Participating Local District (PLD) Consolidated Retirement Plan

2018 Changes Under Consideration

Prepared for Joint Committee on Appropriations and Financial Affairs 3-15-18

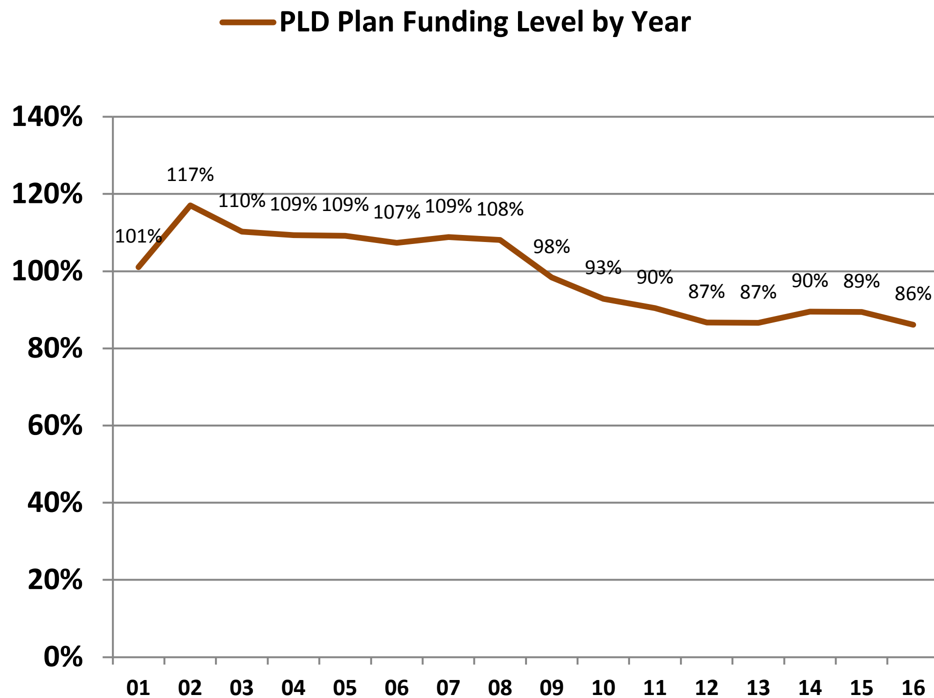
MainePERS PLD Defined Benefit Plan

- The PLD Consolidated Plan was established in 1994 (many employers participated as individual PLDs prior to 1994)
- The Plan offers multiple options, all based on:
  - The average of your highest 3 years of salary
  - The number of years you worked under the plan (also known as service credit)
  - A multiplier of 1 or 2%
- Some MainePERS employers also participate in Social Security
- MainePERS offers one defined contribution plan option to PLDs
- The PLD Advisory Committee reviews and recommends changes to the PLD Plan to the MainePERS Board of Trustees

PLD Advisory Committee

- The PLD Advisory Committee membership is set in statute and consists of 10 voting members (5 from labor and 5 from management):
  - One member designated by the MEA
  - One member designated by the AFSCME
  - One member designated by MSEA/SEIU
  - One member designated by IAFF
  - One member designated by Teamsters
  - Three members designated by MMA
  - Two members designated by MSMA
- And 2 non-voting members
  - One designated by the Governor
  - MainePERS Executive Director who serves as chair

