National Public Pension Trends: What They Mean for Texas

(and how they relate to TCDRS)

TCDRS Annual Conference

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TEXAS COUNTY & DISTRICT RETIREMENT SYSTEM

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It's No Secret

- The investment markets have been volatile for the last 12 years.
- 41 states enacted significant legislation to at least one state retirement plan in 2010 and 2011.

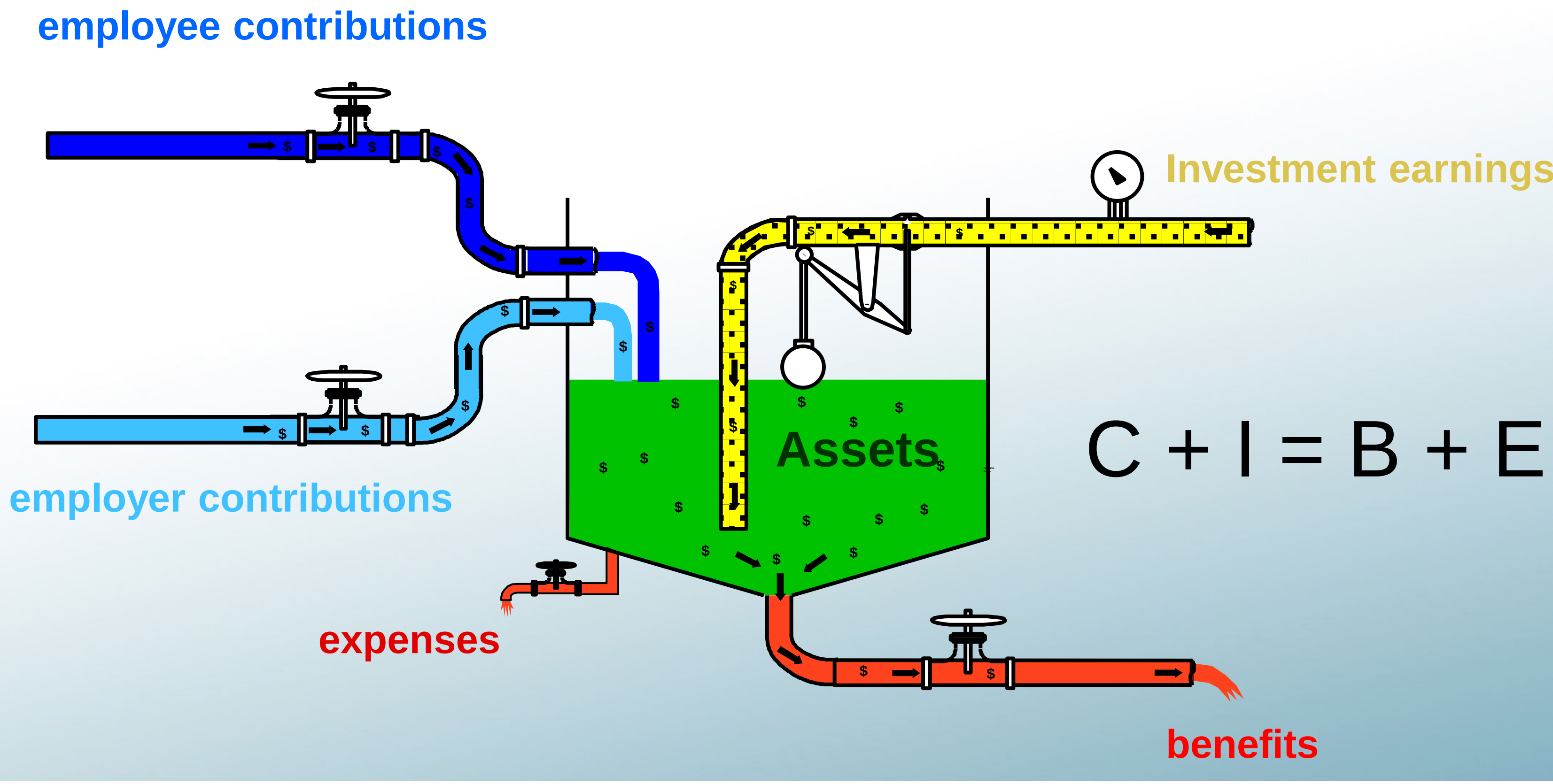
NCSL 2011 Report

Changes

- What changes are we seeing?
- What rules govern the changes?
- How does this affect TCDRS employers?

