Testimony to the Vermont Pension Benefits, Design, and Funding Task Force

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Retirement Security
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About NIRS

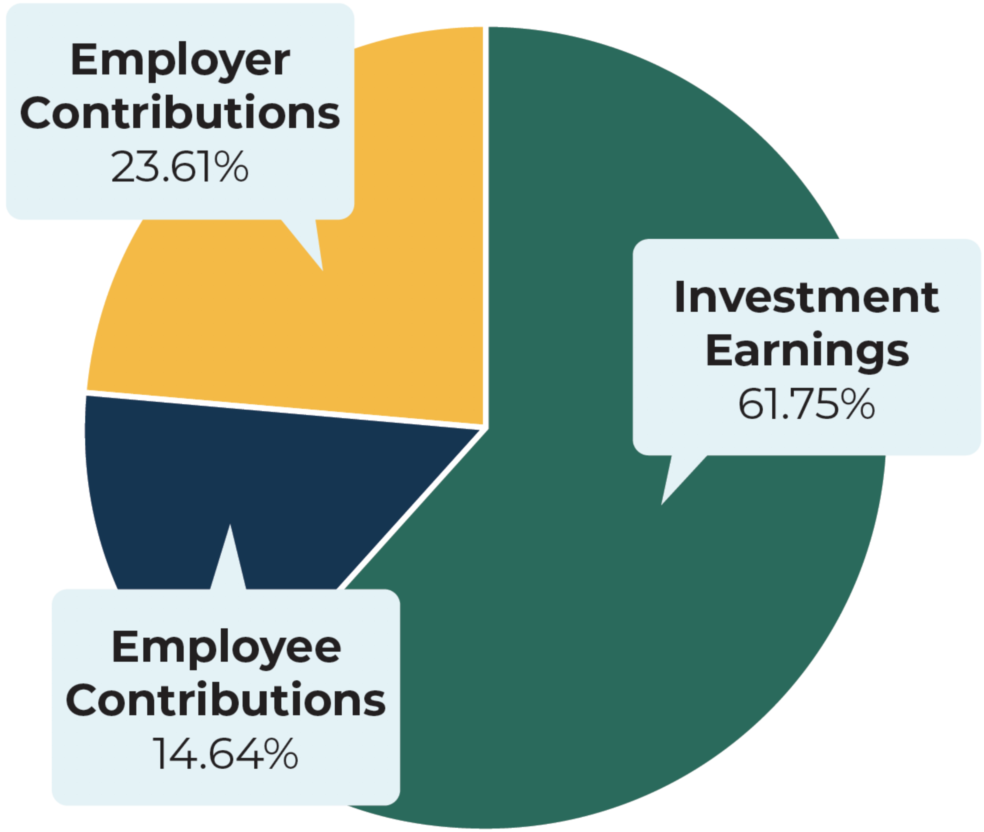
The National Institute on Retirement Security was created in 2008. We are a non-profit, non-partisan research organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers and the economy.

Located in Washington, D.C., NIRS' diverse membership includes financial institutions, actuarial firms, employee benefit plans, trade associations, and other retirement service providers.

Pension Spending has a Significant Economic Impact in VT

- Benefit Payments: $524.4 million (2018)
- Employment impact: 4,280 jobs paying $208.6 million in wages
- Economic impacts:
  - Direct: $313.4 million
  - Indirect: $188 million
  - Induced: $152.5 million
  - Total: $654 million
- Pension expenditure multiplier: $1.28 (economic output supported)
- Taxpayer investment factor: $5.41 (supported by taxes)

Investment Earnings and Employee Contributions Account for over 75% of VT Public Pension Revenues