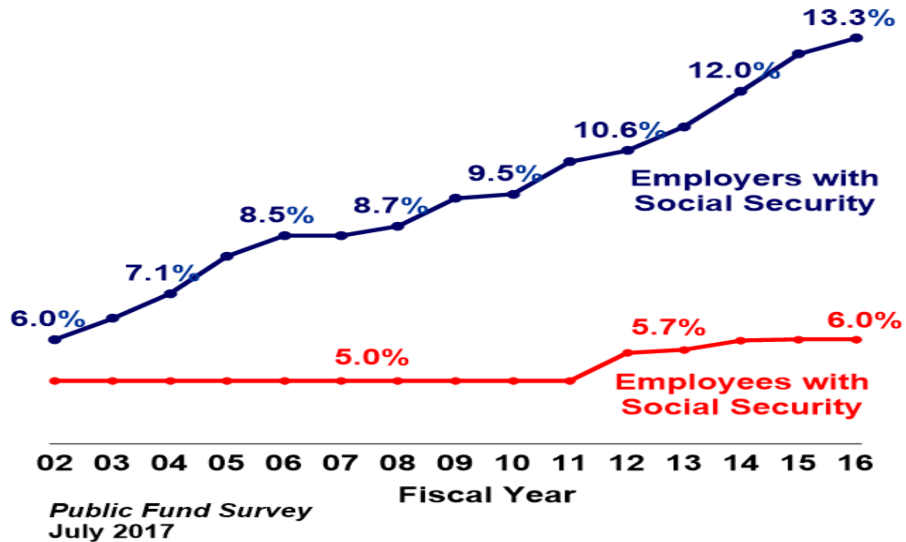
What is the Current PLD Plan Funding Status?



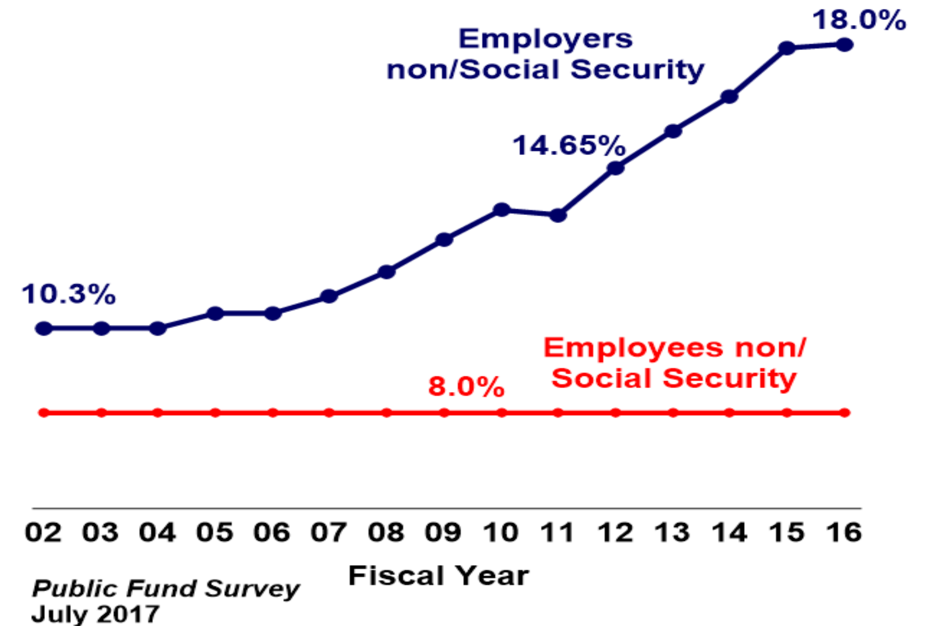
- The PLD Plan funding, like others, was harmed by the 2008-09 market crash
- Aggregate member rates have increased from 6.5% to 8% in response to market volatility of the last decade
- Aggregate PLD employer contribution rates have moved to 10% and will go higher without investment earnings regularly exceeding 10-11%
  - Long-term earnings have steadily dropped over the years along with a low-interest rate environment

How Do PLD Contribution Rates Compare with Spending on Other US Public Pensions?

