

February 27, 2020


Senator Shenna Bellows, Senate Chair  
Representative Mike Sylvester, House Chair  
Members, Joint Standing Committee on Labor and Housing  
100 State House Station  
Augusta, ME 04333-0100

Dear Senator Bellows, Representative Sylvester, and Members of the Labor and Housing Committee:

Please accept the enclosed report on the Maine State Employee and Teacher Retirement Plan, which MainePERS developed and prepared in response to Resolve 2017, Chapter 57.

We would be pleased to respond to any questions you might have about the report.

Respectfully,



Sandra J. Matheson  
Executive Director

SJM/mg

Enclosure

128<sup>th</sup> Legislature – Resolve 2017, Chapter 57  
A Review of the Maine State Employee and Teacher Retirement Plan

# State/Teacher Plan Review

REPORT TO THE JOINT COMMITTEE ON LABOR AND HOUSING

February 28, 2020

Prepared by: Maine Public Employees Retirement System

128<sup>th</sup> Legislature – Resolve 2017, Chapter 57  
A Review of the Maine State Employee and Teacher Retirement Plan

**Table of Contents**

Executive Summary	1
1. New State/Teacher Retirement Plan History and Overview	3
2. Possible New Retirement Plan Framework	7
2.1 State/Teacher Plan Preliminary Recommended Framework	8
Attachment 1 – Resolve 2017, Chapter 14	10
Attachment 2 – IRS Federal State Reference Guide Excerpt	12
Attachment 3 – Resolve 2017, Chapter 57	14
Attachment 4 – Pensions & Investments Article	15

## Executive Summary

The 128<sup>th</sup> Legislature of the State of Maine appointed a Working Group in 2017 to evaluate and design retirement plan options for members currently in the State Employee and Teacher Retirement Program (State/Teacher Plan) 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.

This report updates the April 9, 2018 report which first responded to the original legislative request for a new retirement program. This 2020 report is written entirely by MainePERS without stakeholder participation in order to meet the February 29, 2020 extended deadline to update the April 9, 2018 report. The original goal for the updated report was to meet with stakeholders and determine their interest in a new plan design based on voluntary participation in Social Security. Events between the original report and this report made that impossible. In addition, all but two members of the original Working Group have retired or moved to other positions. As a result, MainePERS has updated the report based on our extensive experience and nationally recognized knowledge in risk-sharing plans that protect defined benefit plans in the modern economic environment. If there is interest in pursuing the framework in this paper, we can put together a plan to determine stakeholder interest.

Under this MainePERS-developed updated framework, new employees hired by employers participating in Social Security going forward would have the choice of two retirement plans supplemental to Social Security – 1) a hybrid defined benefit/defined contribution option; or 2) a defined benefit option. The defined benefit plans in these options would be based on risk or cost-sharing enabling these plans to remain well-funded without the contribution volatility of the current

State/Teacher Plan Review Report to the Joint Committee on Labor and Housing – Executive Summary

State/Teacher Plan. New employees hired by employers continuing without Social Security participation would be automatically enrolled in Tier 2 of the current State/Teacher Plan. Tier 2 would also be based on similar risk or cost-sharing strategies in order to remain well-funded without the contribution volatility of the current, or Tier 1, State/Teacher Plan. No new employees would be enrolled in the current tier (Tier 1) 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	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, the economy 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 the original 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.

Only two of the original Working Group members remain in their position. They have not reviewed this framework and therefore express no opinion at this time. Due to the unique features of public safety, 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.

Recommendation

*MainePERS recommends Legislative briefings on this and successor reports. The framework provided will allow for cost-effective, secure defined benefits while allowing employer flexibility on the decision of whether or not to participate in Social Security and avoid the current issues members face with the Government Pension Offset (GPO) and the Windfall Elimination Provision. Further work on costs and design will only be effective driven by legislative, employer, and stakeholder interest.*

## 1. New State/Teacher Retirement Plan History and Overview

The 125<sup>th</sup> 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 128<sup>th</sup> 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.<sup>1</sup> (See Attachment 2 for history of public plans that do not participate in Social Security).

This update is written entirely by MainePERS without stakeholder participation in order to meet the February 29, 2020 extended deadline to update the April 9, 2018 report (See Attachment 3). The original goal for the updated report was to meet with stakeholders and determine their interest in a new plan design based on voluntary participation in Social Security.<sup>2</sup> Events between the original report and this report made that impossible. In addition, all but two members of the original Working Group have retired or moved to other positions. As a result, MainePERS has updated the report based on our extensive experience and nationally recognized knowledge in risk-sharing plans that protect defined benefit plans in the modern economic environment. If there is interest in pursuing the framework in this paper, another effort can be initiated to determine stakeholder interest.

### 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 private sector workplace defined benefit pensions has been declining over the last decade and a half. Private sector 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 many people that are no longer covered by fixed

---

<sup>1</sup> See New Pension Plan Design and Implementation Plan Report to the 125<sup>th</sup> Legislature First Regular Session, March 2012 for information regarding qualified replacement plans - [https://www.maineopers.org/Pensions/NPP\\_Report\\_3-5-2012.pdf](https://www.maineopers.org/Pensions/NPP_Report_3-5-2012.pdf).

