128th Legislature – Resolve 2017, chapter 14
A Review of the Maine State Employee and Teacher Retirement Plan

State/Teacher Plan Review

REPORT TO THE JOINT COMMITTEE ON APPROPRIATIONS AND FINANCIAL AFFAIRS

April 9, 2018
Prepared by: Maine Public Employees Retirement System
And State/Teacher Plan Working Group

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The Working Group provided review of the Plan Option framework. Their participation was valuable in assessing the plan design's impact on employees' ability to create an income in later life and on employers who pay for part of this benefit and who use retirement plans to recruit and retain employees:

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Executive Summary

The 128th Legislature of the State of Maine appointed a Working Group in 2017 to evaluate and design retirement plan options for all state employees and teachers in accordance with:

1. **Retirement plan options.** The working group shall evaluate various retirement plan options, including but not limited to the:
   - A. Creation of a new tier of the current retirement plan for new hires;
   - B. Establishment of a separate and new retirement plan for new hires;
   - C. Modification of the current retirement plan for existing members and new hires;
   - D. Coverage of new hires under the United States Social Security Act; and
   - E. Establishment of supplemental voluntary retirement plans.
2. **Evaluation criteria.** In evaluating retirement plan options, the working group shall assess the likelihood of each option to:
   - A. Attract and retain new state employees and teachers;
   - B. Provide for portability that benefits employers and employees;
   - C. Meet the needs of state employees and teachers for retirement security, including providing a secure income stream in retirement;
   - D. Manage risk with predictable and realistic long-term costs and benefits;
   - E. Be administratively efficient; and
   - F. Provide financial information to employees in planning for retirement.

The Working Group consisted of representatives from the Department of Administrative and Financial Services (DAFS), Maine State Employees Association (MSEA), Maine School Management Association (MSMA), Maine Education Association (MEA), a non-voting member from the Maine Association of Retirees, and the Maine Public Employees Retirement System (MainePERS).

MainePERS created a possible retirement plan framework for the Working Group to review. This framework was designed to meet the legislative intent, the retirement security and retirement cost needs of members, and the recruitment, retention and cost needs of employers. This framework offers two tracks: one where employers would participate in Social Security and one where they would not, i.e. they would continue in a new tier of the current State/Teacher Plan.

Under this MainePERS-developed framework, employees participating in Social Security would have the choice of one of three supplemental plans – 1) a hybrid defined benefit/defined contribution option; 2) a defined benefit option; or 3) a defined contribution option. New employees hired by employers continuing without Social Security would be automatically enrolled in a defined benefit plan that meets the Internal Revenue Service safe harbor requirements. No new employees would be enrolled in the current tier of the State/Teacher Plan.

			Social Security	Open to New Members	Existing UAL	New UAL
A	New	Hybrid Defined Benefit/Defined Contribution	Yes	Yes		Shared
B	New	Defined Benefit	Yes	Yes		Shared
C	New	Defined Contribution	Yes	Yes		Shared
D	New	Tier 2 of Current State/Teacher Plan	No	Yes		Shared
		Tier 1 of Current State/Teacher Plan	No	No	State	State
		Public Safety – No Change	No	Yes	State	State

MainePERS developed this framework rather than a one-size fits all model based on the continually changing nature of the workplace, the workforce and retirement. The options included in this framework are intended to meet the current and future retirement savings needs of varying ages and the wide variation in occupations in state government and teaching. In addition, the options have incorporated many of the financial sustainability lessons learned from the intense scrutiny retirement plans have been under since 2002.

These options, how each can work, and the type of benefit each can provide are described in this report. Specific costs and benefits of each option can be developed with additional work to fully develop the variables within each option and ensure each provides an attractive, meaningful and sustainable benefit for employees.

Working Group members express no opinion on this framework at this time, and as individual organizations reserve the option to express opinions separate from the group. The group in total, however, recommends that the efforts assigned to the group continue under legislative direction until additional work can be completed to recommend this or some variation of this framework. Additional efforts start with outreach to employers and employees to fully understand their needs, what works or does not work for them in the current State/Teacher Plan, and what their needs are from a future retirement plan.

This feedback is critical in determining whether one, two or all three supplemental options will effectively meet the recruitment and retention needs of employers and the retirement security needs of employees. Retirement planning is becoming increasingly complex, and retirement plans of all types have not been fully redeveloped for an age where increasing longevity can create lengthier retirements. Additionally, retirement plan choice is permanent, but decisions on which plan to choose are often based on a person's current situation. For example, young workers may opt for the least costly option or workers of all ages may opt for more defined contribution opportunities when the markets are strong. A sound education component is required for any framework where employees have a choice of retirement plans.

Once the needs of Maine public employers and employees are identified from outreach, focus groups, surveys or other means, variables within each of the options can be developed to determine which of the options supplemental to Social Security will or will not be recommended. This analysis will include the benefit adequacy and sustainability of each option as well as affordability for both employers and employees. It will also take into account all stakeholder concerns, such as current State/Teacher Plan members and retirees who want assurance that their benefit will not be reduced to subsidize movement into Social Security and new retirement plan designs.

The MainePERS' and the PLD Advisory Committee's similar approach in recent changes to strengthen the PLD Consolidated Retirement Plan took approximately 18 months. Changing the State/Teacher Plan framework, however, is more complex and requires documenting the needs of the various stakeholders through an outreach effort. This level of effort is critical, however, to avoid the risks that exist when recommending a framework based on assumptions that may or may not be accurate.

Public safety and special plans were not addressed in this effort. These plans have traditionally had unique situations that are best studied independently and with working group members specifically knowledgeable in the unique needs.

The information in this report was developed by MainePERS for consideration by the Working Group for their continuing efforts and the Joint Committee on Appropriations and Financial Affairs for consideration in extending this effort. Working Group members express no opinion on this information at this time, and as individual organizations reserve the option to express opinions similar to or different from the information contained in this report.

Recommendation

MainePERS and the Working Group recommend that the Joint Standing Committee on Appropriations and Financial Affairs introduce a bill directing the Working Group to continue the evaluation and design of retirement plan options for state employees and teachers, and submit a supplemental report, including any proposed implementation legislation, to the 129th Legislature.

1. New State/Teacher Retirement Plan History and Overview

The 125th Legislature of the State of Maine appointed a Working Group in 2011 to develop a plan to close the current State Employee and Teacher Retirement Program (State/Teacher or current Plan) to new hires and replace it with a retirement benefit plan supplemental to Social Security for state employees and teachers hired on or after July 1, 2015. A hybrid plan consisting of ½ defined contribution and ½ defined benefit based on an innovative risk-sharing model was submitted. A second resolve requested and resulted in a full implementation plan, which was never adopted.

The 128th Legislature appointed a second Working Group in 2017 to evaluate and design retirement plan options for all state employees and teachers where new hires may be covered under the United States Social Security Act. (See Attachment 1) The current State/Teacher Plan is an Internal Revenue Service qualified replacement defined benefit plan under which members do not participate in Social Security.[1] (See Attachment 2 for history of public plans that do not participate in Social Security)

The 2017 Working Group discussed the environmental and workplace changes that have occurred since 2011 to be informed in developing retirement plans that fit the workplace and employee retirement requirements.

Retirement Plan Environment

Group and workplace retirement plans have received and continue to receive a substantial amount of scrutiny from public and private interest groups and academic centers following the 2009 recession. The recession negatively impacted defined benefit plan funding, with several groups advocating for their replacement with defined contribution plans. The recession had an equally negative impact on defined contribution plans, resulting in continuing design improvements in their ability to contribute to a secure retirement.