US Plans with Social Security



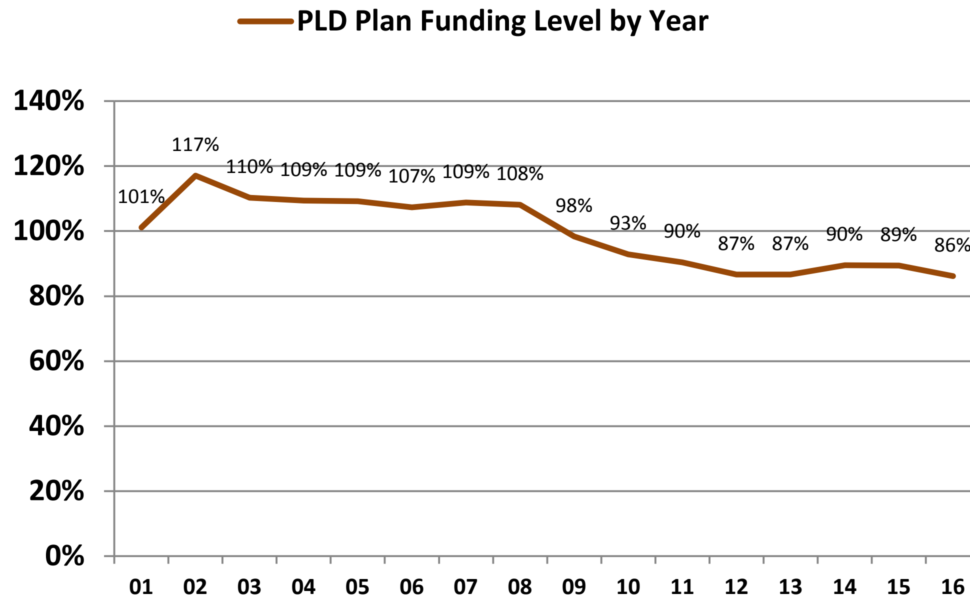
US Plans without Social Security



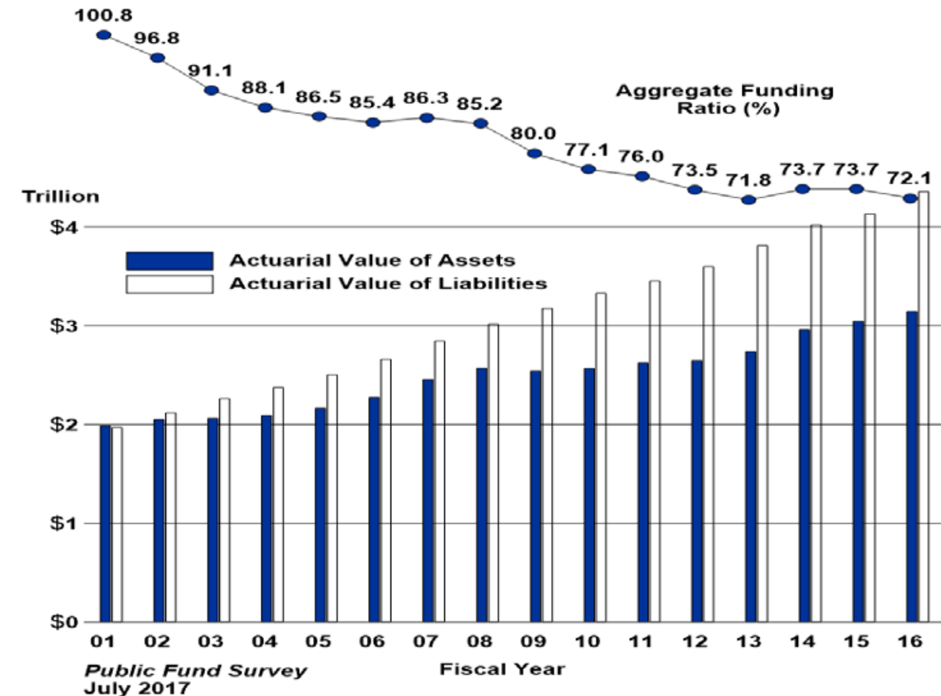
Take-away - PLD Plan contribution rates remain lower than average rates throughout the country, but tolerance for rates is often regionally determined

Is Decreasing Funding and Increasing Contribution Rates Only a PLD Plan Problem? Definitely *Not*.

PLD Consolidated Plan Funding Levels



US Public DB Plan Funding Levels



Take-away - The PLD Plan has managed market volatility better than most, but investment performance alone cannot bring the Plan back to 100% funding

Why is the Funding Lower than 15 Years Ago?

