization schedule to 2034 and enrolling new educators hired on or after July 1, 2015 in Social Security and the selected combination DB/DC plan. These projections are based on actuarial assumptions such as the rate of turnover and new hires, rate of payroll growth, and others that will vary from actual future experience.

Table A8.3

Total Employer Costs Extending the UAL Amortization Schedule through 2034 for Educators Only

(in millions)

FYE	Closed State/Teacher Plan			New Combination DB/DC				Closed & New Plan
	NC	UAL	Total	6.2% Soc Sec	1% DC	1% APP	Total New	
2016	$32	$150	$182	$5	<$1	<$1	$7	$188
2017	$29	$150	$179	$14	$2	$2	$18	$197
2018	$27	$151	$178	$21	$3	$3	$28	$206
2019	$25	$151	$177	$28	$5	$5	$37	$213
2020	$24	$152	$176	$35	$6	$6	$46	$222
2021	$22	$152	$174	$42	$7	$7	$55	$229
2022	$21	$153	$173	$48	$8	$8	$64	$237
2023	$19	$153	$172	$55	$9	$9	$73	$244
2024	$18	$153	$170	$62	$10	$10	$82	$252
2025	$16	$153	$169	$68	$11	$11	$90	$259
2026	$15	$153	$168	$75	$12	$12	$99	$267
2027	$14	$153	$167	$81	$13	$13	$107	$274
2028	$13	$153	$166	$87	$14	$14	$115	$281
2029	$12	$146	$158	$93	$15	$15	$124	$281
2030	$11	$146	$156	$100	$16	$16	$132	$288
2031	$10	$146	$155	$106	$17	$17	$140	$295
2032	$9	$145	$154	$112	$18	$18	$149	$303
2033	$8	$145	$153	$119	$19	$19	$157	$310
2034	$7	$145	$152	$125	$20	$20	$165	$318
2035	$7	<$1	$7	$131	$21	$21	$174	$180
2036	$6	<$1	$6	$138	$22	$22	$182	$188
2037	$5	<$1	$5	$145	$23	$23	$191	$196
2038	$5	<$1	$5	$151	$24	$24	$200	$204
2039	$4	<$1	$4	$158	$26	$26	$209	$213
2040	$4	<$1	$4	$165	$27	$27	$218	$221

Differences may occur due to rounding

ATTACHMENT 9 – LEGAL CONSIDERATIONS FOR CLOSED PLANS

Vesting. Governmental plans must provide full vesting of an employee's interest upon attaining normal retirement age and completion of the required years of service and any other reasonable requirements set forth in the plan. Rev. Rul. 66-11. <u>If contributions cease, or the plan terminates, then the plan must also provide 100% vesting, to the extent benefits are funded</u>. If the plan "freezes" or "closes" to new participants, the full vesting at termination clause does not activate.

Employer Contributions. Governmental plans are not subject to minimum funding standards under ERISA or the Internal Revenue Code. Accordingly, so long as full vesting is provided upon plan termination or discontinuance of contributions to the plan, the plan need only be funded to meet current or future benefit commitments, provided that funds are actually set aside to meet those commitments. Rev. Rul. 71-91 (plan that contained no funding arrangement but provided that employer would pay monthly pension benefit to employee directly did not qualify under IRC § 401(a)).

ATTACHMENT 10 - LEGAL CONSIDERATIONS FOR CHANGING RETIREMENT PLANS

In this section we cover general legal considerations that are not covered elsewhere in this report.

EMPLOYEE CHOICE

Often in discussions of changing plan design, the question is asked whether current employees can be given an individual election to participate in the new plan or stay in their current plan. Individual member selections have been the focus of concern for both the Internal Revenue Service ("IRS") and the United States Treasury Department ("Treasury") with regard to qualified governmental defined benefit plans. That concern arises because of the pre-tax nature of "picked-up" employee contributions, which all of Maine's qualified plans currently include. The IRS spent considerable time over the last five years trying to formulate and then communicate a consistent policy on how much employee choice of contribution amounts a qualified government plan may allow before the contribution amount cannot be treated as a pre-tax contribution (i.e., a picked-up contribution).