Economic Impacts by Industry in VT

Industry	Employment Impact (# Jobs)	Labor Income Impact	Value Added Impact	Output Impact
Hospitals	265.70	$21,619,229	$24,987,208	$47,256,611
Full-service restaurants	192.80	$5,248,578	$7,602,788	$13,240,384
Limited-service restaurants	145.00	$3,745,268	$5,806,528	$11,888,657
Individual and family services	134.30	$3,603,844	$3,210,127	$5,046,953
Retail - Food and beverage stores	125.60	$4,151,017	$5,549,494	$9,191,873
Offices of physicians	123.20	$13,640,378	$16,232,966	$23,567,327
Other real estate	121.60	$2,295,107	$9,538,562	$23,805,884
Nursing and community care facilities	109.20	$5,305,780	$5,763,103	$9,500,845
Offices of other health practitioners	92.30	$5,015,096	$4,740,357	$6,892,206
All other food and drinking places	79.30	$2,625,079	$4,054,970	$5,820,189

Industry totals include the first round of impacts from pension payments to state residents, and do not account for recaptured “leakage” to or from other states.

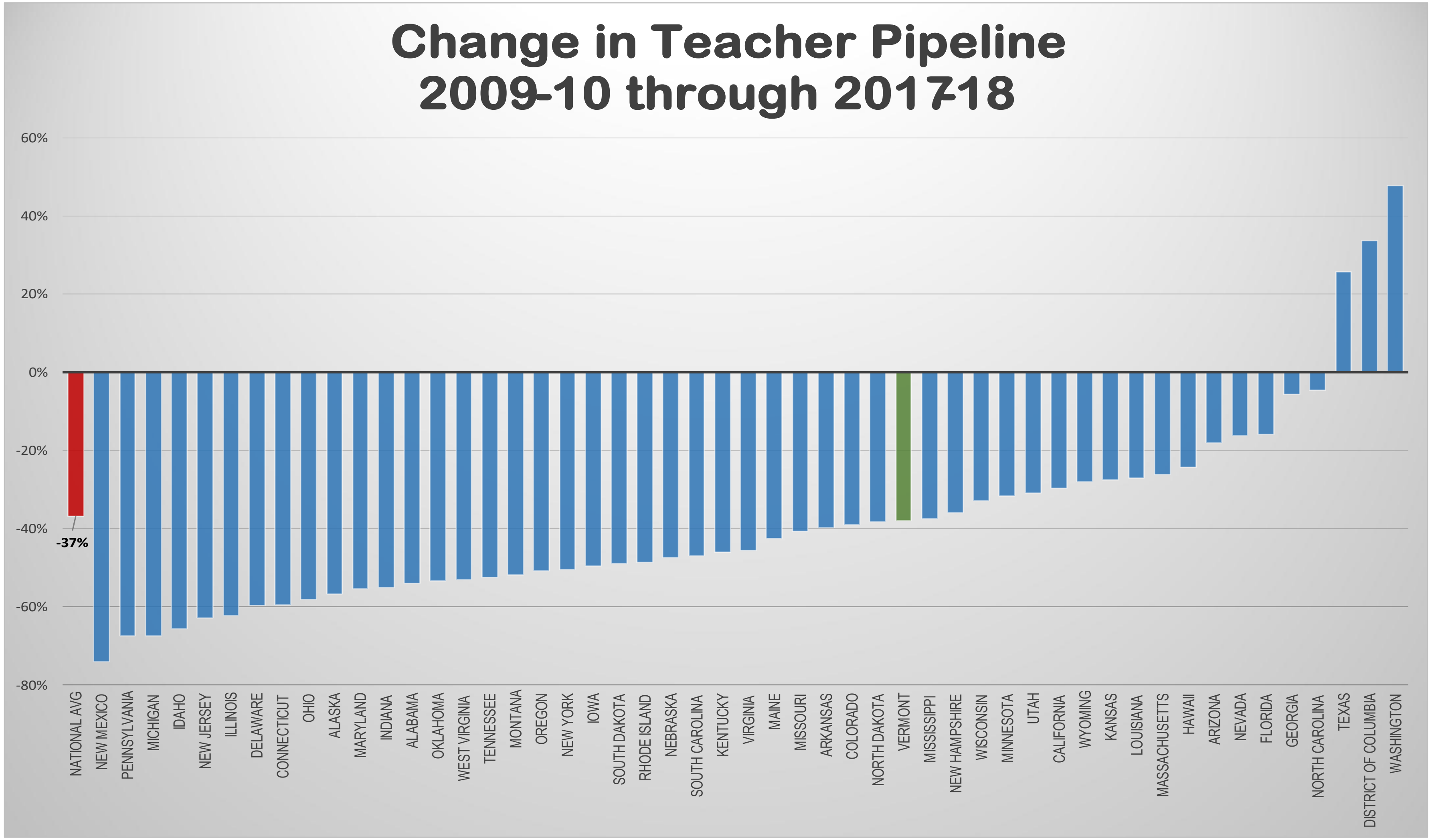
Key Considerations on Pension Policy

There is a need to balance a number of objectives, including:

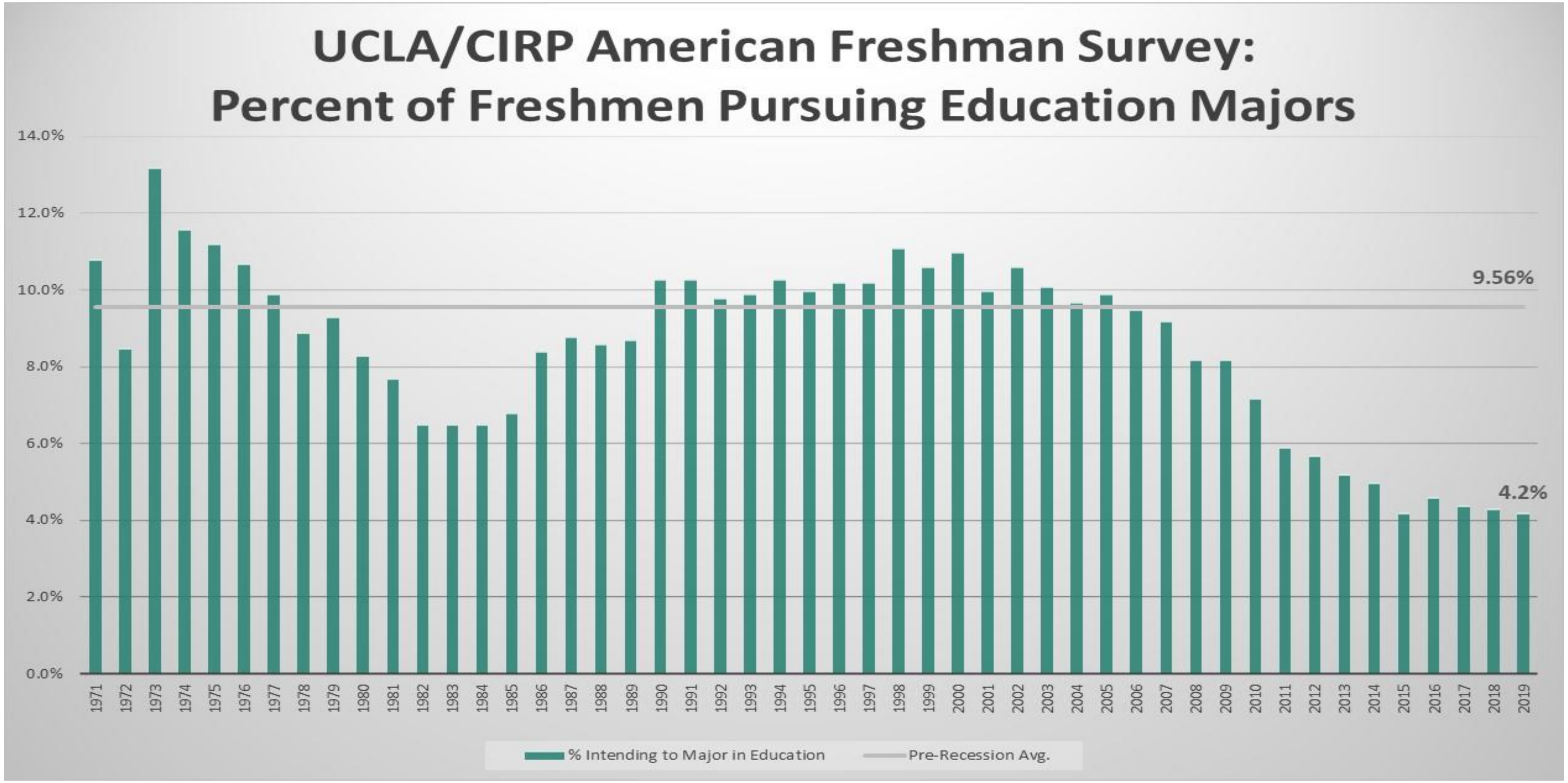
- Attracting and retaining a strong workforce for quality services
- Retirement security
- Costs and impact on state economy