The use of workplace defined benefit pensions has been declining over the last decade and a half. The number of defined benefit plans has decreased in the private sector. This trend became noticeable following the 2002 market downturn when, coupled with increases in longevity, pension contribution costs began to rise. Market volatility, new accounting standards, and a lengthy low-interest rate environment continued to intertwine to further increase the unpredictability of cost and impacts on financial statements. Many private sector companies providing retirement benefits have moved to defined contribution plans for their employees to control cost and create financial statement stability. Private sector multi-employer private sector defined benefit plans, which are collectively bargained between a union and multiple employers within the same or related industries, have largely remained in place although some are facing financial challenges.

Movement into defined contribution plans shifted the responsibility to workers to manage their own retirement savings investments. This shift has not necessarily improved retirement readiness for

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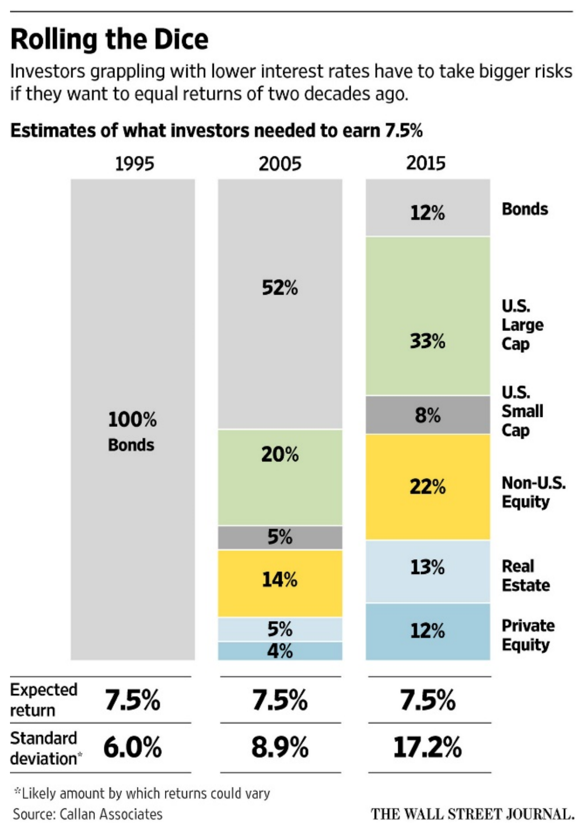
[1] See New Pension Plan Design and Implementation Plan Report to the 125th Legislature First Regular Session, March 2012 for information regarding qualified replacement plans.

many people that are no longer covered by fixed income stream retirement plans. While most employers encourage participation in their defined contribution plans, a significant percentage of participants do not fully participate or select the investment options that are best for them. Many defined contribution plan sponsors have modified their plans with successful features like opt-out, target date funds, and annuities. But these still require individual decisions, and participant success in building a secure retirement varies.

Defined benefit plans meet many of the needs that other retirement savings vehicles do not. These plans provide a defined monthly payment to retirees, acting like a paycheck in retirement. This is a model most households are used to for budgeting and spending, and one that is not easily duplicated using retirement savings account withdrawals. Therefore, Social Security continues to be an attractive retirement option for workers not covered by workplace plans or who believe they have no room to save for retirement. They know how much they can expect to receive each month and what type of budget they will have in retirement.

But some workplace defined benefit plans have faced sustainability challenges. Shifting demographics and changing economic conditions have highlighted some of the evolving structural challenges in the original design of defined benefit plans.



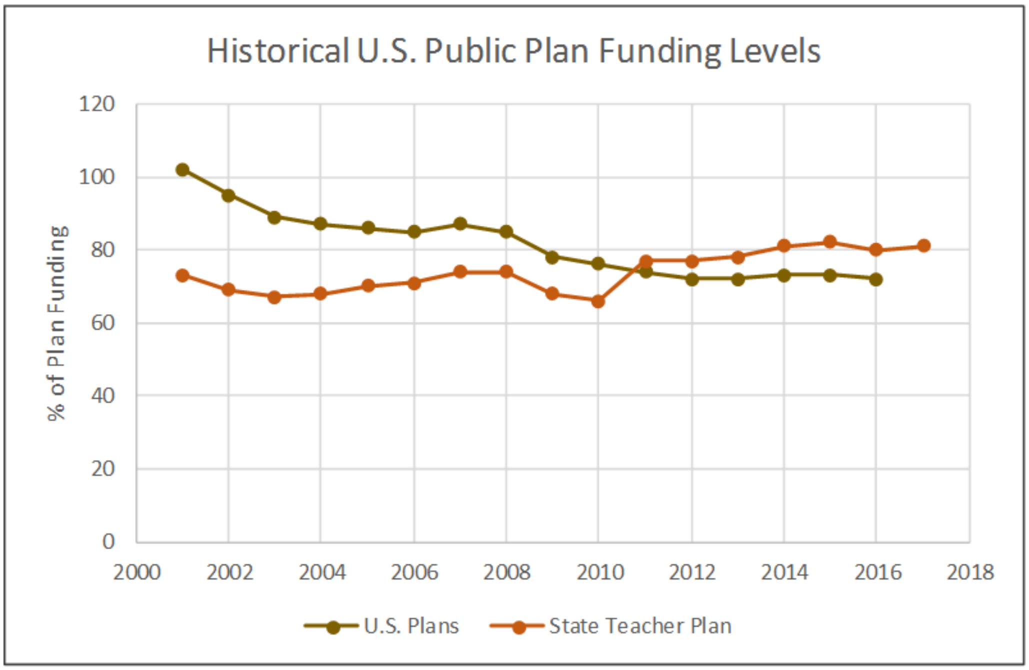
Most defined benefit plans were created when a mix of fixed income and equities, somewhere in a 40-60% continuum, safely met the investment returns needed to maintain reasonable contribution costs. Strong equity returns coupled with healthy fixed income returns may have masked the growing impact of longevity increases for a time. In addition, sustained periods of strong investment returns created deceptively low annual pension costs. Sponsors sometimes used these savings to increase plan benefits or spend the savings elsewhere.

Increased contribution rates inevitably resulted from financial market reversals that followed the lengthy high investment returns of the 1990s. Unanticipated sustained low interest rates created a gradual increase in investment risk to meet the return assumption needed to contain contribution rates. Earnings volatility created by higher risk portfolios gradually increased contribution costs and unfunded liabilities.

The changing economic environment and investment landscape has had an impact on pension plan trust fund asset allocations. While at one point in time retirement systems could earn a 7.5% return wholly invested in lower-risk bonds, a 7.5% return today requires a well-diversified portfolio that carries nearly three times the risk of a bond-only portfolio. Remaining with a total bond portfolio is equally problematic. It would have required a decrease in the earnings assumption accompanied by an increase in liabilities and contributions that can be assumed would have been unacceptable to both employers and members.[2]

The Effects of Changing Economic and Demographic Factors on Defined Benefit Plans

Changes in the aggregate actuarial funding levels of the nation's largest public retirement plans reflect the impact of increased longevity and evolving financial market conditions. Public Plans Data reflect this as average funding levels for US public plans dropped from 102.1% in 2001 to 71.5% in 2016.



Source: FY 2016 Public Funds Data
NASRA.Org

The State/Teacher Plan followed a different funding history for important reasons. Starting at 22% funding in 1986, the Plan benefitted from constitutional provisions adopted in 1995. While the average funding level of public plans was slightly more than 100% funded in 2001 due to the high-return markets of the 1990s, many of these plans had used a portion of the high returns to enhance benefit packages. When the markets experienced reversals in 2002 and 2009, these plans had higher liabilities. The State/Teacher Plan, on the other hand, had not granted additional benefits in the 1990s and continued its climb toward full funding in 2028. Most plans, like the State/Teacher Plan, implemented changes such as reducing the cost-of-living increase following the recession, but continue to trail the State/Teacher Plan in funding recovery and growth.