MainePERS Fiscal Year Performance Results Net of Fees										
Year	Market Value (in millions)	1 year	2 year	3 year	5 year	10 year	15 year	20 year	25 year	30 year
FY 2017	$ 13,385	12.5%	6.4%	4.9%	8.4%	4.9%	7.0%	6.3%	7.8%	7.9%
FY 2016	$ 12,283	0.6%	1.3%	6.2%	6.0%	5.2%	5.6%	6.6%	7.8%	7.9%
FY 2015	$ 12,610	2.0%	9.1%	9.8%	10.2%	5.9%	5.0%	7.4%	8.1%	8.7%
FY 2014	$ 12,732	16.7%	13.9%	9.3%	12.1%	6.9%	5.5%	8.1%	8.4%	9.5%
FY 2013	$ 12,264	11.1%	5.7%	11.0%	4.3%	6.9%	5.2%	7.5%	8.3%	8.7%
FY 2012	$ 10,470	0.6%	11.0%	11.0%	1.5%	6.3%	5.6%	7.7%	7.8%	9.7%
FY 2011	$ 10,739	22.4%	16.6%	3.4%	4.4%	5.4%	6.8%	8.3%	8.2%	9.6%
FY 2010	$ 8,934	11.1%	-5.0%	-4.4%	1.8%	2.5%	6.4%	7.5%	8.4%	9.4%
FY 2009	$ 8,291	-18.8%	-11.3%	-3.0%	1.9%	2.3%	6.8%	7.5%	9.0%	9.5%
FY 2008	$ 10,538	-3.2%	6.1%	6.5%	9.5%	5.6%	8.5%	9.3%	9.6%	10.7%
FY 2007	$ 11,031	16.2%	11.7%	11.8%	11.4%	7.7%	9.8%	9.4%	11.4%	11.0%
FY 2006	$ 9,559	7.5%	9.6%	11.9%	6.4%	7.9%	9.6%	9.2%	10.7%	
FY 2005	$ 8,921	11.8%	14.2%	11.1%	3.2%	8.8%	9.5%	10.1%	11.0%	
FY 2004	$ 8,021	16.6%	10.8%	4.3%	2.8%	9.4%	9.4%	10.8%	11.1%	

- The 2008-09 recession
- Continuing low interest rates
- Receding bull markets
- There is no indication that consistently strong market returns by themselves will restore PLD funding to 100%

Important Note – MainePERS investment returns mirror other US institutional investors

Myth
Market Recovery Means the Plan Should Be Fine

Total recovery requires two steps

1. Retirement plans first have to get back to their pre-recession level
2. Then they have to catch up to where they would have been had the recession never occurred

Example: You had $50,000 in 2007 expecting to earn 5% each year

- If all had gone as planned, you would expect to have $81,500 in 2017
- Given actual market conditions, you are more likely now to have $71,000

To fully catch up and reach $81,500, you must have earned 9.75% each year from 2009 on, or . . .

You could have added an additional $900 each year, or $8,100 total, to your original savings beginning in 2009 to get back to $81,500 today

Takeaway – Financial markets alone cannot make up the losses they create

The $2.6B in PLD Plan assets in trust would likely be closer to $3.0B if the recession had not occurred.

Recent Headlines about Public Pensions

- "NY State Teamsters pension fund cuts approved" *September 13, 2017 P&I*
- "Kentucky Pension Crisis: Local governments face 50-60% increase in pension costs" *September 7, 2013 Courier Journal*
- "Consultants recommend switching current Kentucky workers to a DC plan and voiding effects of COLA since 1996" *August 30, 2017 NASRA*
- "Milliman report lower aggregate public pension funding" *August 30, 2017 NASRA*
- "U.S. states' pension plans' funding ratio down in 2016" *June 26, 2017 Reuters*
- "Colorado PERA Board Endorses Package of Reforms" *– Colorado Public Employees Retirement Association*

The Good News: The PLD Plan has remained strong throughout these times by paying attention and making changes when needed.

First - What Has Already Been Done to Keep Plan Funding Stronger than Other Plans?

- MainePERS has made sound decisions for the PLD Plan over the last ten years in response to the recession
  - MainePERS has gradually reduced the expected investment return used to calculate funding needed to pay benefits from 8% to 6.875% as long-term investment return expectations continue to decrease in a low-interest rate environment
    - Most US plans are just beginning to phase in reductions to 7.00-7.50%
  - MainePERS has kept up the funding for demographic changes that increase plan cost, such as people living longer
    - By keeping up with changes, there are no big underfunding surprises
  - Contribution rates have been increased to help restore the funding lost in the recession
  - Some changes were made to PLD requirements and discretionary benefits in 2014
  - MainePERS invests to earn strong returns without taking undue risk

True or False?