- Almost all states have adopted new tiers since 2009, despite:
  - Limited short-term cost impact and
  - New members are more likely to leave.

Teacher Pipeline: Dept. of Ed Title II Data



Teacher Pipeline: Fewer Freshmen Entering Education



Younger Teachers More Likely to Leave

Separation from Service before Retirement (Due to Withdrawal and Disability):

Representative values of the assumed annual rates of withdrawal and disability are as follows:

	Rate (%)			
	Withdrawal		Disability	
Age	Male	Female	Male	Female
25	7.80%	8.30%	0.005%	0.008%
30	5.20	5.40	0.007	0.008
35	3.10	3.25	0.009	0.008
40	2.20	2.15	0.014	0.011
45	1.85	1.66	0.023	0.024
50	1.75	1.54	0.060	0.074
55	1.60	1.50	0.040	0.050
60	1.50	1.50	0.132	0.088

Similar Trend Among State Employees

Separation from Service before Retirement (Due to Withdrawal and Disability):

Representative values of the assumed annual rates of withdrawal and disability are as follows:

Rate (%)

	Withdrawal				Disability[1]		
	Groups A/D	Group C					
Age	Male/Female	Service	Male	Female	Age	Groups A/D/F	Group C
25	4.9066%	0	10.800%	21.600%	25	0.0158%	0.0770%
30	3.9275%	1	6.480%	12.960%	30	0.0204%	0.0990%
35	3.2826%	2	5.400%	10.800%	35	0.0272%	0.1325%
40	3.0392%	3	3.456%	6.912%	40	0.0406%	0.1980%
45	2.6920%	4	3.456%	6.912%	45	0.0665%	0.3235%
50	2.2464%	5	3.456%	6.912%	50	0.1055%	0.5455%
55	1.8935%	6-19	3.240%	6.480%	55	0.1862%	0.9080%
60	1.8935%				60	0.3005%	1.4640%

[1] 20% of disability incidents are assumed to be accidental for Group C and 10% of disability incidents are assumed to be accidental for all other members.

Withdrawal Group F[2]

Ultimate Rates		Increase Factors	
Age	Male/Female	Service	Male/Female
25	6.3933%	1	2.800
30	5.1207%	3	1.750
35	4.2723%	5	1.350
40	3.9542%	7	1.175
45	3.5148%	9	1.515
50	2.9240%		
55	2.4695%		
60	2.4695%		

[2] The Ultimate Rates are multiplied by the Increase Factors during the first 10 years of service.

25-year-old in 3rd year:
6.3933% * 1.75 = 11.2%

-- 11.2% Chance of quitting in the next year

Pensions Help Deliver Career Employment

Table 4
Projected Teacher Age and Service Years at Exit

Teacher Pension Plans	Median Service Years	Median Age	% with 20+ Service Years
Colorado	17	57	43% (All Education)
Connecticut	28	60	76%
Georgia	23	57	59%
Kentucky	26	54	63%
Missouri	27	55	73%
Texas	26	62	67%
6-State Average	**25**	**58**	**65%**

Note: Authors' analysis based on retirement system active membership data and actuarial assumptions as of FY 2017. 6-state averages are weighted by teacher membership count.