[2] "Multiple Employer Pension Plan Risk-Sharing Model" • MainePERS and Cheiron response to Society of Actuaries Call for Public Sector Models January 2018

Assisting Employees in Planning for Retirement

Traditional "retirement" has expanded from permanently leaving the workplace to a wide array of options including leaving the workplace to work part-time or continuing to work into a person's 70s and 80s. For an increasing number of people, "retirement" is no longer a clearly defined phase of life where individuals quit working and pursue leisure activities. This change has occurred for three primary reasons:[3]

- Improved health and increased lifespans have increased older workers desire to continue working in some fashion, i.e. in their same work, in a new career, or part-time;
- Many individuals must continue to work to pay for their health care costs;
- The 2009 recession and lingering effects have made continuing to work past their planned retirement age a necessity for more and more people.

Another significant factor that complicates retirement planning is the increasing mobility of the workforce. Incentives to retain workers for a sufficient length of time beyond their initial training or learning period is important. Teacher retention is considered highly important at the beginning of a career because in general it takes 5-7 years for new teachers to become independently functional in the complex educational environment. Further, due to the stable nature of general government services, lower turn-over may also be beneficial in that sector as opposed to the private sector that must continually innovate to remain competitive. For example, building roads or licensing vehicles or providing human service is unlikely to require changing product lines and re-staffing.

Never-the-less, worker mobility is a modern-day fact-of-life, and MainePERS actuarial data demonstrates that state and teacher turnover does occur. Mobility, coupled with decreasing predictability for when workers will retire, has created complexity in retirement plan design. While there are indications that younger workers intuitively prefer cash-in-hand because they do not trust that defined benefit plans or Social Security will be there for them, there is also speculation that populations just beginning to retire on defined contribution plans may; 1) have difficulty determining a drawdown rate; 2) underestimate their longevity; and 3) run out of money late in life.

As the retirement income requirements for employees become decreasingly predictable, the need for guidelines to save for these future demands during a person's income producing years remains. Principles for determining retirement income may include:

- Everyone should participate in plans that are *viable* and *secure*, providing income streams in retirement that act as insurance against extreme market volatility and/or outliving personal savings;
- Employers and employees together should contribute an average of 22% - 25% of base compensation to adequately fund retirement benefits that cover essential needs. Employees with short working careers (less than 35 years) need to contribute more;
- Vested tax-deferred savings should be able to be retained with the current employer, transferred to a new employer or consolidated through rollovers, and converted to annuities;

[3] Vanguard - https://personal.vanguard.com/us/insights/article/working-longer-04172012 "The good news (really!) about working longer"

- Everyone should understand how much to save for their essential needs and account for aspirational goals separately;
- Investment choices should be lower risk and limited in complexity for essential needs;
- Expanded investment choice and risk are more suited to aspirational or lifestyle goals.

New research finds that 95% of millennials are not saving adequately for retirement, and that two-thirds have saved nothing. Savings rates vary among sub-populations, with some saving more and some less. The research also suggests that the millennial savings rate should be 15-22% in addition to Social Security. This is a daunting challenge for young workers in their lower earning years also facing higher school debt than previous generations.[4]

2. Possible New Retirement Plan Framework

The legislation (See Attachment 1) creating the Working Group required that plan options covering new members that would be supplemental to Social Security be designed to:

A. Attract and retain new state employees and teachers;
B. Provide for portability that benefits employers and employees;
C. Meet the needs of state employees and teachers for retirement security, including providing a secure income stream in retirement;
D. Manage risk with predictable and realistic long-term costs and benefits;
E. Be administratively efficient; and
F. Provide financial information to employees in planning for retirement.

The State of Maine requires a diverse workforce in terms of job requirements. Some jobs require physical activity, and some are primarily office jobs. Within the range of these jobs, some are suited to longer-term employment and some may be attractive to a mobile workforce consistent with more recent trends in the national marketplace. In addition, Maine has one of the oldest median ages in the country.[5] This means retirement benefits must be highly attractive to a younger workforce to attract those workers, but also attractive to the more available labor pool of older workers, both of which may or may not be prone to be mobile.

Schools face a different recruitment and retention predicament. The workforce covered by the State Employee and Teacher Plan is restricted to educators, which has a more uniform set of educational and skill requirements than state employment. It accounts for approximately 2/3 of the membership base of the State/Teacher Plan but operates in the same limited labor pool market. Further, teaching is a challenging profession subject to high turnover in the first five to ten years of employment as individuals pursue alternative careers. This situation is not unique to Maine but may be exacerbated by Maine's location and higher rural population.

[4] Millennials' and Retirement: Already Falling Short, National Institute on Retirement Security, February 2018
[5] "These are the Youngest States in America", David Johnson, Time, By David Johnson Updated: November 6, 2017 4:50 PM ET | http://time.com/5000792/youngest-oldest-us-states/

Retirement plans are an important part of a set of recruitment and retention factors for all employers. The attractiveness of the job, growth opportunities, organizational characteristics such as workplace and learning environments, and base pay and health benefits play equally important roles. A retirement plan alone cannot overcome the recruitment challenges of the State of Maine and Maine schools, but the right plan can add to the mix of tools instead of making recruitment and retention more challenging.

Based upon legislation and an understanding of the economic, workplace and retirement environment, MainePERS presented the Working Group with a framework that expands retirement benefit choices, suggesting this could better serve employers and employees than the current one-size-fits-all model. This approach allows employers to continue in the State/Teacher Plan in a new tier or provide Social Security with employee choice of a supplemental retirement plan that best meets their retirement needs.

The goals for the new tier for new employees of employers opting to stay in the existing State/Teacher Plan are to:

- Provide a benefit equivalent to the current state teacher plan;
- Assure participants the benefit they earn will be there as planned at and throughout their retirement;
- Be managed so unfunded liabilities are minimized.

The goals for the framework of plan choice based on Social Security participation are to:

- Meet the goals of the legislative intent;
- Provide a range of tax-deferred options, instead of one-size-fits-all, designed to:
  - Provide a recruitment and retention incentive by offering choices that can appeal to different generations and contribute to a sound and secure retirement;
  - Provide a recruitment and retention incentive attractive to differing occupations and wage levels;
  - Support both long-term and mobile employment through retention incentives and portability;
- Provide opportunity for additional voluntary member retirement savings;
- Enable movement into Social Security in a manner that employers can adapt to the change within their budgetary means:
  - Eliminates the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP) that apply to retirees in the current State/Teacher Plan for new members entering plan options where they also participate in Social Security;
- Minimize the risk of creating unfunded actuarial liabilities through plan design where applicable specifically addressing or mitigating as much as possible the major known risks including investment, funding rate volatility, inflation and longevity, disability, pre-retirement death, and termination risks, and by fairly sharing financing risk between the employer and member;
- Use plan funding mechanisms designed to provide affordable costs that can be predictably maintained over time;

- Benefit state employees, teachers and the State by being in a MainePERS managed plan through administrative and investment economies of scale and consistent legislative and fiduciary oversight;
- Minimize risk to retirees;
- Recognize the need to protect legacy plan benefits and ensure benefits are not jeopardized by the cost of new plans.

Public safety and special plans were not addressed in this effort. These plans have traditionally had unique situations that are best studied independently and with Working Group members specifically knowledgeable in the unique needs.