Internal Revenue Code ("Code") Code Section 414(h)(2) provides that contributions otherwise designated as employee contributions shall be treated as employer contributions if: (1) the contributions are made to a plan determined to be qualified under Code Section 401(a); (2) the plan is established by a State government or a political subdivision thereof; and (3) the contributions are "picked up" by the governmental employer.

In Revenue Ruling 2006-43 (the IRS's most recent formal guidance), the IRS summarized the requirements for a valid pick-up:

- In the first requirement for a valid pick-up, Revenue Ruling 2006-43 adds a requirement that is not in the underlying Internal Revenue Code ("Code") provision (Code Section 414(h)(2)) – formal action by the employing unit. This first prong is not implicated by the Governor's proposal.

  In the second requirement, Revenue Ruling 2006-43 incorporates into the pick-up concept the requirements that are applicable under Code Section 401(k). That is, the governmental employing unit must not permit an employee to have the right to a cash or deferred arrangement ("CODA"). This is a constriction of IRS positions in prior revenue rulings. Previously, the IRS had issued favorable private letter rulings with respect to such features as one-time irrevocable elections for each new plan that was offered to an employee (and permitting pick-ups in those cases) and with respect to pick-ups of service purchases. However, the IRS is now taking a very restrictive interpretation of the "no CODA" concept.

  From the IRS perspective, elective pick-ups (that create pre-tax treatment) for existing employees raise two types of tax issues. First, the IRS takes the position that a defined benefit plan, specifically a governmental defined benefit plan, cannot include a pre-tax elective deferral. Consequently, the IRS now asserts that elective pick-ups raise a tax qualification issue for a governmental defined benefit plan. Second, the IRS takes the position that a pick-up of elective contributions outside of a 401(k) plan cannot result in a deferral of compensation. Consequently, the IRS also asserts that there is a taxation impact for the member. ***Note:*** The IRS and Treasury do agree that a one-time irrevocable election at the commencement of employment is permissible. Their concerns involve only elections by existing employees with respect to pre-tax contributions. IRS and Treasury have also not raised concerns with regard to elections involving post-tax employee contributions by any employees.

Thus, any choice or elective feature will require an analysis of this guidance and an assessment of where the IRS and Treasury are at that point. In addition, unless clear guidance has emerged, a private letter ruling request should be filed with the Internal Revenue Service prior to the implementation of employee elections that involved picked-up contributions.

SOCIAL SECURITY COORDINATION WITH NON-SOCIAL SECURITY COVERED EMPLOYMENT

In a situation where Maine public employees will be entering Social Security, it will be important to realize that some of those employees may have government service in non-Social Security positions from their past employment (in Maine or in other states). Individuals covered by Social Security who have non-Social Security covered periods of employment may be subject to two types of Social Security reductions:

- A windfall elimination provision ("WEP") that affects the worker's Social Security benefit.
- A government pension offset provision ("GPO") that affects spouses, widows and widowers.

Windfall Elimination Provision

The Windfall Elimination Provision affects how the amount of a retirement or disability benefit is calculated if the member receives a pension from work where Social Security taxes were not taken out of their pay. In that case, a modified formula is generally used to calculate their benefit amount, resulting in a lower Social Security benefit than they otherwise would receive. The Windfall Elimination Provision primarily affects people who have earned a pension in any job where they did not pay Social Security taxes and they also worked in other jobs long enough to qualify for a Social Security retirement or disability benefit.

Government Pension Offset

If an individual receives a pension from a federal, state or local government based on work where they did not pay Social Security taxes, the Social Security spouse's or widow's or widower's benefits may be reduced.

The spouse's/widow's/widower's benefits will be reduced by two-thirds of the government pension. In other words, if such an individual gets a monthly federal civil service pension of $600, two-thirds of that, or $400, must be deducted from their Social Security benefits. For example, if the individual is eligible for a $500 spouse's, widow's or widower's benefit from Social Security, they will receive $100 per month from Social Security ($500 – $400 = $100).