Source: Teacher Pensions Vs. 401k's in Six States:
https://www.nirsonline.org/reports/teacher-pensions-vs-401k/

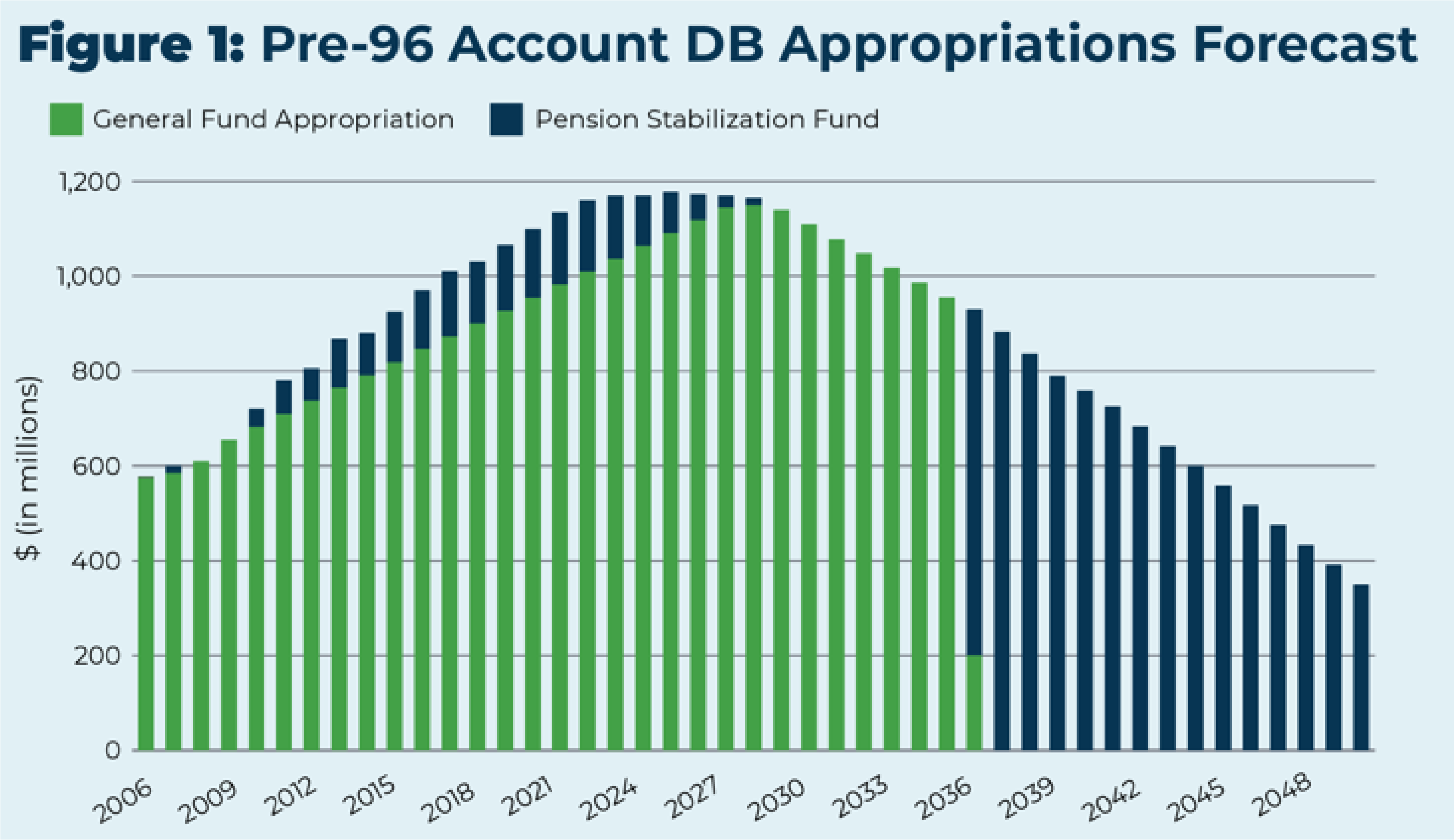
Liability Partition - Indiana Example

- **The Problem**: Indiana's Teacher Retirement Fund (TRF) was late to transition to prefunding, remaining largely pay-go until the mid-1990s.

- **The Solution**: Indiana created a new TRF plan with the same benefit structure, but which would be prefunded from the beginning. This effectively "partitioned" the existing legacy debt in the Pre-96 TRF.