2.1 State/Teacher Plan Preliminary Recommended Framework

MainePERS discussed various plan design options with the Working Group and presented the group with a set of options for those participating in Social Security and a new tier of the current State/Teacher Plan for those not participating in Social Security:

			Social Security	Open to New Members	Existing UAL	New UAL
A	New	Hybrid Defined Benefit/Defined Contribution	Yes	Yes		Shared
B	New	Defined Benefit	Yes	Yes		Shared
C	New	Defined Contribution	Yes	Yes		Shared
D	New	Tier 2 of Current State/Teacher Plan	No	Yes		Shared
		Tier 1 of Current State/Teacher Plan	No	No	State	State
		Public Safety – No Change	No	Yes	State	State

The four proposed new option designs incorporate the following concepts to assist employees and employers in creating a sound, sustainable retirement:

- Three options build on participation in Social Security that provide 12.4% of a 23% - 28% retirement savings goal - 6.2% from the employee and 6.2% from the employer;[6]
- The hybrid and defined benefit options are annuitized retirement benefits, and the defined contribution option offers the ability to convert to an annuitized benefit;
- The hybrid and defined contribution options include the ability to make additional contributions toward the 23-28% savings goals;
- An optional 457(b) deferred compensation plan provides the opportunity to save additional amounts toward basic retirement income and aspirational or lifestyle goals;

6 Alicia H. Munnell, Anthony Webb, and Wenliang Hou*, “How Much Should People Save?” Issue Brief No. 14-11, Center for Retirement Research at Boston College, Chestnut Hill, MA

- Liabilities in new defined benefit options will be discounted at 5-5.5%, reducing the probability of defined benefit underfunding and increasing the probability that the hybrid multiplier will exceed the floor benefit;
- All options coordinate eligibility age for benefits with traditional retirement ages to enable people to make the determination to continue working, change careers, or make other work/life balance choices.

3. Supplemental Plan Option A - Hybrid

The hybrid plan is supplemental to Social Security participation. Option A has a defined benefit (DB) and a defined contribution (DC) component with a goal to:

- Provide a total payment, when added to Social Security payments, that can be equivalent to or higher than the benefit employees receive under the current State/Teacher Plan;
- Provide employees with the opportunity to make additional contributions to a defined contribution plan to complete a retirement income stream that covers their essential living expenses;
- Minimize investment risk and share that risk, good and bad, between the employee and employer;
- Provide employees with the opportunity to make additional contributions to a deferred compensation plan to help save for lifestyle or aspirational retirement goals.

Defined Benefit Component – Adjustable Pension Plan

Employees meeting age and service requirements in Option A receive a defined, or fixed, benefit (DB). This design is called the Adjustable Pension Plan (APP), which provides a floor benefit accrual rate times the average of a pre-determined number of highest earning years times the number of years worked, plus a potential share of investment gains incorporated into the accrual rate (using a lower risk investment portfolio). This is a newly developed defined benefit model designed to provide lower risk and predictable lifelong income in later life. This design was created to mitigate and share risk (primarily investment gains and losses) between the employee and employer. Special situation benefits such as subsidized disability and death are not included in the APP.[7] Option A generally relies on Social Security to provide these benefits.[8]

Important Note: *This plan has been designed to minimize the potential of an unfunded liability through actuarial assumptions and trust fund investment allocations so that employer costs can be anticipated to be stable over time.*

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[7] A death benefit provision for members having reached an early retirement age is the exception.
[8] Social Security Disability may be reduced in the future –http://articles.washingtonpost.com/2012-05-30/politics/35456380_1_disability-program-disability-benefits-disability-trust-fund, *"Social Security disability trust fund projected to run out of cash by 2016"*

Defined Contribution Component – 401(a)

A 401(a) plan has been used for the employee defined contribution plan because currently these plans have contribution limits independent of 457(b) deferred compensation plans. This means that employees can max out both their 401(a) and their 457(b) plans. The 2018 tax reform bill originally collapsed these limits, reducing the tax-deferred amounts could contribute. Those provisions were removed from the final bill.

A 401(a) plan requires that employee contribution percentages be determined at time of hire. That determination remains in effect for the employee's entire career with that employer. Employees cannot withdraw their contributions until they terminate employment. Research indicates that mandatory employee contributions to defined contribution plans are more effective than voluntary contributions in building later life income adequacy.[9] However, the one-time contribution determination can reduce overall savings if employees fear making that commitment or are unable to at their time of hire.

Alternative Design

Option A can be designed where the employer pays the full defined benefit cost and the employee pays a mandatory contribution to their defined contribution plan. The employee selects a contribution amount at hire from a schedule of choices designed to accommodate a variety of individual situations.

4. Supplemental Plan Option B – Defined Benefit Plan

The defined benefit plan option is supplemental to Social Security Participation. Employees meeting age and service requirements in Option B receive a defined, or fixed, benefit (DB). This design is the same as the defined benefit portion of Option A. It is called the Adjustable Pension Plan (APP) which provides, as a stand-alone plan, a floor benefit accrual rate times the average of a pre-determined number of highest earning years times the number of years worked, plus a potential share of investment gains incorporated into the accrual rate (using a lower risk investment portfolio). This is a newly developed defined benefit model designed to provide lower risk and predictable lifelong income in later life. This design was created to mitigate and share risk (primarily investment gains and losses) between the employee and employer. Special situation benefits such as subsidized disability and death are not included in the APP.[10] Option B generally relies on Social Security to provide these benefits.

Important Note: *This plan has been designed to minimize the potential of an unfunded liability through actuarial assumptions and trust fund investment allocations so that employer costs can be anticipated to be stable over time.*

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[9] New York Times, Ghilarducci - http://www.nytimes.com/2012/07/22/opinion/sunday/our-ridiculous-approach-to-retirement.html?_r=0

[10] A death benefit provision for members having reached an early retirement age is the exception.

5. Supplemental Plan Option C – Defined Contribution Plan

The defined contribution plan option is supplemental to Social Security participation. It is a straightforward option where the employer contribution is fixed, and the employee contribution is selected at the time of hire. The defined contribution plan option:

- Can provide a total payment, when added to Social Security payments, that can be equivalent to or higher than the benefit employees receive under the current State/Teacher Plan depending on the level of contributions;
- Minimizes investment risk and increase retirement security through choices offered to employees;
- Provides employees with the opportunity to make additional contributions to a deferred compensation plan to help save for lifestyle or aspirational retirement goals.

The same 401(a) plan design has been used for the defined contribution plan because currently these plans have contribution limits independent of 457(b) deferred compensation plans. This means that employees can max out both their 401(a) and their 457(b) plans. The 2018 tax reform bill originally collapsed these limits, reducing the tax-deferred amounts that could be contributed. Those provisions were removed from the final bill.

A 401(a) plan requires that employee contribution rates be determined at time of hire. That determination remains in effect for the employee's entire career with that employer. Employees cannot withdraw their contributions until they terminate employment. Research indicates that mandatory employee contributions to defined contribution plans are more effective than voluntary contributions in building later life income adequacy.[11] However, the one-time contribution determination can reduce overall savings if employees fear making that commitment or are unable to at their time of hire.

Special situation benefits such as subsidized disability and death are not included in Option C, which relies on Social Security to provide these benefits.[12]

6. Option D – Defined Benefit with No Social Security Participation

Option D is included for those employers that do not want to enter Social Security. Employees meeting age and service requirements in Option D receive a defined, or fixed, benefit (DB). This design is the same as the defined benefit portion of Option A. It is called the Adjustable Pension Plan (APP) which provides, as a stand-alone plan, a floor benefit accrual rate times the average of a pre-determined number of highest earning years times the number of years worked, plus a potential share of investment gains incorporated into the accrual rate (using a lower risk investment portfolio).