Rules - How do you fund a retirement plan?

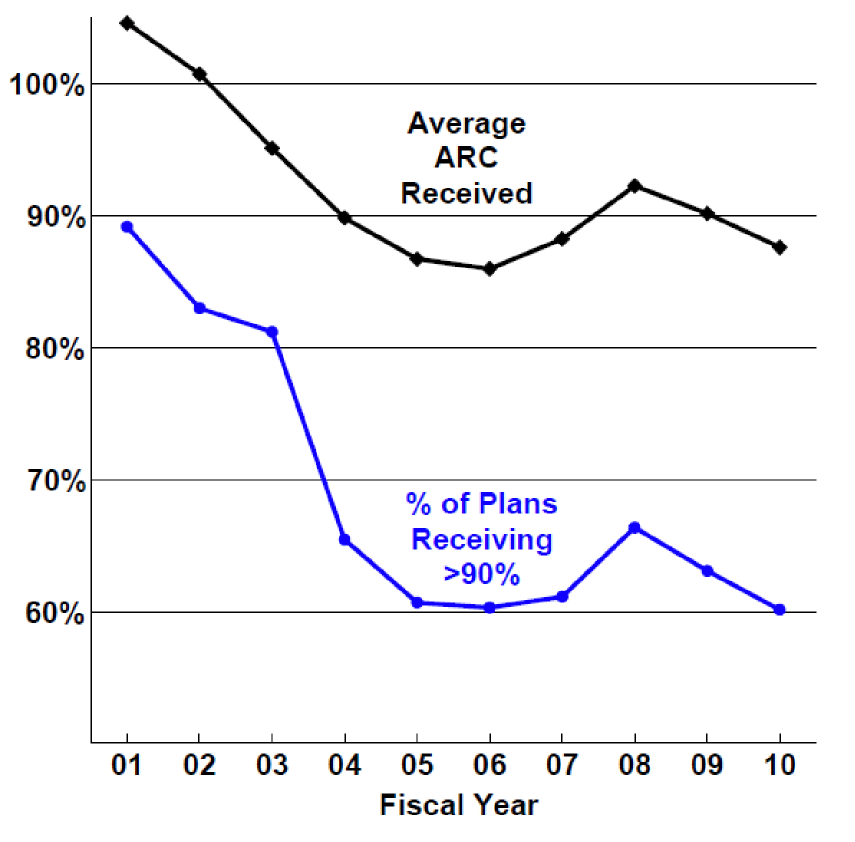
- Benefits + Expenses are funded by Contributions + Investment Earnings



C + I = B + E

Rules – Benefits Require Contributions

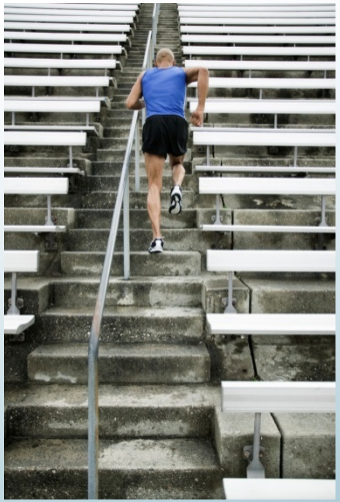
NASRA Public Fund Survey



- 100% of TCDRS Employers pay at least 100% of the Annual Required Contribution (ARC).
- Only 60% of employers in the Public Fund Survey are paying 90% or more.

Funding Policy Enforces Contribution Discipline

- TCDRS Funding policy requires employers to fund their own unfunded liabilities within 20 years of creation.
  (15 years for plan changes)
  - Enforces responsible funding
  - Minimizes passing excessive costs to future taxpayers.