<sup>2</sup> See State/Teacher Plan Review, April 9, 2018 - <https://maineopers.org/Laws%20Rules%20Legislation/State%20Teacher%20Report%20to%20the%20Appropriations%20Committee%204.9.18%20FINAL.pdf>

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 individual 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 defined contribution 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.

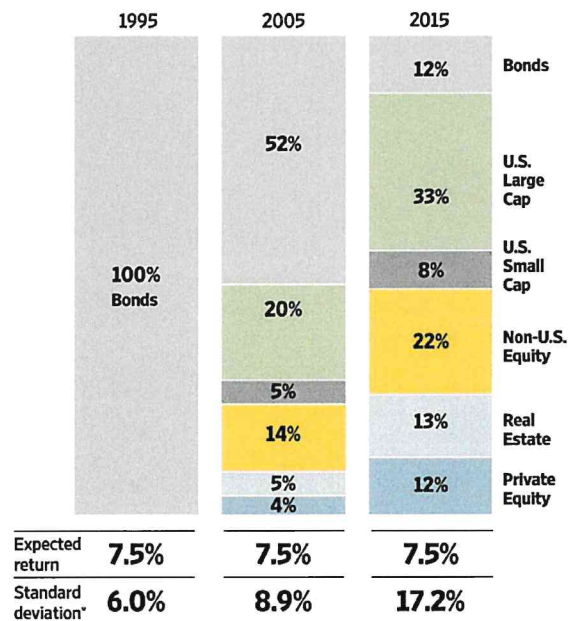
Unanticipated sustained low interest rates created a gradual increase in investment risk to meet the return assumption needed to contain contribution rates. Earnings volatility created by higher risk portfolios gradually increased contribution costs and unfunded liabilities.

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

### Rolling the Dice

Investors grappling with lower interest rates have to take bigger risks if they want to equal returns of two decades ago.

Estimates of what investors needed to earn 7.5%



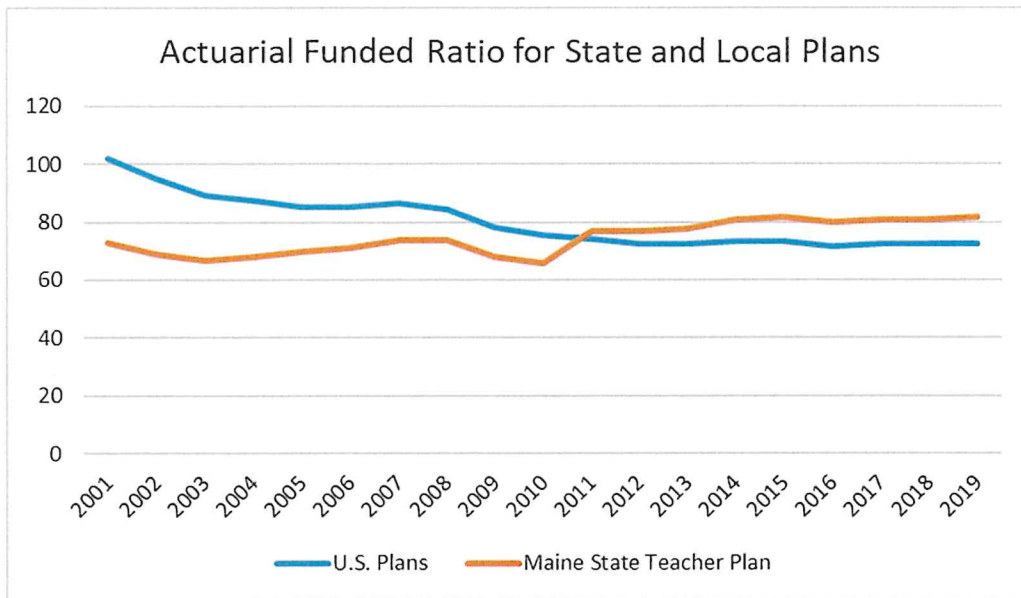
\*Likely amount by which returns could vary  
Source: Callan Associates

THE WALL STREET JOURNAL.

an increase in liabilities and contributions that can be assumed would have been unacceptable to both employers and members.<sup>3</sup>

### 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 state and local public plans dropped from 102.1% in 2001 to 73% in 2019.



The State/Teacher Plan followed a different funding history for important reasons. Starting at an extremely low 18% funded level in the 1980s, 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.

### 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

<sup>3</sup> “Multiple Employer Pension Plan Risk-Sharing Model” • MainePERS and Cheiron response to Society of Actuaries Call for Public Sector Models January 2018



where individuals quit working and pursue leisure activities. This change has occurred for three primary reasons:<sup>4</sup>

- 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. Possible 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;
- 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.