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[11] New York Times, Ghilarducci - http://www.nytimes.com/2012/07/22/opinion/sunday/our-ridiculous-approach-to-retirement.html?_r=0

[12] Social Security Disability may be reduced in the future –http://articles.washingtonpost.com/2012-05-30/politics/35456380_1_disability-program-disability-benefits-disability-trust-fund, *"Social Security disability trust fund projected to run out of cash by 2016"*

This is a newly developed defined benefit model designed to provide lower risk and predictable lifelong income in later life. This design was created to mitigate and share risk (primarily investment gains and losses) between the employee and employer. Option D provides death and disability benefits because members do not participate in Social Security, which would otherwise provide these benefits.

7. Elective Deferred Compensation Plan

The optional 457(b) plan, developed in addition to Options A-D, provides employees the opportunity to save additional tax-deferred contributions to reach a retirement income stream that meets their essential and lifestyle or aspirational goals.

The 457(b) plan is designed with a limited number of low-fee investment options.[13] Research has demonstrated that most people are not investment experts, and that a wide array of investment choices is confusing and overwhelming, potentially creates higher fees, and is not necessarily as productive in building a secure and viable later-life income stream as once thought.[14]

Employees will be encouraged to retain the balances in both the defined contribution and deferred compensation plans for later-life income by leaving the balances in the two plans or rolling them over to another qualified plan rather than withdrawing the balance at termination or retirement.[15] Employees will also be given the opportunity to purchase an annuity with the combined balance at the point where they create their later-life income stream.

8. Comparison of New and Existing Plans

Options A-D were influenced by this century's two significant market disruptions – the dot.com bubble burst and the 2009 recession – and the subsequent conversions and studies of defined benefit and defined contribution plans.

Conversion by many private sector stand-alone defined benefit plans to defined contribution plans should not be used as a basis to conclude defined benefit plans are no longer relevant, or that defined contribution plans are better. The advantage of defined benefit plans is that they provide an income stream in retirement rather than a lump-sum of wealth accumulation. Most people effectively manage their monthly household expenses within a stated budget, like a paycheck when they were working. The disadvantage of defined contribution plans is that the individual bears the investment responsibility and risk that create a lump-sum at retirement which individuals must determine how to spread over their remaining lifetime without running out of money.

[13] Fees may will decrease with increased participation and money in the fund.
[14] Business Insider - http://e.businessinsider.com/public/1261891 *"The Average Person is Absolutely Horrible At Investing"*
[15] Retirement is the term used to formalize the date at which the member begins drawing a benefit from the Plan.

The disadvantages and advantages of defined benefit and defined contribution plans have been the subject of research and design improvements. Both types of plans are subject to market volatility and leaving whichever party assumes the downside investment volatility at risk. Options for strengthening the impact of market volatility on both have been introduced over the intervening years and these have been incorporated into Options A-D to help create a secure retirement for employees without excessive downside investment risk. These have also been designed to appeal to different generations.

The following chart demonstrates the variables that determine the benefit and cost in each design. These would be finalized after outreach to employers, members and other stakeholders.

	Supplemental to Social Security			In Lieu of Social Security	
	Option A Hybrid	Option B Defined Benefit	Option C Defined Contributio n	Option D Defined Benefit	Existing State/Teacher Plan
Defined Benefit					
Normal Retirement Age	Up to SS	Up to SS		Up to SS	65
Multiplier	1% - 2%	1% - 2%		1.5% - 2%	2%
Years in High Average Salary	3 – 10 yrs	3 – 10 yrs		3 – 5 yrs	3 yrs
Early Retirement or Incentive	Y or N	Y or N		Y or N	N
Vesting	5 or 5+ yrs	5 or 5+ yrs		5 yrs	5 yrs
Disability	In SS	In SS	In SS	Yes	Yes
Cost-of-Living-Adjustment	Y or N	Y or N		Y	Y
UAL or Risk-Sharing	Shared	Shared		Shared	Employer
Liabilities Discount Rate	5-5.5%	5-5.5%		5-5.5%	6.875%
Level Dollar Amortization	Y or N	Y or N		Y or N	
Level % of Pay Amortization	Y or N	Y or N		Y or N	Y
Defined Contribution					
Withdraw without penalty	59 ½ up		59 ½ up		
Investment Choice	Limited		Limited		
Employee Contribution	Determined at hire		Determined at hire		
Employer Contribution Vest	3-5 yrs		3-5 yrs		
Elective Deferred Comp	Yes				
Withdraw without penalty	59 ½	59 ½	59 ½	59 ½	59 ½
Employee Contribution	Up to max	Up to max	Up to max	Up to max	Up to max

9. Cost

Retirement benefit plans are part of an employee's total compensation and should be considered in that context. The goal in designing these options was to make each option somewhat equivalent in total mandatory cost, i.e. the basic cost that will be collected from employers and members. Total costs can vary thereafter based on the voluntary contributions members make.

The reason for this approach is that employers face the dual challenge of recruitment and balanced budgets. This could lead an employer to select a plan based on cost rather than its recruitment strengths, temporarily advantaging or disadvantaging them from attracting the available labor pool. This may be particularly problematic for the State of Maine, which has an interest in a uniformly high-quality education for all students.

The reason for keeping the base cost as low as reasonable is to meet the wide-range of budgeting and retirement readiness goals of potential new hires. Each plan option needs to provide a proportionate benefit to salary that will be earned. This means that the base benefit will not be means weighted towards higher or lower salaries. Any needed means weighting can occur through Social Security weights that benefit workers with lower lifetime earnings

Each of the potential plan options in this preliminary framework is designed to appeal to some portion of the potential workforce. No one design, unless it is very generously funded by the employer, is likely to appeal to all age, income and mobility preference ranges.

Options A, B & C are supplemental to Social Security. Members in these options will not be subject the Government Pension Offset and the Windfall Elimination Provision. They will earn Social Security benefits that are calculated as part of the total benefit Maine provides when comparing to the non-Social Security options.

The Adjustable Pension Plan design is used for all defined benefit options. This allows members to share in possible upside investment gains while retaining a guaranteed that they will receive a floor benefit, i.e. they will know at a minimum what their benefit will be. At the same time, the Adjustable Pension Plan is designed to avoid or minimize any employer UAL.

Employer Cost Growth Curve

Total newly designed retirement plan costs will initially be a lower percentage of payroll than the legacy State/Teacher Plan. This is because approximately 1/3 of a substantial unfunded actuarial liability remains from 1996, when a Constitutional Amendment became effective to bring the State/Teacher Plan to full funding. This initial liability will be fully paid by 2028.

Once the 1996 liability is fully paid, the State/Teacher Plan costs will be lower than the combination of the new plan options and Social Security. New unfunded liabilities, however, can still occur from current market disruptions, increases in longevity, or similar factors.

The 1996 liability is a significant portion of the State of Maine's approximately 18% of payroll retirement plan costs. Absent any significant new unfunded liabilities, State/Teacher employer retirement costs without new plan options would reduce to approximately 4% of payroll.

When entering new plan options, employer retirement benefit costs rise when entering Social Security for the reasons previously stated. However, these are quite low in the early years because they grow only as fast as new employees are hired. Further, new employees are generally less experienced than retirees or other employees they are replacing. Costs are therefore also lower initially because they are incurred on lower salaries. This shift allows for a gradual budget increase over an estimated 15 to 25-year period depending on turnover.

10. Investments

10.1 Investing the Defined Benefit Plan Assets

Employer and employee Adjustable Pension Plan (APP) DB contributions will be invested in the MainePERS co-invested trust fund. The co-invested trust fund allows for assets to be jointly invested to achieve economies of scale but accounted for separately to protect the unique purpose of the assets. In other words, the assets and earnings of the Options A, B and D defined benefit components can only be used to pay those plan options DB benefits.

Liabilities in the defined benefit plan options will be discounted at 5.5%. Investment earnings will be targeted for the current risk-free rate plus the expected real return.