However, generally, Social Security benefits as a spouse, widow or widower will not be reduced if the participant paid Social Security taxes on earnings during the last 60 months of government service.

PORTABILITY

"Portability" is a discussion that also frequently arises when considering a significant plan design change. In our experience, portability has a number of facets that should be considered.

The first facet is to what extent do policymakers wish to dedicate pension resources to short term employees. Traditional defined benefit plans tend to "spend" pension assets on longer term employees rather than shorter term employees. However, as new designs are considered, policy makers must confront the same question of the appropriate allocation of relatively scarce plan resources, regardless of the design. For example, in moving to a pure defined contribution option, should employees with less than 5 years of service be vested in their employer contribution account balance, or should those accounts be reallocated to remaining employees or used to offset employer required contributions. In the current design, there is little expended for this short term group. More benefits for this group will cost more or will reduce what is available for the longer term employee.

If policymakers do want to dedicate pension resources to short term employees, do they only want to do it for retirement benefits? Studies show that lump sum cash-outs of relatively small amounts to terminating short term employees are rarely rolled over to another retirement vehicle, but instead are spent. Plan design can mandate that vested benefits not be cashed out for some period or point that might result in higher percentages being used for retirement purposes. In some plans (e.g., defined benefit plans) this is fairly easy to do and administer. In other plans (e.g., defined contribution with participant directed investments) it is harder and costlier to do. However, it is an important consideration.

The third facet of portability is what options a plan is willing to offer when an employee is separating from employment after becoming vested in a benefit. The traditional defined benefit focuses on a lifetime stream of benefit payments. The traditional defined contribution plan often has lump sum payments, and only sometimes annuity contracts. The new hybrids often offer some degree of choice, between 100% lifetime benefits, or access to a partial lump sum with the remaining balance in lifetime benefits, etc. These plans offer a mixture of options designed to ensure a significant portion of the benefits are indeed paid as retirement benefits, as opposed to termination benefits.

IRS PROCESS

In any significant design restructuring, it will be advisable to refile with the Internal Revenue Service to assure the continued qualified status of the existing plans, as well as the initial qualified status of any new plans.

ATTACHMENT 11 – COMPARISON TO STATE/TEACHER PLAN PROVISIONS

Plan Provision	State/Teacher Plan	New Pension Plan		
		Social Security	Adjustable Pension Plan	Defined Contribution Plan
Employer Normal Cost Contribution Rate	2.94%	6.2%	1%	.50% - 1.15%
Employer UAL Cost Contribution Rate	11.76%	-	-	-
Employee Contribution Rate	7.65%	6.2%	4.5%	Employee decision
Vesting period	5 years	None	5 years	3 years
Benefit Accrual Rate	2%	n/a	1% +	n/a
Average Salary Period	High 3 years	n/a	Career average	n/a
Normal Retirement Age	60/62/65	67	65	59 1/2
Early reduction factor	Age 60 plan-2 ¼% Age 62/65 plan-6%	SS formula	7%-8%	10% penalty
Cost-of-living adjustment (COLA)	CPI based 3% Cap on $20k benefit	CPI based	Employee funded	n/a
Disability Benefit	59% average final salary		n/a	n/a

ATTACHMENT 12 – WORKING GROUP MEMBERS

Sandy Matheson, Working Group Chair, Executive Director, MainePERS

Terry Brann, State Controller, Dept. of Administrative and Financial Services

Steve Butterfield, Director of Information Services, Maine State Employees Association

Sue Campbell, President, Maine School Board Association

Dale Douglass, Executive Director, Maine School Management Association

Jon Kosinski, Government Relations, Maine Education Association

Terry McCabe, Associate Executive Director, Maine School Management Association

H. Sawin Millett, Jr., Commissioner, Dept. of Administrative and Financial Services

Joyce Oreskovich, Director, Human Resources, Dept. of Administrative and Financial Services

Chris Quint, Executive Director, Maine State Employees Association

Jennifer Smith, Legislative Coordinator, Dept. of Administrative and Financial Services

Rob Walker, Executive Director, Maine Education Association