---

<sup>4</sup> Vanguard - <https://personal.vanguard.com/us/insights/article/working-longer-04172012> "The good news (really!) about working longer"

Recent 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.<sup>5</sup>

## 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.<sup>6</sup> 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.

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

---

<sup>5</sup> Millennials' and Retirement: Already Falling Short, National Institute on Retirement Security, February 2018

<sup>6</sup> "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/>

schools, but the right plan can add to the mix of tools instead of making recruitment and retention more challenging.

Maine faces a low rate of unemployment.<sup>7</sup> This can translate into public employer recruitment and retention challenges. This can translate into public employer recruitment and retention challenges. Benefits can play a significant role on which governments can compete for talent, and should be designed to weather various economic conditions without requiring modification.

MainePERS has worked with stakeholders to implement changes in the Participating Local District Consolidated Retirement Plan (PLD Plan) to protect against economic risks so that benefits can be paid throughout each member’s lifetime. The framework presented in this report reflects a growing body of knowledge about how to protect defined benefits through every member’s lifetime in a modern economic environment.

## 2.1 State/Teacher Plan Preliminary Recommended Framework

This framework was developed specifically to provide a range of options that meet the widely varying goals of employers while providing defined benefits to employees and reduce funding volatility. While the private sector largely moved to defined contribution plans resulting from the economic turmoil of 2002 and 2009 and changing accounting standards, governments for the most part have continued to focus on defined benefit plans.

Retirement plan providers in general now recognize that annuitized income in retirement is a model that works well for many people, whether from purchased annuities or defined benefits. Assuming government resources to fund pension plans are not unlimited, risk or cost-sharing is a framework that is increasingly viewed as a sound framework for defined benefits.<sup>8</sup>

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

<sup>7</sup> Maine Center for Workforce Research and Information - <https://www.maine.gov/labor/cwri/news/release.html>

<sup>8</sup> PEW Charitable Trusts “Cost-Sharing Features Can Help State Pensions Manage Economic Uncertainty” November 5, 2019 - <https://www-aws.pewtrusts.org/en/research-and-analysis/articles/2019/11/05/cost-sharing-features-can-help-state-pensions-manage-economic-uncertainty>

## 2018 State/Teacher Plan Review – Report to the Joint Committee on Labor and Housing

- Two 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;<sup>9</sup>
- The hybrid and defined benefit options are annuitized retirement benefits and 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;
- 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;
- Tier 1, or the existing State/Teacher Plan, can remain in place for current members;
- New employees can be enrolled in Tier 2, which is a risk or cost-sharing model provided in lieu of Social Security for employers that wish to remain outside of that federal system for reasons such as cost (WEP and GPO will still apply);
- 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.

The 2017 Report to the Legislature expands on these options. The difference between this framework and the 2017 report are:

- The 2017 framework included a defined contribution plan option and this framework does not;
- There are now two risk or cost-sharing options to consider in developing the new tier of the defined benefit options (See Attachment 4 for description of one of the options and <https://www.soa.org/resources/announcements/press-releases/2018/retirement-20-20/> for a description of the other).

MainePERS has done a significant amount of work in risk or cost-sharing and speaks frequently on this topic from our experience in implementing a framework in the PLD Plan. We believe a combination of the options provided in this report will provide a path forward to allowing those employers who wish to join Social Security and eliminate the effects of the WEP and GOP for future employees to provide a cost-effective, secure benefit while allowing those employers who do not wish to join Social Security a path forward to providing cost-effective, secure benefits to their employees.

---

<sup>9</sup> 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

## 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 – Resolve 2017, Chapter 57

#### Resolve, To Continue a Review of the State Employee and Teacher Retirement Plan

**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 continues a working group to evaluate and design retirement plan options for all state employees and teachers; and

**Whereas,** the working group has already been convened pursuant to Resolve 2017, chapter 14; and

**Whereas,** an interruption in the activities of the working group would be to the detriment of the goals and timelines established for the working group; 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 Resolve 2017, c. 14, §2, amended. Resolved:** That Resolve 2017, c. 14, §2 is amended to read:

**Sec. 2 Preliminary report. Resolved:** That no later than January 1, 2018, the Maine Public Employees Retirement System shall submit to the Legislature ~~the a preliminary~~ 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; and be it further

; and be it further

**Sec. 2 Resolve 2017, c. 14, §3, enacted. Resolved:** That Resolve 2017, c. 14, §3 is enacted to read:

**Sec. 3 Final report. Resolved:** That no later than December 1, 2019, the Maine Public Employees Retirement System shall submit to the joint standing committee of the Legislature having jurisdiction over retirement matters the final report of the working group established in section 1 on the retirement plan option or options that the working group recommends, including proposed legislation. The joint standing committee is authorized to introduce legislation in the 129th Legislature on matters related to the report.

; and be it further

**Sec. 3 Retroactivity. Resolved:** That this resolve applies retroactively to January 1, 2018.

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

## Attachment 4 – 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.

2018 State/Teacher Plan Review – Attachments to the Report to the Joint Committee on Labor and Housing

“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>