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TCDRS Employer Contributions

Some TCDRS employers pay more than required.

	2008	2009	2010	2011	2012
Minimum Contribution	9.17%	9.28%	10.20%	9.90%	10.36%
Additional From Elected	0.21%	0.22%	0.14%	0.19%	0.12%
Actual Contribution	9.38%	9.50%	10.34%	10.09%	10.48%
Additional Lump Sum	0.16%	0.37%	0.21%	0.87%	
Total Contribution	9.54%	9.87%	10.55%	10.96%	10.48%
Only Employers with an Elected Rate					
Number of Employers	153	170	153	183	165
Additional from Elected	0.97%	0.90%	1.02%	1.45%	1.08%

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What Changes are We Seeing?

- Increased Normal Retirement Ages
- Increased Early Retirement Reductions
- Increased Employee Contributions
- Increased Final Average Pay Periods
- Reduced Return to Work
- Reduced Salary Spiking
- Reduced Benefit Formulas (e.g., 2% of pay × years of service)
- Reduced COLAs

How does this affect TCDRS employers? First, you need to understand how TCDRS is different.

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Typical Public Plans

- About 90% of Public Employees are in Defined Benefit plans
- Most plans are "Final Average Salary"
  - Replace % of average salary at retirement for each year of service
  - Average salary is based on a specific number of years, "the averaging period"

- Final Average Salary example: a "2% Plan"

Benefit % x Service at retirement x Final average salary
= 2.0% x 30 years of service x $50,000

= 60% x $50,000 = $30,000 per year

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TCDRS is Different

- ALL retirement benefits are account based
  - Employee contributions earn 7% interest
  - Employers match from 100% to 250%
  - Converted to an annuity at retirement

- Example (Age 65)
  - Employee account = $80,000
  - With 200% employer match = $240,000
  - Benefit = $240,000 ÷ 117.5 = $2,043 per month ($117.5 approximates the value of $1 per month for the rest of the retiree's life)
- How Unique is TCDRS?
  - Only 3 of the 87 "Major Public Employee Retirement Systems" in the most recent Wisconsin study have this type of plan design.

Side by Side

Typical Public Plans	TCDRS
Based on final average salary	Based on employee account at retirement with match
Number of years in salary averaging period is important	Employee contributions are spread over the entire career
Employees who leave early may get subsidized benefits	Employee accounts always grow with 7% interest and are converted into an equivalent monthly benefit (with match)
Relationship between employee contributions and benefit is not clear	Employee accounts receive specific employer match

Many Changes Lower Benefits

- Many systems have lowered basic retirement benefits for **future hires**:
  - Increased Normal Retirement Ages
  - Increased Early Retirement Reductions
  - Increased Final Average Pay Periods
  - Other Benefit Formulas Reductions
  - Impact: Smaller benefits at specific ages for **future hires**.
- TCDRS: Employers can reduce:
  - the Employee Deposit Rate: 4% - 7%, and / or
  - the Employer Matching Rate: 100% - 250%
  - Impact: Smaller benefits at specific ages earned for future service for **all employees**, not just future hires.
  - Local control, no legislation required

TCDRS Changes to Savings Rate

- Savings rate = Deposit + (Deposit × Match)
- Example:
  - Employee Deposit Rate = 7% of pay
  - Match = 200%
  - Savings rate = 7% + (7% × 200%) = 21% of pay
- 24 out of 617 employers changed 2012 savings rate:
  - 18 increases (Largest: 8.00% to 14.00% of pay)

    (4% deposit & 100% match to 7% deposit and 100% match)
  - 6 decreases (Largest: 22.75% to 14.00% of pay)

    (7% deposit & 225% match to 7% deposit and 100% match)

TCDRS Changes to Savings Rate

System-Wide Averages Weighted by Payroll

	2008	2009	2010	2011	2012
Employee Deposit Rate	6.86%	6.85%	6.85%	6.68%	6.68%
Employer Matching Rate	207%	207%	206%	205%	205%
Savings Rate	21.07%	21.06%	21.00%	20.34%	20.33%

Increased Normal Retirement Ages

- 16 states increased age and service requirements for normal retirement in 2011. This generally **applies only to future hires**. (NCSL)
  - Some also increased early retirement reductions or reduced benefit formulas
  - Impact: Smaller benefits at specific ages for **future hires**
- TCDRS: Individual employers can change the employee deposit rate and the employer matching rate for **all employees**. Local control. No legislation required.