"The only options in the current economic environment are to raise contribution rates, decrease benefits (such as freeze COLAs), or change to defined contribution plans."

Myth Buster – Looking at the Same Problem from a Different Perspective Can Create a Framework for Success

Traditional Framework

- Raise contributions to whatever level is needed to keep a plan funded
- Change benefit levels
- Lower, freeze, or eliminate COLAs
- Close the plan and replace it with a defined contribution plan to get predictable cost

New Framework

- ***Fairly*** share the market risk between all parties – employers, members and retirees
- Create minimum ***and*** maximum contribution rates to create predictable costs
- Determine which parts of the benefit are critical for a sound retirement, which are nice to have but not critical, and modify or eliminate high-cost discretionary benefits that are not critical to a sound retirement
- Determine member and employer tolerance for maximum contribution rates for a sound retirement benefit
  - Contribution rates should generally be well under the maximum, with the difference available to absorb large financial market declines

The New Framework for Creating PLD Plan Sustainability

Priority - Protect the Basic Benefit

- The basic benefit formula provides a stable and sound basis for member retirement saving and planning
- Average final compensation X multiplier X years worked = basic benefit

Part 1

Adjust Incentives, Subsidies & Discretionary Add-ons

- Adjust high-cost provisions that are not part of the basic retirement benefit

Part 2

Introduce New Market Risk Sharing Mechanisms

- Manage the negative impacts to the plan when short-term market losses erode plan funding

Protecting the Basic Benefit

- The basis of a defined benefit is the formula that is used to calculate the fixed payment that is the benefit each member will earn in retirement

Average final compensation X multiplier X years worked under plan / 12

Example: $54,000 X 2% X 20 years = $21,600 / 12 = $1,800 per month

- This benefit is protected when the plan is sheltered from market volatility and has contribution levels that employers and members are willing to pay

- This provides an attractive benefit for the workforce

"Gallup report finds many workers would leave their employers for better benefits and perks" ***September 6, NASRA***

Framework for Changes Under Consideration

Part 1- Adjusting Incentives, Subsidies & Discretionary Add-ons

- ***Retention Incentives***

Part 1 – Adjusting Incentives, Subsidies, and Discretionary Add-ons

Retention Incentives

Current Provision

- All retiring members may include up to 30 days of unused, paid sick and/or vacation leave in AFC calculation
- All retiring members may receive service credit for up to 90 days of unused, unpaid sick and/or vacation leave

Proposed Change

- This benefit would be available to members with 20 or more years of service at retirement, not to all retiring members
- This benefit would be available to members with 20 or more years of service at retirement, not to all retiring members

Part 1 – Adjusting Incentives, Subsidies, and Discretionary Add-ons

Why this Change in Retention Incentives?

- Currently all retiring members can receive this boost in their retirement benefit, regardless of years served
- Going forward, limiting this to eligible members with 20 or more years of service provides an incentive to remain with a PLD employer in the Consolidated Plan
  - Low turnover reduces overall employer costs
  - This provision assists career employees in planning their retirement
- Long-term employment is encouraged while reducing plan costs

Frameworks for Changes Under Consideration

Part 1 – Adjusting Incentives, Subsidies, & Discretionary Add-ons

- ***Benefits Subsidized by Others***
  - Early retirement
  - Retire return-to-work

Part 1 – Adjusting Incentives, Subsidies, and Discretionary Add-ons

Early Retirement Subsidy

Current Provision

- Early retirement subsidies are available to all eligible members
  - Benefits for members in the plan before July 1, 2014 are reduced by an average of 2.125% per year for repayment of additional unearned benefit
  - Benefits for members in the plan after June 30, 2014 are reduced by an average of 6% per year for repayment of additional unearned benefit

Proposed Change

- Retirement benefits for all members that retire before normal retirement age will be reduced to pay the cost to the Plan (average 6-7%+% per year)
  - ★ *Important exception: Current retirement subsidies will continue to be available to members with 20 or more years of service as of July 1, 2019*

Part 1 – Adjusting Incentives and Subsidies and Discretionary Add-ons

Why this Change in Early Retirement?