MainePERS sets the asset allocation of the current State/Teacher Plan assets in accordance with a risk-based approach that reduces employer contribution rate volatility for the State of Maine. MainePERS would use this same risk framework for the A, B and D options, but with a lower long-term expected rate of return to further reduce employer expected contribution volatility.

Potential employer contribution rate volatility corresponds with the risk and return choices for retirement fund assets. The lower risk and return choice for these new options reduces the potential for employer rates to vary significantly year-to-year. The effects of a catastrophic market event such as the 2009 recession will be meaningfully diminished.

10.2 Investing the Defined Contribution Plan Assets

Throughout the private sector movement from defined benefit to 401(k) plans, sponsors provided an array of options employees could use to plan their retirement. This was based on the idea that employees know best what to do with their money.

Subsequent experience and widely fluctuating markets indicate that employees do not necessarily know best when it comes to managing their retirement funds. While a minority may, most employees are focused on their jobs and family lives and do not have the time or knowledge to be an expert in investments. Prior data demonstrates that individual investors earn substantially less than the average of the asset classes in which they invest; [16]

[16] http://www.businessinsider.com/chart-average-investor-returns-2012-12#ixzz2JIMfTi2i

An analysis by BlackRock indicates why:

> *Volatility is often the catalyst for poor decisions at inopportune times. Amidst difficult financial times, emotional instincts often drive investors to take actions that make no rational sense, but make perfect emotional sense. Psychological factors such as fear often translate into poor timing of buys and sells. Though portfolio managers expend enormous efforts making investment decisions, investors often give up these extra percentage points in poorly timed decisions. As a result, the average investor underperformed most asset classes over the past 20 years. Investors even underperformed inflation by 0.5%.*[17]

Most defined contribution plans have reduced their options for retirement savings, recognizing that most individuals need a narrower range of options specifically targeted toward retirement to succeed in reaching their retirement income needs. This can be seen in the growth of target date funds that automatically change the investment risk and make-up of the portfolio based on the date a person plans to begin to draw-down their later-life income. In fact, recent research shows that the changes made in defined contribution plans may be narrowing the gap between returns that can be created in defined contribution plans and defined benefit plans.[18]

Options A and C and the deferred contribution plan will include a limited range of options designed to provide a sound retirement.

11. Stakeholder Considerations

11.1 State/Teacher Plan Members and Retirees

Retirees and current members who will receive a benefit under the State/Teacher Plan question whether the adoption of a new plan will cause the Legislature to reduce State/Teacher Plan benefits at some point in the future to pay for these new benefits. The transition can be phased into newer plans to further protect the legacy State/Teacher Plan by maintaining similar retirement benefit payments when the 1996 UAL is fully paid. This can be accomplished by various means, including reducing the discount rate on liabilities to move toward immunization of these liabilities.

11.2 Employers

Employers of members in this plan are the State of Maine and School Units. The concerns of each group are related, but different.

Currently, School Units pay the normal costs for their employees that are in the State/Teacher Plan. The State of Maine pays the normal costs for state employees, and UAL costs for all Plan members. State employees are approximately 40% of the total covered lives while teachers make up the remaining approximate 60%.

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[17] http://www.businessinsider.com/chart-average-investor-returns-2012-12#ixzz2JIMfTi2i
[18] Sandy Halim, CFA, CPA and Maaike van Bragt, PhD “Defined Contribution Plans Have Come a Long Way!, February 2018, CEM Benchmarking

A member's employer must remit payment to Social Security. This means School Units will be directly responsible for those costs. There is no similar federal requirement that employers pay the costs of the supplemental plan options.

Social Security and optional retirement plan costs may be a concern for some or many School Units. This is because these would be additional costs which could strain their budgets.

11.2.1 Addressing Cost Concerns

This framework addresses school cost concerns in two ways:

- Option D provides a retirement plan designed to avoid an unfunded actuarial liability and therefore have predictable costs and does not participate in Social Security.
- Options A, B and C cumulative costs are lower in the early years because they grow only as fast as new employees are hired. Further, new employees are generally less experienced than retirees or other employees they are replacing. Costs are therefore also lower initially because they are incurred on lower salaries. This shift allows for a gradual budget increase over an estimated 15 to 25-year period depending on turnover.

12. Plan Qualification

All retirement plans are required to satisfy rules of the Internal Revenue Service (IRS) to provide tax-deferral advantages for employees. The current State/Teacher Plan and other plans MainePERS administers most recently were determined by the IRS in 2014 to be qualified for following required law and regulations.

The new framework and plan options should be submitted for IRS approval in the same manner as the State/Teacher Plan. MainePERS and its pension counsel and actuarial consultants would prepare the plan qualification documents, submit them to the IRS, and work with the IRS to receive final qualification for the plan.

The Adjustable Pension Plan is a relatively new plan design created in response to issues surrounding some defined benefit plans today. The design has been approved and adopted by some private sector employers. See Attachment 3 for a summary description from when MainePERS proposed this design in 2013.

MainePERS, its pension counsel, and its actuarial consultant do not anticipate substantive qualification issues with the options in this framework.

12.1 Entering Social Security

Social Security taxes were first collected in 1937. The funding mechanism for the Social Security program was officially established in the Internal Revenue Code as the Federal Insurance Contributions Act (FICA). Under the original Social Security Act of 1935, state and local government employees were excluded from Social Security coverage because of unresolved legal questions regarding the Federal government's authority to tax state and local governments. Beginning in 1951, states were allowed to enter into voluntary agreements with the Federal government to provide

Social Security coverage to public employees. These arrangements are called “Section 218 Agreements” because they are authorized by Section 218 of the Social Security Act.

State/Teacher Plan Current Social Security Status

State employees and teachers who participate in a Maine-sponsored retirement plan are currently not covered by Social Security. A government employee is excluded from Social Security coverage if he or she is (1) a member of a qualified replacement plan, and (2) not in a position that is covered by a Section 218 Agreement for that government.

The following are true for members of the State/Teacher Plan who are, therefore, excluded from Social Security:

- 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.

Obtaining Social Security Coverage for New Hires

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) Options A-C 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.

The purpose of this Section is to discuss these two separate "routes" to Social Security coverage, including the comparative advantages and disadvantages of each.

Route 1: If Options A-C do not Satisfy the Requirements of a Qualified Replacement Plan

Options A-C include Social Security coverage with either a defined benefit plan, a defined contribution plan, or a defined benefit plan with defined contribution components. As currently configured, Options A-C could trigger mandatory Social Security for all new hires at any time the accrual rate and other benefit features do not satisfy the requirements of a qualified replacement plan. The following considerations demonstrate the potential serious challenges to this uncertain route into entering 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 Option A-C benefits in the future could automatically trigger a loss of Social Security coverage for affected employees who would be very difficult and complicated for both employees and employers. Any contemplated future change in benefit design would have to consider the potential impact to Social Security coverage;

Benefits designs that use variable benefit rates based on years of service or other factors, such as the APP, require careful consideration under the Social Security rules to determine whether the plan is a qualified replacement plan with respect to all 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: Cover New Employees' Positions under the State's 218 Agreement

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."

Considerations Regarding this Route of Entry to Social Security

The State cannot modify its Section 218 Agreement unless it conducts one or more referenda for members of Options A-C and the majority of members vote in favor of Social Security coverage. The State and the Social Security Administration would have to agree on the terms of any referendum and conduct it.

- Following a favorable referendum, the State's 218 Agreement would have to be modified with respect to employers with employees voting in the referendum.
- Once a Section 218 Agreement is modified to include a particular group of positions, those positions will always 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.