Final Average Salary Periods

- 6 states lengthened final average salary periods in 2011 and 8 states in 2010. (NCSL)
  – In most cases increased from a 3 year period to 5 years.
  – Only applies to **future hires**.
- TCDRS:
  - Benefits are NOT based on final average salary
  - Benefits ARE based on employee contributions over an entire career.

Changes Applying Only to Future Hires have Less Impact than Changes to All Employees

- Future Benefits vs. Future Hires
  - TCDRS employers can reduce future benefits earned by all employees. This is more effective.
  - Most Systems can only reduce future benefits earned by future hires.
- Reducing benefits for only future hires:
  - Has small initial cost savings
  - Requires harsher reductions for the same total cost savings
  - Creates different “tiers” of employees
  - Breeds discontent by allowing different employees to have different benefit levels for the same period of employment
  - Complicates communication and increases administrative expenses

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Vesting Requirements

- 8 states increased vesting requirements in 2011 and 5 states in 2010. (NCSL)
  - Generally from 5 to 6 years or 8 to 10 years and for future hires only.
- TCDRS: Employers choose between 5, 8 and 10 year vesting. They can reduce the vesting requirement but can not increase it.
- This is generally a small to moderate cost item.

Employee Contributions

- 16 states increased employee contributions in 2011 and 11 made increases in 2010. (NCSL)
- TCDRS: Employers make their own decisions
  - Employee Deposit Rate: 4% - 7%
  - Local control, no state legislation required.

COLAs (Cost of Living Adjustments)

- 10 states revised provisions for automatic COLAs in 2011 and 8 states in 2010. (NCSL)
- TCDRS does not have automatic COLAs.
- TCDRS: fewer recent Ad-Hoc COLA elections:

	2008	2009	2010	2011	2012
CPI COLAs	93	89	57	46	46
Flat-Rate COLAs	64	72	N/A	34	11
Total	157	161	57	80	57

Salary Spiking

- Many traditional “final average salary” plans have been changed to reduce “salary spiking.”
  - Salary spiking is caused by large pay increases just before retirement in final average pay plans.
  - Salaries used to calculate benefits have been limited.
  - Longer final average periods have been used.
- TCDRS does not have a salary spiking problem because benefits are NOT based on final average salary. Benefits are based on employee contributions made over an entire career.

Return to Work

- Many traditional plans have been changed to address funding problems caused by employees returning to work, but continuing to collect retirement benefits. Why?
  - Benefits are paid over a longer time
  - Less time for investments to earn interest
  - Benefits do not take this into account
- TCDRS' funding is not sensitive to this behavior.
  - Value of benefits are based on accumulated contributions with match.

  Therefore:
  - Longer expected life is reflected in smaller benefits.
  - Smaller accumulated contributions with interest result in smaller benefits.

Hybrid Plans

- A few states have changed to “hybrid plans,” but most states have revised their traditional defined benefit plans instead.
- Hybrid plans combine features of defined benefit and defined contribution plans
  - Defined benefit plans guarantee a benefit for life that is not based on accumulated assets.
  - Defined contribution plans accumulate contributions in an account. Benefits only last as long as the account.
- TCDRS is a hybrid plan.