- Members that retire early create substantial additional cost to the plan which is subsidized, or paid, by employers and remaining active members
  - The average 2.125% and 6% reduction per year are not “penalties” – they are partial payments of the full cost of retiring early
- Early retirement is a personal choice of the member that is paid for by other members
- This change removes the burden on members that retire at normal retirement age of subsidizing the choice of other members who choose to retire before normal retirement age
- This change removes the additional cost created by this choice for active plan members and employers

Part 1 – Adjusting Incentives, Subsidies and Discretionary Add-ons

Retire/Rehire Subsidy

Current Provision

- Members who retire at or after their normal retirement age may return to employment for a MainePERS PLD Consolidated Plan employer and receive their full pension benefit
- There is no direct cost to the employer or rehired retiree

Proposed Change

- Members who retire at or after their normal retirement age may return to employment for a MainePERS PLD Consolidated Plan employer. The UAL will be paid on rehired retirees salary on all new rehires on or after July 1, 2019 and after 3 years for existing rehires.
- Members who retire may return to the PLD Plan, suspend their benefit, and continue to earn additional service credit until they retire again.

Part 1 – Adjusting Incentives, Subsidies and Discretionary Add-ons

Why this Change in Retire/Rehire Policy?

- Retire/rehire can reduce the stability of a multiple-employer cost-sharing Plan
  - Retire/rehire adds incremental costs to the Plan
  - Subsidizing retire/rehire creates increasingly significant cost as it becomes a regular HR practice
- Depending on the restrictions selected, employers, active members and returning retirees continue to benefit from the plan
  - Everyone benefits by keeping the plan stable, sustainable and affordable
  - The retiree benefits by continuing to receive a retirement benefit and a salary without hurting the stability of the plan

Frameworks for Changes Under Consideration

Part 1 – Adjusting Incentives, Subsidies & Discretionary Benefits

- ***Cost-of-Living Adjustment***

Part 1 – Adjusting Incentives, Subsidies, and Discretionary Benefits

Cost-of-Living Adjustment (COLA)

Current Provision

- Eligible retirees may receive up to 3% of their entire benefit based on the Consumer Price Index for Urban Consumers (CPI-U) as of the 12 months ending June 30th of each year
- COLA adjustments are cumulative
- COLAs may be reduced or frozen to protect plan funding

Proposed Change

- Eligible retirees may receive up to 2.5% of their entire benefit based on the Consumer Price Index for Urban Consumers (CPI-U) as of the 24 months ending June 30th of each year
- COLA adjustments are cumulative
- COLAs may be reduced or frozen to protect plan funding

Part 1 – Adjusting Discretionary Benefits

Why this Change in COLA?

- COLAs reflect the times
  - The PLD COLA remains high in relation to other plans which are continuing to adjust or reduce their COLA
    - For example, Texas recently enacted future COLA reductions and some COLA eliminations to save the Dallas and Houston Firefighter plans
    - Most state and local plans have reduced their COLA since 2009, some more than once
- A cumulative COLA is the single largest cost component of any defined benefit plan while providing one of the greatest benefits to members in retirement
- The change to up to 2.5% on the retiree’s benefit remains higher than or competitive with COLA’s across the country

Frameworks for Changes Under Consideration

Part 2 – Introduce New Market Risk Sharing Mechanisms

- ***Risk-sharing***

Part 2 – Introducing New Market Risk Sharing Mechanisms

Recognizing and Meeting Market Risk Head-on

- Short-term financial market ups and downs are currently the biggest risk to defined benefit plans
- Why currently?
  - Because all retirement plans (defined benefit and 401(k) or 457) are still recovering from the 2008-09 great recession, making each new down market very costly
  - While long-term financial market returns may even out over time, short-term market volatility has a significant impact on annual contributions to the plan
  - Member contributions have already risen, and short-term volatility combined with lower returning markets are creating continuing increases in employer contributions
  - Without a structured formula to moderate the effects of financial risk, employers and members may no longer wish to participate in the Plan, which places the Plan in jeopardy
- Retirement plans are most sustainable using short-term protections that support long-term plan management

