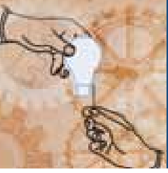

What Makes Some Pension Reforms More Successful than Others?

By Rachel Barkley

Of the many states making pension reforms in recent years, few have been able to both decrease their annual pension contributions and increase their funded levels. Maine and Tennessee are two that managed it.

Most states have made pension reforms in recent years, but between 2010 and 2014, few of them were able to both decrease their annual pension contributions and increase their funded levels. This article examines two states that accomplished just that — Maine and Tennessee — to see how they were able to achieve this feat, looking at what reforms were enacted, the effects, and how these reforms compare to those implemented in other states.

MAINE

The State of Maine passed pension reform in 2011, to be effective at the beginning of fiscal 2012. For new hires and for current members with less than five years of service, the normal retirement age was increased from 62 to 65. The state froze cost of living adjustments (COLAs) for a period of three years with future COLA increases of 3 percent, to be indexed in future years. COLA benefits will only apply to the first $20,000 in benefits. Non-permanent COLAs may be awarded on an ad hoc basis. Reforms affect state employees, with the exception of public safety personnel. The state has since passed several one-time COLAs.

The state's pension contribution decreased by 25 percent from a high of $334 million in fiscal 2011 to $252.8 million in fiscal 2012, after the reforms were implemented. Since then, contributions have gone up but remain roughly 20 percent lower than fiscal 2011 levels. The aggregate funded ratio has also begun to increase from the recent low of 2011's 77 to 81 percent for fiscal 2013 and 2014. This was despite a decrease in the assumed investment return for the state's pension plan to 7.125 percent in 2014 from 7.75 percent in 2010 and 7.25 percent in 2011, which offset a portion of reform's effect on funded levels.

State-level pension benefits for Maine are consolidated in one plan, the State Employees' and Teacher Pension Plan.

TENNESSEE

Tennessee was able to achieve the largest decrease in state contributions among the three states, a reduction of approximately 50 percent from 2010 levels. The decrease in state contributions has been even greater in recent years, as contributions peaked in fiscal 2012 at $731.4 million, equal to a still modest 3.8 percent of spending and a full 60 percent higher than fiscal 2014 levels. Fiscal 2014 contributions equaled a quite low 1.5 percent of general fund spending.

The state's pension reform was effective July 1, 2014. New hires are enrolled in a hybrid pension plan with

both defined benefit and defined contribution portions. This new plan has been separated as a distinct agent plan within the Tennessee Consolidated Retirement System (TCRS), which provides pension benefits for state employees, teachers, and political subdivision employees. The new plan requires a 5 percent employee contribution to the defined benefit plan — a marked change, as prior hires were enrolled on a non-contributory basis. Normal retirement age has been extended five years to 65, while COLAs are based on the Consumer Price Index and have been capped at 3 percent.

TCRS contains agent multi-employer plans for the state and local subdivisions and a cost-sharing multi-employer plan for teachers. Legislation passed in 2014 further clarified that the state is not responsible for teacher pensions.

The two states featured here took varying avenues to achieve their results, illustrating that pension reform is not a one-size fits all process.

The state also enacted local pension reform in 2014, requiring local governments to make full actuarially determined contributions after a six-year phase-in period. If they fail to comply, the state can divert local aid to those governments, using it instead to make pension payments on their behalf. While this will not affect the state's pension burden, due to the agent-multi-employer structure of TCRS, it will aid the long-term pension health of local entities that are not currently funding the actuarily determined contribution.

Assumed investment returns have remained stable from 2010 to 2014 at 7.5 percent.

SOME SIMILARITIES

The two states featured here took varying avenues to achieve their results, illustrating that pension reform is not a one-size-fits-all process. However, there are a few similarities among the Maine and Tennessee reforms. Both increased the normal retirement age. Maine and Tennessee also restricted

Exhibit 1: Historical Pension Contributions and Funded Levels

	2014	2013	2012	2011	2010	Percent Change 2010-2014
Maine						
Annual State Contribution ($000s)	264,245	264,381	252,830	333,935	329,212	-19.7 percent
Contribution as Percent of GF Spending	7.6 percent	8.2 percent	7.4 percent	10.4 percent	10.5 percent	-2.9 percent
Aggregate Funded Level	81 percent	81 percent	78 percent	77 percent	78 percent	3.8 percent
Tennessee						
Annual State Contribution ($000s)	289,648	393,892	731,352	721,759	578,404	-49.9 percent
Contribution as Percent of GF Spending	1.5 percent	2.1 percent	3.8 percent	3.7 percent	3.2 percent	-1.7 percent
Aggregate Funded Level	93 percent	92 percent	92 percent	90 percent	90 percent	3.4 percent

future COLA awards, and Maine also implemented reforms affecting not only new hires, but also a portion of current employees. The state with the largest relative decrease in state contributions enacted the most comprehensive reforms for new hires, including a defined contribution portion of the plan as well as employee contributions.

Many of the reforms that both states implemented were used in other states at roughly the same time. Between 2009 and 2011, 28 states increased or implemented employee contributions.

Many of the reforms that both states implemented were used in other states at roughly the same time. Between 2009 and 2011, 28 states increased or implemented employee contributions.[1] Of these, reforms in 21 states affected at least a portion of current employees. Increased age and service requirements for normal retirement were also implemented by 28 states over the same time period. Eighteen states reduced COLAs, with six states applying these changes to at least some active employees and six states applying them to current retirees as well as active employees. Several states, including Rhode Island and Utah, also implemented hybrid plans.

These reforms have led to a total of four states, in addition to the two discussed here, reducing state contributions between 2010 and 2014: Alabama, Florida, Rhode Island, and South Carolina. Florida and Rhode Island also have 2014 funded levels equal to those in 2010, as well as decreasing state contributions.

CONCLUSIONS

Pension reforms in other states shouldn't necessarily be deemed unsuccessful if they did not result in either decreasing pension contributions or increased funded levels. Reforms are typically measured for each plan based on what would be expected to happen if no reforms had been enacted. Due to this, reforms may change the trajectory of plans without necessarily leading to increased funded levels or decreased contributions.

Increased employer contributions are often included in these reforms, especially for those with low funded levels. Other variables, including actuarial assumptions and investment returns, also affect funded levels. Savings included in reforms can be planned for different time periods and may not show up right away.

Note

1. Ron Snell, *State Retirement Legislation 2009-2012*, National Conference of State Legislatures.

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