13.0 Recommendation

MainePERS and the Working Group recommend that the Joint Standing Committee on Appropriations and Financial Affairs introduce a bill directing the Working Group to continue the evaluation and design of retirement plan options for state employees and teachers, and submit a supplemental report, including any proposed implementation legislation, to the 129th Legislature.

Attachment 1 – Resolve 2017, chapter 14

Emergency preamble. Whereas, acts and resolves of the Legislature do not become effective until 90 days after adjournment unless enacted as emergencies; and

Whereas, this resolve establishes a working group to evaluate and design retirement plan options for all state employees and teachers; and

Whereas, the working group must be convened before the 90-day period expires in order that the evaluation may be completed and a report submitted in time for submission to the next legislative session; and

Whereas, in the judgment of the Legislature, these facts create an emergency within the meaning of the Constitution of Maine and require the following legislation as immediately necessary for the preservation of the public peace, health and safety; now, therefore, be it

Sec. 1 Evaluation and design of retirement benefit plan for state employees and teachers; working group established. Resolved: That the Maine Public Employees Retirement System and the Department of Administrative and Financial Services, within their existing resources, shall jointly convene and provide necessary staffing assistance to a working group to evaluate and design retirement plan options for all state employees and teachers in accordance with this section.

1. Definitions. As used in this resolve, unless the context otherwise indicates, 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 Title 5, section 17001, subsection 42.

2. 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 the commissioner's designee;

C. One member appointed by the Commissioner of Administrative and Financial Services;

D. Two members appointed by the chair of the working group from nominations submitted by the Maine Education Association;

E. Two members appointed by the chair of the working group from nominations submitted by the Maine School Management Association;

F. Two members appointed by the chair of the working group from nominations submitted by the Maine State Employees Association; and

G. One member appointed by the chair of the working group from nominations submitted by the Maine Association of Retirees, who serves as a nonvoting member of the working group.

3. Retirement plan options. The working group shall evaluate various retirement plan options, including but not limited to the:

A. Creation of a new tier of the current retirement plan for new hires;

B. Establishment of a separate and new retirement plan for new hires;

C. Modification of the current retirement plan for existing members and new hires;

D. Coverage of new hires under the United States Social Security Act;

E. Establishment of supplemental voluntary retirement plans.

4. Evaluation criteria. In evaluating retirement plan options, the working group shall assess the likelihood of each option to:

A. Attract and retain new state employees and teachers;

B. Provide for portability that benefits employers and employees;

C. Meet the needs of state employees and teachers for retirement security, including providing a secure income stream in retirement;

D. Manage risk with predictable and realistic long-term costs and benefits;

E. Be administratively efficient; and

F. Provide financial information to employees in planning for retirement.

5. Duties. In evaluating and designing retirement plan options for state employees and teachers, the working group shall consult, as needed, with experts in the retirement and investment field and shall identify the plan or plans that it recommends for consideration by the Legislature. In identifying a plan or plans, the working group shall determine the financial impact of each plan on the employee or teacher and on the State and shall develop implementation timelines and criteria for the plan or plans the working group recommends for consideration by the Legislature; and be it further

Sec. 2 Report. Resolved: That no later than January 1, 2018, the Maine Public Employees Retirement System shall submit to the Legislature the report of the working group established in section 1 on the retirement plan option or options that the working group recommends for consideration by the Legislature, including any necessary implementing legislation that, notwithstanding Joint Rule 353, is authorized for introduction to the Second Regular Session of the 128th Legislature.

Emergency clause. In view of the emergency cited in the preamble, this legislation takes effect when approved.

Attachment 2 – IRS Federal State Reference Guide Excerpt

Chapter 1 – Social Security and Government Employers

Federal tax requirements generally apply to public employers in the same way that they do to private employers. However, there are some differences arising from the unique history of laws governing social security and Medicare coverage for state and local government employees. Special provisions apply to the application of these taxes as well as certain withholding requirements.

Historical Overview

Social security taxes were first collected in 1937. The funding mechanism for the social security program was officially established in the Internal Revenue Code (IRC) as the Federal Insurance Contributions Act (FICA). Under the original Social Security Act of 1935, state and local government employees were excluded from social security coverage because of unresolved legal questions regarding the federal government's authority to impose taxes on state and local governments and their employees.

Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide social security coverage to public employees. These arrangements are called "Section 218 Agreements" because they are authorized by Section 218 of the Social Security Act. Originally, governmental entities filed with the SSA, but since 1987, the IRS has been responsible for collecting these taxes from governmental employers.

All 50 states, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have Section 218 Agreements with SSA, providing varying degrees of coverage for employees in the state.

Social security coverage of government employees varies greatly from state to state. In 26 states, at least 90% of state and local government employees work in positions covered by social security. By contrast, in California, Colorado, Louisiana, Nevada, and Texas, less than half of state and local government employees are covered. As of 2008, 27.5%, of the state and local government workforce, or 6.6 million, state and local government employees, were not covered by social security.

The largest proportion of uncovered government employees work at the local level. The majority of uncovered local government public employees are police officers, firefighters and teachers. Approximately one-fourth of the nation's public employees are not covered by social security.

The following chart includes the major historical developments since state and local employees first became eligible for social security coverage in 1951.

Key Dates

January 1, 1951	Beginning this date, states could voluntarily elect social security coverage for public employees not covered under a public retirement system by entering into a Section 218 Agreement with SSA. Prior to this date, there was no mandatory social security coverage.
January 1, 1955	Beginning this date, states could extend social security coverage to employees (other than police officers and firefighters) covered under a public retirement system.
July 1, 1966	Beginning this date, employees covered for social security under a Section 218 Agreement are automatically covered for Medicare.
April 20, 1983	Beginning this date, coverage under a Section 218 Agreement cannot be terminated unless the governmental entity is legally dissolved.
April 1, 1986	State and local government employees hired on or after this date, not already covered, are mandatorily covered for Medicare, unless specifically excluded by law. For state and local government employees hired before April 1, 1986, Medicare coverage may be elected under a Section 218 Agreement.
January 1, 1987	Beginning this date, state Social Security Administrators were no longer responsible for collecting social security contributions from public employers or for verifying and depositing the taxes owed by public employers. After 1986, public employers pay Federal Insurance Contributions Act (FICA) taxes directly to the Internal Revenue Service (IRS) in the same manner as do private employers.
July 2, 1991	Beginning this date, most state and local government employees became subject to mandatory social security and Medicare coverage, unless they are (1) members of a public retirement system, or (2) covered under a Section 218 Agreement.
August 15, 1994	The Social Security Independence and Program Improvements Act of 1994 established the SSA as an independent agency, effective March 31, 1995. This Act also increased the FICA exclusion amount for election workers from $100 to any amount less than the threshold amount mandated by law in a calendar year. (To verify the current year amount, see the SSA website.) States were authorized to amend their Section 218 Agreements to increase the FICA exclusion amount for election workers to a statutorily mandated threshold. The Act also amended Section 218 of the Act to allow all states the option to extend social security and Medicare coverage to police officers and firefighters who participate in a public retirement system. (Under previous law, only 23 states were specifically authorized to do so.)
October 21, 1998	Public Law 105-277 provided a 3-month period for states to modify their Section 218 Agreements to exclude from coverage services performed by students. This provision was effective July 1, 2000, for states that exercised the option to take this exclusion.
March 2, 2004	Public Law 108-203 enacted, requiring public employers to furnish Form SSA-1945 to public employees hired after December 31, 2004, informing them that they are earning retirement benefits not covered by social security, and closing the Government Pension Offset (GPO) loophole effective April 1, 2004.

Attachment 3 – Pensions & Investments Article

Adjustable pension plan design begins to gain converts

Benefits can shrink or grow depending on performance

By Kevin Olsen | April 29, 2013

A new pension plan design that allows employers to drastically reduce their risk while still providing lifetime income to participants is gaining support as an alternative to moving employees into a defined contribution plans.