- Defined benefit plans manage market risk in three ways:
  - Setting appropriate investment goals and asset allocations
  - Moderating the variability of inflows (contributions) into the plan
  - Moderating discretionary outflows (COLAs) from the plan

Part 2 – Introducing New Market Risk Sharing Mechanisms

Managing Inflows (Contributions) into the Plan

- Can inflows, or contribution volatility be moderated? *Yes.*
  - Variable contribution rates can provide both employers and members with rates that annually decrease during strong markets and increase during weak markets
    - Currently only employer rates are automatically adjusted each year based on market performance
- Can excessively high or low contribution rates be controlled? *Yes*
  - Minimum and maximum contribution rates (i.e., caps) can be successfully implemented, creating predictability and budget stability for both employers and members while simultaneously strengthening the plan

Part 2 – Introducing New Market Risk Sharing Mechanisms

Managing Discretionary Outflows in a Better Way

- Defined benefit plans have traditionally frozen COLAs when extreme market losses occur
  - This is why you increasingly see COLAs being frozen or eliminated across the country when costs get too high
  - COLA freezes are very difficult for many retirees
- Is there a better way than a freeze?
  - Yes – a partial COLA reduction formula can significantly reduce the potential for a COLA freeze
  - Depending on the extent of the market losses, COLAs would be partially reduced by varying amounts

Part 2 – Introducing New Market Risk Sharing Mechanisms

What Do These Proposed Changes Look Like?

Current Rate Structure

- Current aggregate employer rate is 10% with no upper limits
- Current aggregate member rate 8.0% is fixed, without annual market gain/loss sharing

Proposed Future Rate Structure

- Base will be FY17 calculated rates
- Employer and member cost split of future *total annual increase or decrease* is 55%/45%
- Employer aggregate cap will be 12.5%, minimum not less than 55% of total calculated normal cost
- Member aggregate cap will be 9.0%, minimum not less than less 45% of total calculated normal cost

COLA

- If any market losses are severe enough to exceed the employer and member contribution caps, the COLA formula would reduce the COLA
  - This would most likely partially reduce rather than freeze the COLA

Re-Cap of Changes Under Consideration

Protecting the Basic Benefit

- The initial benefit earned stays the same
- Protections enabling continued payment of the basic benefit are strengthened

Adjusting Discretionary Add-ons

- 30 & 90 day provisions used to encourage career employment
- Retirement subsidies paid by active members and employers are eliminated
- COLA provisions updated to match the environment and enable continued payment

Introducing New Market Risk Sharing Mechanisms

- Employer rates minimum 55% of normal cost and maximum 12.5%
- Member aggregate rates minimum 45% of normal cost and maximum 9%
- Variable COLA adjustments when excessive market volatility creates excessive losses

How Have These Changes Been Managed

- These changes were developed by MainePERS in 2016 in response to potentially continuing low-performing markets
- These changes and new framework were reviewed by the PLD Advisory Committee over an 18 month period
- A presentation was available to members, employers and retirees
  - 25 2-hour presentations throughout the state in October and November
  - Over 500 members and employers attended, and a limited number of retirees
  - Feedback was generally positive that MainePERS is protecting the plan before problems occur, although some negative feedback was received
- Input received over the 18-month period was integrated into the changes

Changes Incorporated Over 18 Months

Provision	Original	PLD Advisory Committee	Member /Employers	PLD Advisory Committee Final
Unused Vacation/Sick	Eliminate	Keep for 20 yr. service		
Early Retirement Subsidy	Eliminate	Keep for 20 yr. service as of June 30, 2018		Keep for 20 yr. service as of June 30, 2019
COLA	Reduce rates up to 2%	Up to 3% of 1st $30k indexed	Same for all	2.5% with 24 month delay
Retire/Rehire	Cost-Neutral	Re-enter the Plan		
Retire/Rehire	Cost-Neutral	Pay normal and UAL costs as of July 1, 2018 or return to employment as a member in the Plan	Pay normal and UAL costs after current agreements expire and as of July 1, 2018 on new, or return to employment as a member in the Plan	Pay UAL costs on new hires as of July 1, 2018 and on current agreements after 3 years or July 1, 2021, or return to employment as a member in the Plan