TCDRS DC Hybrid Features

Because benefits are based on employee accounts growing with 7% interest with a match, TCDRS has these Defined Contribution (DC) advantages :

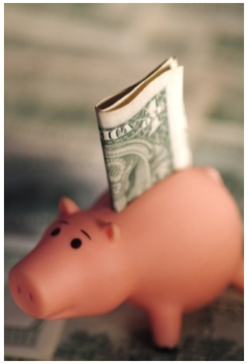
- Appreciation of account balance
- Benefits based on employee accounts reflect the time value of money, and are therefore more predictable and fair
- Portability (take it with you)
- No funding problems due to: salary spiking, return to work or subsidized early retirement factors

TCDRS DB Hybrid Features

TCDRS has these Defined Benefit (DB) advantages:

- Guaranteed lifelong income
- Attraction and retention of public employees
- Lower cost for the same benefit

Better Bang for the Buck*



Why do defined benefit plans have a lower cost for the same benefit?

- Longevity pooling – avoids "over saving"
- Avoids necessity for conservative asset allocation in retirement – "forever young"
- Higher Investment Returns
  - Professional investment management
  - More investment options
  - Lower expenses
- The "Better Bang for the Buck" study found the same benefit could be provided in a defined benefit plan for 46% less cost than in a defined contribution plan*.

*A Better Bang for the Buck - Almeida & Fornia, 2008

Only a Few States have Recently Adopted Hybrid Designs – Utah has an Unusual Hybrid:

- Employees take the Defined Benefit (DB) Risk
- Prior Utah DB plan closed 7/1/2011
- New Employees choose between:
  - Defined Contribution (DC) Plan— Employer contributes 10% of pay. Employee's can contribute if they wish.
  - Hybrid Plan—Combined DB & DC
    - Employer **always** contributes 10% of pay: Up to 10% as needed goes to the DB and whatever is left goes to the DC.
    - Employee DB Contributions: If the DB plan needs more than 10% of pay, the employees will make up the difference.
    - Employee DC Contributions: Optional

Some States Give New Hires a Choice

- In the last 10 years some states have decided to let new hires choose between a DB and a DC plan.

New Hire Elections in Most Recent Complete Year

System	DB Plan Enrollments	DC Plan Enrollments	Combined Plan Enrollments
Colorado PERA	88%	12%	Not offered
Florida	75%	25%	Not offered
Montana PERS	97%	3%	Not offered
North Dakota PERS	98%	2%	Not offered
Ohio Public Employees	95%	4%	1%
Ohio Teachers	89%	9%	2%
South Carolina	82%	18%	Not offered

Decisions, Decisions - Olleman & Boivie, 2011

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Some States Give New Hires a Choice

- 74% is the lowest defined benefit election rate in any state in any of the 9 years of experience so far.
- Newly hired public employees choose defined benefit.
- Defined benefit plans have long been recognized as strong tools for retaining employees.
- Defined benefit plans are highly valued and are strong tools both for attracting and retaining employees.

- Also true for private companies: In 2011, 63% of workers under 40 with a DB plan said it was an important reason they chose to work for their current employer, up from 28% in 2009. For employees under 40 with only a DC plan the increase was from 19% to 28%.
  (Attraction and Retention: What Employees Value Most - Steve Nyce, March 2012)

What does it all mean to me?

- TCDRS gives individual employers choices
  - Contributions
  - Benefit Provisions
- Local control
- No legislation required

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Important Decision - Contributions

- Contribution Options
  - Pay the required rate?
  - Pay a higher elected rate?
  - Lump Sums?
- Make a long term plan
  - Consider rate projections

Important Decisions - Benefits

You make the call

- Evaluate Benefit Options
  - COLAs
  - Employer match
  - Employee deposit rate
- Remember to evaluate adequacy

Evaluating Your Plan

- Your Employer Service Representative has more information on:
  - Potential contribution increases
  - Potential benefit changes
  - Potential impact of future investment returns

Conclusions

- Legislation in 41 states has made unilateral changes to statewide retirement systems in 2010 and 2011.
- TCDRS employers choose their own:
  - Level of benefits
  - Responsible contribution level
- TCDRS already has a superior plan design.
- No additional legislation is required.
- Evaluate your plan.
- TCDRS lets each employer make the decision that is best for them.