- Plan administrators consistently clear that the Pre-96 TRF's funded status was low by design, but they also set out to systemically exceed their low bar for funding.
  - A Pension Stabilization Fund (PSF) was created for the legacy costs and seeded with $425 million
  - Cash flow needs were mapped out
  - A general fund appropriation would be made each year, which largely covers the pay-go benefit costs until 2037
  - The PSF also would receive lottery proceeds, and 50 percent of state reserve balances above 10 percent of appropriations. The PSF also would retain investment earnings.

Indiana Mapped Out Its Cash Flow Needs



Indiana Partition, Continued

- Over time the balance of liabilities has shifted as a greater portion of active workers are in the new, prefunded plan. Today there are more workers in the prefunded plan than in the Pre-96 plan: only 15% of active teachers remain in the Pre-96 TRF.

- When the plan was closed, liabilities continued to grow, and workers continued to accrue benefits in the Pre-96 TRF plan. However, those liabilities seem to have peaked in 2015 at $17.0 billion. Since then, the Pre-96 TRF liabilities have drifted down to $14.3 billion, which is now about 25% pre-funded.

- The success of the partition of existing liabilities in Indiana's TRF has earned the state credibility with stakeholders and external groups, including bond ratings agencies. A large part of this success has been the state's commitment to stick with the strategy in times when it was convenient and times when it wasn't.

Kentucky Uses Different Approach to Partitioning Existing Liabilities

- As of June 30, 2020, the plan was 14.2 percent funded. Due to the plan's large unfunded liabilities, the contribution rate for retirement benefits increased to 81 percent of payroll for 2020, of which 73 percent is going solely to service that was earned in the past.
- Employers reduced their plan payroll, shifting costs and causing plan payroll to fall by 24 percent.
- With this proposal, an employer's share of unfunded liabilities would no longer be driven by their share of the plan payroll, preventing employers from "gaming" the funding formula with employment practices.
- Similarities with Indiana:
    - In each case, some costs were separated from traditional plan funding methods. However, customary actuarial funding strategies were used for benefits going forward with contribution levels that were closer to the value of the benefits being earned.
    - Key difference: Indiana kept legacy plan on pay-go; Kentucky is fully funding over 30 years.

Dedicated Revenues

- **Sports Betting and Gambling**:
  - Kentucky – legislation introduced in 2020
  - Oregon – SB 1049 dedicated sports betting revenue to PERS
  - Illinois – Chicago casino will fund police and fire pensions
  - Kansas – casino revenue
  - Oklahoma – state lottery proceeds
  - New Jersey – transfer of state lottery
- **Coal Severance Tax**: Montana
- **Tobacco Settlement Securitization**: West Virginia's Teacher System
- **Stabilization Funds**: Louisiana, North Carolina, Oklahoma

Incentivize Working Longer: Many Are Currently Eligible to Retire

Plan/Tier	VSERS – Group F	VSTRS - Group A
Eligibility for Unreduced Benefit	Age 62 or 30 years	Age 60 or 30 years
	Age 65 or Rule of 87 (hired after 2008)	
Demographic details as of June 30, 2020	-2,158 of 8,028 members > age 55 -1,110 members > age 60	-2,210 of 9,996 members > age 55 -1,028 members > age 60

Considerations for Incentive Program

- Pension impact
- Retiree health impact
- Optional for worker
    - Threats to near-retirees can backfire with increased retirements
- Need to get assumptions right
    - What % work past unreduced now?
    - What % might with incentive?
- Incentive: Via pension, cash or something else?

DB Plans Can Offer Attractive Benefits to Non-Career Workers

- Colorado PERA: In lieu of refunding non-vested contributions, participants can choose:
  - Leave funds, which receive interest and 50% match
  - Employer match increases to 100% at age 65
  - Annuitization of non-vested benefits at cost

  ➔ Shares access to PERA's efficiency & longevity pooling

  ➔ Prevents cash-outs

- Efficiency of pension systems allow for generous terms that are less than the cost to your plans

Key Design Decisions for Non-Vested Provisions

- Default option
- Interest crediting – fixed or linked to assumptions
- Match – immediate or at retirement
- Annuitization – fixed or linked to assumptions

Questions and Discussion