The adjustable pension plan was conceived by executives at Cheiron Inc., originally for multiemployer plans and adapted for single-employer plans by Richard Hudson, principal consulting actuary at Cheiron in New York. Its key difference from a traditional DB plan is that the benefit received each year is adjusted from an original multiplier based on the previous year's investment performance.

The plan design shares the investment risk between employees and employers while providing more retirement income security than a typical defined contribution plan.

Earlier this month, Consumers Union, Yonkers, N.Y., reached a collective bargaining agreement with the Newspaper Guild of New York to create an adjustable pension plan that will replace the standard DB plan for guild members. The existing plan had about $42 million in assets as of Dec. 31, 2011, according to the company's most recent Form 5500 filing. That plan will be frozen on May 31, and contributions to the adjustable plan will start June 1.

Consumers Union, publisher of Consumer Reports, is the second single-employer plan to switch to the adjustable plan. Last November, The New York Times became the first with its $280 million plan for employees who belong to the newspaper guild.

The very first adopter of the adjustable plan was the Greater Boston Hospitality Employers Local 26 Trust Funds. The multiemployer plan adopted the new design on Jan. 1, 2012, moving from a 401(k) to a pension plan to provide more retirement security, according to a document on the union's website. Under its plan, participants will receive either a guaranteed floor benefit or the adjustable benefit tied to investment performance, whichever is greater. (The 401(k) plan, which had $35 million as of June 30 according to its latest 5500 filing, is still open, but there no longer is an employer contribution.)

The first APP was developed by Cheiron executives working with David Blitzstein, special assistant for multiemployer funds at the United Food and Commercial Workers International Union; Skip Halpern, president of Gallagher Fiduciary Advisors LLC; and Barry Slevin, president of law firm Slevin & Hart PC.

6% contribution

Under the Consumers Union plan, the employer will contribute a fixed 6% of salaries plus $100,000 each year. The New York Times will contribute about $9.5 million to its plan this year and a similar amount after that based on a formula.

"It will vastly reduce risk and volatility for the company and still provide a lifetime payment and PBGC insurance," said William O'Meara, president of The Newspaper Guild of New York. "We're hoping that this becomes a national model for others to adopt. There is some upside potential and very little downside for employees" compared with participant risks in a defined contribution plan.

However, both plans still need approval from the Internal Revenue Service - by July 31, 2014, for The New York Times and March 15, 2015, for Consumers Union. If the plans do not receive approval by those dates, the APP will revert to a new DC plan.

An official at the Pension Benefit Guaranty Corp., who declined to be named, said the new adjustable plan sounds like a "great idea." But the plan won't be covered by the agency unless the IRS says it is a tax-qualified plan. If that designation is granted, it will be treated like any other DB plan, the official said.

An IRS spokesman did not respond to requests for interviews. However, Mr. Hudson said he has met with IRS and Treasury Department officials and did not think it would be a problem receiving approval.

Sources said the plan design makes sense for employers with union pension plans because they have collective bargaining rights, which can often prevent, or slow, a move to DC plans.

Interest from Maine

Still, the state of Maine is considering the APP for employees and teachers participating in the $11.5 billion Maine Public Employees' Retirement System, Augusta. Cheiron is Maine's actuary.

Maine employees are exempt from Social Security and the Legislature created a task force two years ago to design a supplemental plan for new employees who would also receive Social Security for the first time. The result was a hybrid within a hybrid — half adjustable pension plan and half DC plan.

"Maine would become the first state to enter Social Security from a non-Social Security position," said Sandy Matheson, executive director of Maine PERS.

The task force has drafted legislation to create the new plan and is awaiting a bill sponsor. Ms. Matheson said it is unlikely the proposal will be picked up during the current legislative session.

"The Legislature had very specific criteria for us to work with," specifically long-term cost exposure of 2% of salaries, and the task force "agreed on the principles we wanted to see in the plan," Ms. Matheson said. One percent each would go to the DB and DC components, with a 6.2% contribution to Social Security, equaling a total 8.2% employer contribution.

The state contributes 3.67% of payroll to the state employees and teachers plan in addition to unfunded actuarially liability cost, which equals 11.59% and is expected to increase to 13.43% for the next two years.

The task force wanted to provide new hires with benefits as close as possible to the traditional pension plan, Ms. Matheson said.

Cheiron's Mr. Hudson said a plan needs to immunize retiree liabilities, instead of “letting it ride” on a 60% equity/40% fixed-income portfolio that does not take into account how much of a plan's liabilities are tied up with retirees. There should only be risk in the active group, he added.

Risk transfer

When moving to a DC plan from a DB plan, all the risk is transferred to the employee, Mr. Hudson said.

“Plans increase the risk first and then pass it on to employees. So we said we can do that without increasing the risk,” Mr. Hudson said. “If you can't handle the risk you have, how would (participants) be able to take on more risk on their own?”

Under the APP there is a cut in benefits, Mr. Hudson acknowledged, but much less than with a move to a DC plan — and there is guaranteed retirement income.

“It might be a lower benefit than the traditional defined benefit plan, but at least it's secure,” said the person from the PBGC. The official added that the adjustable plan is more cost controlled than a traditional DB plan and not as dependent on big contributions.

What differentiates the adjustable plan from a cash balance plan is that the cash balance plan benefit is determined by a benchmark such as 10-year Treasuries; the adjustable plan's benefit depends on actual investment performance of the plan.

Bruce Cadenhead, chief actuary for U.S. retirement at Mercer LLC in New York, said the adjustable pension plan is similar to the variable annuity plan design that has been around for decades but differs in that the employer still bears investment risk.

“I think it's something we're beginning to see more discussion about,” Mr. Cadenhead said. “I think (this type of plan) is promising because one of the biggest risks is more people becoming retirement ready that will outlive their money, and this design addresses all those concerns.”

The APP has an emphasis on low volatility and uses a lower discount rate. Mr. Hudson said the goal is get down to around a 6% return target with a standard deviation of about 5.5% to 6%.

'Essential principles'

The important part of the APP is that it includes all the “essential principles” for a new pension plan design such as employer contributions, pooled assets that are professionally invested and lifetime income, said Karen Ferguson, director of the Pension Rights Center, Washington. The PRC is in favor of any DB plan designs that address those principles, she added.

"It significantly reduces the risk to employers and employees," Ms. Ferguson said. "If the plan doesn't do well, then (participants) won't get a better benefit."

The adjustable plan idea probably is most appealing to unions because it helps to have bargaining power for better pension plans, Ms. Ferguson said. And unlike other alternative plan designs, the adjustable pension plan does not need legislative approval.

"It's so logical and makes so much sense," Mr. Hudson said. "When people ask why isn't everyone doing this, I just say, "I don't know.'"

http://www.pionline.com/article/20130429/PRINTSUB/304299981

Attachment 4 – Bill Directing Further Study by the Working Group

Sec. 1 Continued evaluation and design of retirement benefit plan for state employees and teachers. Resolved: That the Maine Public Employees Retirement System and the Department of Administrative and Financial Services, within their existing resources, shall jointly continue and provide necessary staffing assistance to the working group established by Resolve 2017, chapter 14.

Sec. 2 Report. Resolved: That no later than January 1, 2019, the Maine Public Employees Retirement System shall submit to the Legislature a supplemental report of the working group established by Resolve 2017, chapter 14, on the retirement plan option or options that the working group recommends for consideration by the Legislature, including any necessary implementing legislation that, notwithstanding Joint Rule 353, is authorized for introduction to the First Regular Session of the 129th Legislature.